

Japan Enters Reiwa Era with New Identity: Heisei Changes Were Subtle Yet Profound



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On May 1, 2019, the new Reiwa Era began in the middle of a 10-day stretch of holidays. The Japanese were expected to spend an additional \$10 billion on travel and shopping during that period. Reiwa-branded cookies are being sold at every tourist destination. Tokyo's Meiji Shrine saw people queuing for 10 hours or more to get "divine" Reiwa seal stamps. The atmosphere has been festive as there was no mourning associated with the abdication of Emperor Akihito at the age of 85. It marked the end of his three-decade reign, an era called Heisei in Japan, as well as the start of the new era under his son Naruhito, the newly enthroned emperor of Japan.

An era change marks a significant reset of time in Japan. Unlike a decade, an era is long enough to envelope the majority of one's life. Japanese, therefore, tend to recognize their peers by the era in which they were born and grew up. After all, Reiwa is only the fifth era since the Meiji Restoration in 1868, which began the awakening of a modern nation that had been closed to the outside world for more than 250 years.

Growing up in the 1980s, I recall some survivors of the Meiji (1868-1912) generation, some of whom had experienced World War II as adults and helped rebuild the nation in its aftermath. They were the tough ones with the backbone of old-school Japanese. People born in

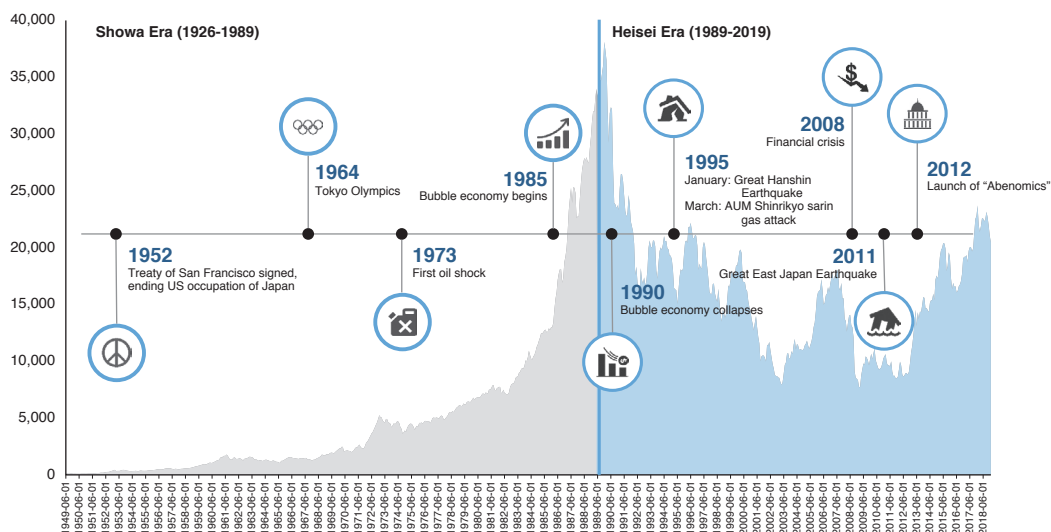
the Taisho Era (1912-1926) were fewer as the period only lasted 15 years. Those born in the Showa Era (1926-1989), by contrast, include my parents' generation as well as mine. Showa was a traumatic period. Those who were born in early Showa (who would be in their 80s today) saw the rise of pre-war militarism, its catastrophic downfall and the postwar economic rise of Japan. A rising militaristic power in the Far East at the dawn of it, the nation had been completely transformed as Showa drew to its close.

Uneventful Heisei?

Even if Heisei still seems quite new for us Showa-born lot, 30 years is a long enough time for a nation to emerge transformed. Yet, on the surface, what is notable about Heisei is that nothing particularly significant happened despite the burst of a horrendous financial bubble in 1989 and two major natural disasters – the Great Hanshin Earthquake in 1995 and the Great East Japan Earthquake and tsunami in 2011 (*Chart 1*).

Domestically, life in Japan proceeded without much drama. Even though property prices plummeted in the early Heisei years, overall consumer prices were remarkably stable, rising by a scant 0.5%

CHART 1
Heisei marked by traumatic events
Historical timeline (Nikkei average)



Note: (1) not an exhaustive list of historical milestones

Source: Statistics Bureau of Japan, National Institute of Population and Social Security Research, Mizuho Research Institute, EY-Parthenon analysis

annually. The unemployment rate at the beginning and end of Heisei are both coincidentally 2% with a surge to 5% only twice, around 2001-02 and 2009. Politically speaking, the once-dominant Liberal Democratic Party briefly lost its grip on power but the non-LDP administrations barely had an impact before voters returned to the LDP, which now faces only weak challengers. Under the security blanket of the US-Japan alliance, possible invasion by a foreign force was a non-issue to ordinary people, with the exception of North Korean provocation.

Moreover, a strict immigration policy resulted in a mere 2% of the population being foreign born, which helped contribute to political stability unlike in European Union countries or the United States. Large-scale immigration, the root cause of political unrest in many developed nations, left Japan untouched. Between 1990 and 2017, the ratio of foreign-born nationals grew from 8% to 14% for the US and 23% to 29% in Australia. Japan, on the other hand, saw an increase from only 1% to 2%, according to Pew Research.

The most notable demographic phenomenon in fact is not about foreign-born citizens but about aging. Japan's population, among the youngest in the developed world at the start of Heisei, is now the oldest (Chart 2). The total population hit a peak in 2008, and is now declining at a pace approaching 400,000 a year. The population increase over the whole of Heisei was just 3% compared to 32% in the US and 23% in China. On the bright side, the average lifespan of a Japanese male grew from 76 to 81, and of a female from 82 to 87. As a result of longevity and a low fertility rate, the population over 65 shot up from 15% of the total at the beginning of Heisei to 36% in 2019 (Chart 3).

Relative to the rest of the world, the changes point to a quietly sinking sun. In the second half of Heisei, 2009 saw Japan being overtaken by China and falling into its current position of third in terms of GDP (Chart 4). While real GDP measured in US dollars grew by 59% in Japan in 1989-2017, it pales by comparison with the US at

243% and China at an astounding 3,419%.

In the global ranking of companies by market capitalization in 1989, there were 32 Japanese names in the top 50, whereas in 2018 there was only one, Toyota Motors. With the automobile industry being a rather anomalous bright spot, the technology industries once brandished as the Japanese hallmark of industrial success have lost their way to global competitors – firstly to South Korea and Taiwan, then more recently to China. While the Japanese market share of semiconductors reached 49% in 1990, it was at a dismal level of 7% in 2017.

In lockstep with its declining industrial position, gone are the days when traditional Japanese management practices symbolized by life-time employment were touted as the best.

The Fraying System

Could an aged Japan be discreetly moving away from the center of the global stage, whose audience is transfixed by the new Cold War between China and the US? The stagnant-looking surface only needs a ripple to reveal dramatic change. In fact, it would be quite wrong to write off Japan as a geriatric sunset country where the only changes that can be expected signal decline.

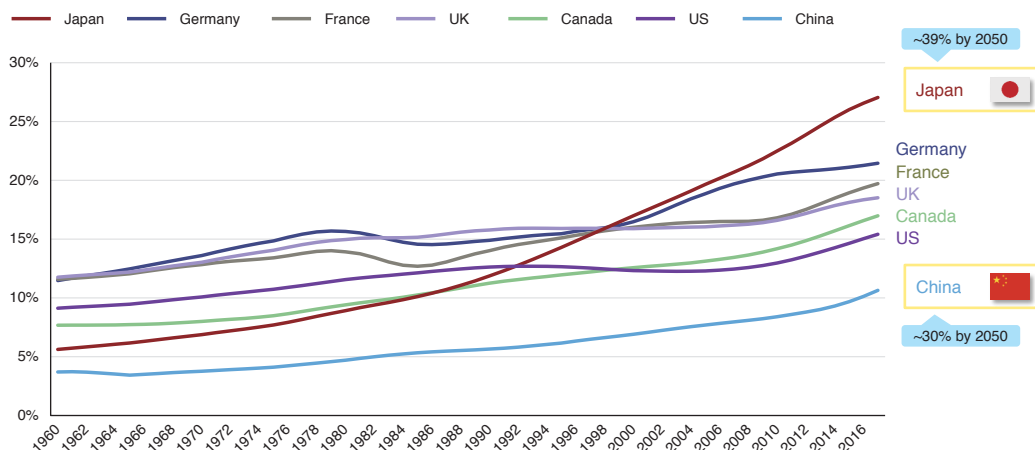
Heisei Japan, too, went through a profound transformation, but it has been a subtle and much less tangible transformation compared to that of Showa. The change, in a nutshell, is the crumbling of a rigid socio-economic system, in which government ministries and large companies dominated very much in the Showa fashion. The 30 years of Heisei can be seen as the period of this transformation, during which the deep-seated skepticism at the beginning was broadly confirmed as we emerged from the era.

The underlying fabric of postwar Japanese success was an efficient class system organized with a clear hierarchy. The public sector during Showa, with its powerful army of career bureaucrats, successfully led

CHART 2

Japan undergoes rapid aging in short time

Aging (>65) in G7* + China states



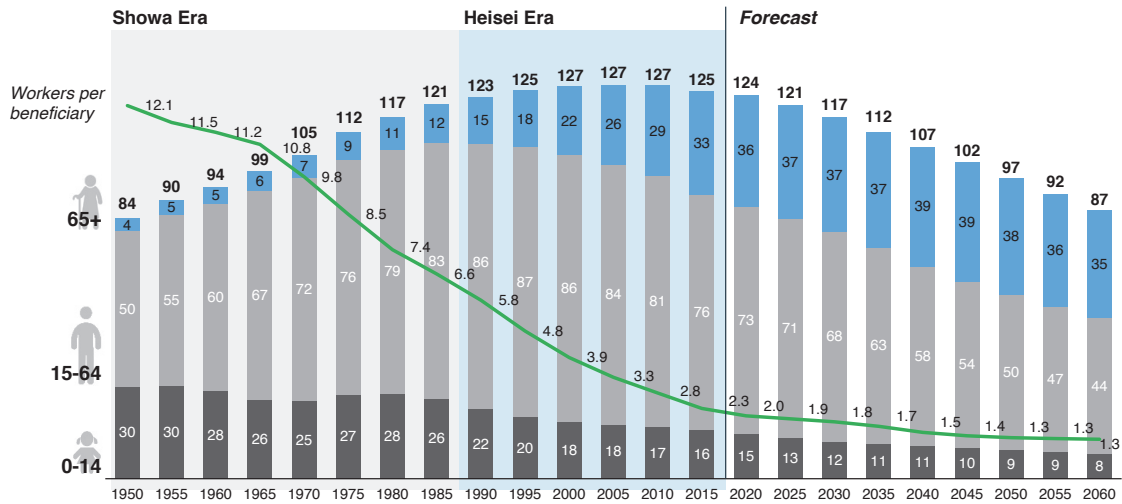
Note: *1 Excludes Italy

Source: World Bank, EY-Parthenon analysis

CHART 3

Japan's shrinking population turns silver

Total population by age bracket (Million people, ratio of workers to beneficiaries)

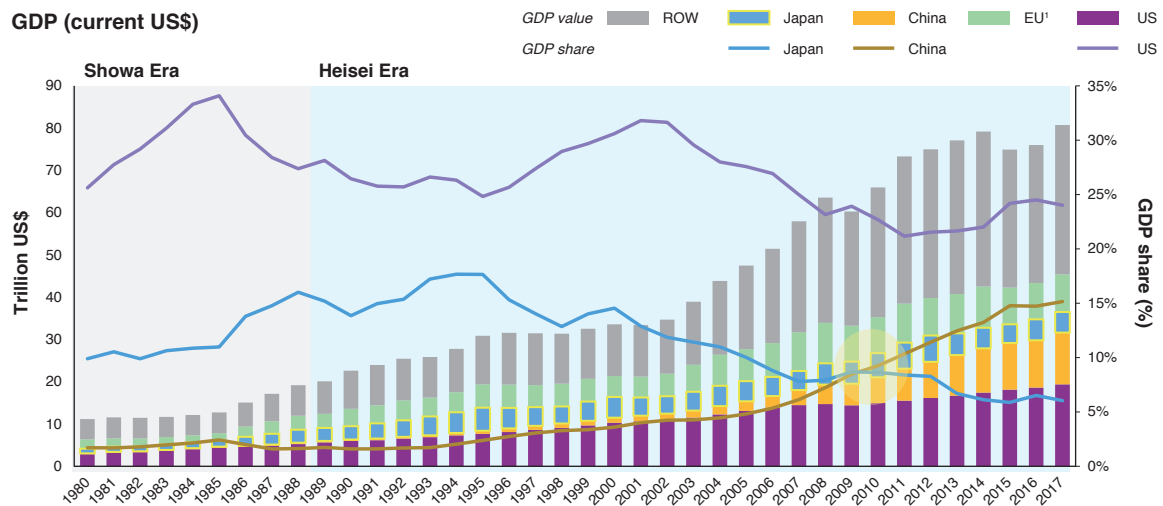


Source: Mitsubishi UFJ, Ministry of International Affairs and Communications, Statistics Bureau of Japan, National Institute of Population and Social Security Research, Reuters

CHART 4

Japan's GDP outgrown by China's during Heisei

GDP (current US\$)



Note: (1) includes Germany, UK, France
Source: World Bank, EY-Parthenon analysis

the rise of Japanese export-oriented industries from steel to semiconductors under the convoy system. The industries in turn were organized in a clear order, visualized by the cascading median salary of their employees, within which the top position was often occupied by *zaibatsu*-related bluechip companies. The *zaibatsu* web of capital and non-capital ties spread cross-sector to allow optimal coordination. The mighty *sogo-shosha* or general trading companies sat in the middle of these webs functioning as the center node.

Within a sector, say automotive, there was a clear separation of tiers which distinguished original equipment manufacturers (OEMs) from Tier-1, Tier-2 and Tier-3 component suppliers. Tier-1s acted as general contractors to source and integrate the necessary ingredients from

various Tier-2s, so that OEMs seldom interacted directly with Tier-2s or Tier-3s. The vertical chain of *keiretsu* allowed for both division of role and coordination. The loyalty of those at the bottom of the pyramid was rewarded with the unwritten assurance that OEMs would always provide more than enough work to guarantee their survival.

In fact, this godfather-like mentality had its mirror within individual companies' organizations. Lifetime employment meant that once you entered a company out of high-school or university, the employer would take care of you as long as you remained loyal. The seniority-based promotion system encouraged workers to grow within the organization. Lack of 401K-like transferable company pension schemes further tipped the balance for those who stayed put.

Before the enactment of the Equal Employment Opportunity Law in 1986 at the end of Showa, one could argue that even marriages were often arranged by employers. The young women in the workforce were treated as bride candidates for the junior staff rather than serious talent to nurture. As late as in the early 1990s it was assumed that women would retire after marriage, never the case for their husbands. Marriage for women therefore had the moniker “eternal employment”, where one does not ever have to worry about job loss. After all, the first employment was more or less eternal for men as well.

For the workers, however, loyalty had its price. For example, it meant having little say in an unexpected transfer to a remote location regardless of family situation. Once you left your employer, God forbid, it was almost impossible to re-enter.

New Japan Emerges

Within the past three decades, this rigid socio-economic structure has crumbled at an accelerated speed few were able to predict at the dawn of Heisei. The most fundamental driver has been the technology-driven so-called Fourth Industrial Revolution, defined as the concurrent commercial arrival of artificial intelligence (AI) and the Internet of Things (IoT) which blurs the boundaries of the physical and digital world and which swiftly rewrote the rules of the game for many industries. The incremental benefit of perfecting mature, hardware-based, mechanical engineering experienced a diminishing rate return. On the contrary, the value-added shifted to software and application-driven innovation as the Internet became ubiquitous after the turn of the century.

Because of the Fourth Industrial Revolution, the world has moved on from vertical to horizontal integration. This is the new regime that most established Japanese companies were ill-equipped to lead, to say the least. For example, the past glory of the Japanese automotive sector was built on the eco-system of tier companies that have been loyal to OEMs through thick and thin. It is therefore a disturbing thought for OEMs to exit the *keiretsu* and form alliances with completely new partners, such as Internet platformers, to make connected cars. The dissolution of *keiretsu*, however, is happening as companies prioritize their own survival. Just last October, Toyota and Softbank formed a joint venture, Monet Technologies, to address mobility services.

It is important to note, however, that this breakdown is not all grim news for smaller *keiretsu* suppliers. Once freed from the implicit chain of loyalty, competitive suppliers with differentiated technologies can now openly seek business opportunities with other OEMs, even non-Japanese.

Globalization, with rising emerging markets as the backdrop, is another driver for change. The export model has now been overtaken by direct foreign investment as Japanese companies prefer to localize operations rather than depend on exports, which involves high labor costs and transportation. Less reliance on exports by Japan, Inc. coupled with a greater need for speed to market has diminished the competitive advantage of the traditional convoy system under the leadership of the public sector, as domestic sector-wide coordination

was too time-consuming and much less effective. The once invincible trading companies, too, seek new identities beyond being the hubs of information and trade flows.

Labor Market Mobility

Again, the crumbling of the system is mirrored within the Japanese labor market. At the turn of the century under the administration of Prime Minister Junichiro Koizumi (2001-2006), Heisei Japan experimented with neo-liberalism. Meritocracy was promoted to replace seniority-based promotion. Triggered by Koizumi's reforms, the once sacred notion of lifetime employment ceased to maintain its untouchable status. This political trend aside, the demographic trend is the major driver in the change in Japanese labor practices. With fewer young applicants entering the workforce, companies now opt to entice the promising young by raising starting salaries, making the compensation curve less steep. This discourages the middle to senior employees from staying longer. In fact, 2018 saw an increase in job-changers for the eighth consecutive year to 3.3 million, approximately 5% of total workers. Among them, those aged 45 and over accounted for 38%, an 11 point increase over a decade.

This labor mobility has coincided with the rise of entrepreneurship. Traditionally regarded as too high risk with iffy returns, now joining a start-up is a reasonable option for graduates from top universities. This is encouraged by the emerging fair shots for small companies to succeed, in the wake of a crumbling industrial hierarchy.

Women now constitute an important labor force, 50.3% of the total in 2017, which Japan, Inc. cannot do without. Around 1998 in the early Heisei years, the number of double-income households exceeded that of single-income and the gap between the two has continued to widen. Working mothers are the norm. Granted that Japan has a long way to go to achieve true gender equality at the level of Scandinavian countries where working women are more or less on an equal footing with men, we have nonetheless come a long way over three decades, increasing the labor participation rate of women by 13+ points from 59.5% to 72.7%.

As women obtain more financial freedom, they marry later. The average age of a first-time bride was 26 at the beginning of Heisei in 1990 and 29 in 2017. Accordingly, the groom's age went up from 28 to 31. According to a government survey in 2015, 8% of women declared they would remain unmarried, up from 5% in 1992. While low fertility rates present an existential threat for Japan, on the bright side this can be interpreted as evidence of acceptance of diverse lifestyles. Individuals feel free to make conscious choices regarding marriage and children, not blindly following the social norm.

Reiwa – Rebirth or Regression?

In summary, Japan at the end of Heisei presents a more fluid, if less secure, society. Reiwa will only accelerate the trend of a dissolving hierarchy. I see the change on a personal level as largely favorable. In the absence of Godfathers, there are more individual choices available, be it with career or personal choices. Positive failures from which we

learn will be tolerated and there will be fewer penalties for trying. A career will be regarded as a long and winding journey, not always a straight road as we pictured in late Showa or the earlier part of Heisei. With more seniors staying active longer, we may completely do away with the notion of a retirement age within Reiwa.

The utopia of individual choices, however, will only be possible if Japan manages to maintain its competitive strength and therefore its economic power. The social security costs of caring for the elderly are mounting to ¥34 trillion, or 6% of GDP. Japan is the only country in the developed world with a level of national debt at 200% of its GDP. The speculation of super inflation at the end of the expansionary monetary policy in place under the current administration of Prime Minister Shinzo Abe will never be put to bed.

In fact, the main failure of Heisei is that Japan lost its visible hallmark industries, other than perhaps its automotive sector. Even though Toyota Motors continues to be a mark of Japanese manufacturing excellence, the competition is now on a new playground of connected cars, something even the mighty Toyota struggles to stay ahead of the game in. In the Reiwa Era of newly found labor mobility and entrepreneurship, it is not yet clear what sectors will emerge as the bright stars of Japan.

Tidying Things Up

My hypothesis is that Japan could leverage its demographic crisis – the aging and declining population. Looking ahead another 30 years, the population is forecast to decrease to around 100 million by 2050, more than 20% down from today's 127 million. Once we accept the reality of a declining population, the only way of maintaining the size of the economy is through improved productivity.

Improvement of productivity has two elements: one is to organize and revamp the fraying existing infrastructure and the other is to inject technology as new blood. Japan already suffers from decaying roads and bridges built during the high economic growth era. Permanently empty houses are on the rise at 13.6% of the national stock of housing, posing a security issue for communities. Rather than making new infrastructure investment, the public sector should put more effort into reorganizing the old.

Once reorganized into a compact and liveable model, communities should take full advantage of available technologies from smart homes to autonomous driving. The end goal is not productivity for the sake of productivity, but the well-being of all, including the elderly and the less privileged. Productivity should also be balanced with the sustainability of the environment. The model of a technology-enabled community to maximize the quality of life will be a collection of innovation and new ideas, mixing hardware and software technologies. This is also a model that other aging nations in Asia will look to import.

Embracing Complexity

With nations, as well as with corporations, growth hides inconvenient truths. Life was simpler in pre-Heisei days as Japan rose in international status. A hard-working labor force directed by

Japanese management was rewarded by a climb in economic power, as was demonstrated by the popularity of made-in-Japan cars in the US. We heard noises about trade friction, but the Kasumigaseki bureaucrats managed to outsmart their American counterparts. In this tidal wave of growth, however, certain social injustices were swept under the rug. For example, gender inequality was tolerated because the nuclear family model with the husband being the sole and dedicated breadwinner worked just fine to prop up the system.

Now after three decades of economic stagnation in Heisei, this inconvenient truth is palpable. We cannot sustain the labor population without the traditional minorities – women, seniors and foreigners. Rural Japan is depleted and faces the threat of extinction after the young took off to the big cities to form these nuclear families. So accustomed to non-growth times, millennials even question the very worthiness of growth.

In other words, post-growth Japan faces an unprecedented degree of uncertainties, made no easier by the fast-paced changes in the outside world, both technological and geopolitical. The direction for industries is not and cannot be dictated from the public sector any longer. Protective *keiretsu* is no longer. The assumption that you will remain at the first company you join is shaky at best.

Today's system is no longer hierarchical but dispersed. The boundaries between industries are no longer rigid but porous so that companies can form alliances cross-sector. Start-ups are sought-after partners for the established. In fact, what used to be a monopoly of those with capital is no longer – 3D printing allows micro factories with an output quality equivalent to mass production plants. On the individual level, workers may handle multiple jobs at the same time. This will be an interesting time for those who enjoy entrepreneurship and fresh thinking. Reiwa will be an era of complexity and it is up to us to embrace it.

Let's Not Fool Ourselves

Japan was literally and figuratively a young developed nation at the start of Heisei. Over its three decades, it has aged and matured at an unprecedented speed. It is now a mature country with considerable experience. Perhaps no longer a miracle, but a country with bench strengths and past failures to learn from. It also has the fortune of political stability which is the envy of many other developed nations.

In middle age, an individual is faced with two choices: to resist changes and yearn for the glorious old days or to accept reality and be the best one can according to one's age. Reiwa Japan needs to look at itself in the mirror and come to terms with its maturity, which, just as with vintage wines, comes with a good deal of complexity. **JS**

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