

The Enigma of Japanese Capitalism (Part 2)

- Restoring the Function of the Market
 - A "New Deal" for the Allocation of Resources
- 30 Years of "Extraterritorial" Exemption from the Rules of the Market
 - Reallocating the Misallocated Assets
- Funding the Current Value Accounting System
 - Taxes on Reassessed Land Assets and Inheritances

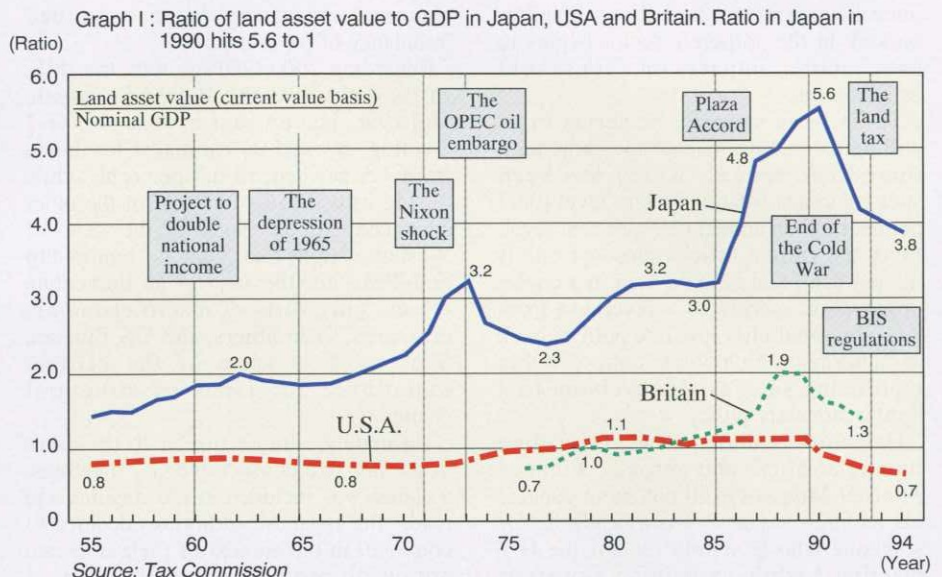
By Wasa Takahiro and Sonoyama Hideaki

How Not to Allocate Resources - Flaws in the Modern Theory of the State and its Idea of "Absolute Liability"

Japan's economic bubble burst in the early 1990s, bringing an unprecedented mountain of bad debt into the glare of public scrutiny. As the full extent of the problem came to light, it became apparent that the dilemma was too big for banks and securities firms to cope with relying only on "their own resources." The country soon found itself faced with a financial crisis. Amidst a growing awareness that Japan was in dire straits, the national government used every fiscal and banking policy stratagem at its disposal to head off a financial panic. It succeeded in this effort because it had heeded the warning signals being sent out by the market.

However, the measures taken pushed public finances (including finances at the prefectural and local levels) into a crisis of unprecedented severity. Oddly enough, Japan at the same time was also becoming the world's largest creditor nation. If a great economic powerhouse like Japan had the will to exercise the power of the state to resolve the crisis, then it ought to have had the sincerity and courage to face this fact head-on.

Markets are supposed to achieve an optimal allocation of resources, but they have done precisely the opposite in Japan. This is one of the world's biggest historical realities of the latter half of the 20th century, and Japan's national government bears a duty to fully discuss, in both domestic and international forums, the nature of the problem, and in doing so, to identify it for what it is - a structural problem that arose from the very nature of the Japanese-style market economy. In other words, a government proves it is qualified to be considered a modern state by adhering to the "ethic of responsibility," and accepting the validity of this ethic as a matter of course.



Finding a Way to Make America Say "Yes"

According to Thomas Hobbes, "civil war [is] death" for a leviathan. If Japan can avoid this death, it would serve as proof that it has the qualifications of an economic leviathan.

Doing this would make it possible (in the highly competitive world that the 21st century is expected to become) for Japan to make "peaceful use" of the enormous influence and power that it wields as the world's largest creditor nation. There is now an urgent need to create the necessary preconditions for such a turn of events.

We wrote about how we should go about achieving this goal in Part I of this series - "What Can We Learn from America, Where the Economy is Subject to the Rule of Law?" As an alternative to the approach of Ishihara Shintaro (the current governor of Tokyo), who advocates the idea of a Japan that can say "no," I proposed in Part I that we should work to create the conditions for Japan that make the United States say "yes".

Explaining the Economic Problems in the Enigma of Japanese Power

Japan has become a very influential player in the world economy. It was the Dutch journalist Karel van Wolferen who attempted to provide a sociological interpretation of Japan as a political system. He published *The Enigma of Japanese Power* over ten years ago. In his book he described the processes by which political power is exercised, and examined the sociological impact thereof. It was a brilliant inquiry into a very elusive subject.

However, the "Japan Problem" that should have long since been resolved has, on the contrary, developed into a major crisis. In the wake of the financial crisis of 1997, the Japanese government had to spend ¥60 trillion in public funds for emergency economic stimulus measures. By aggressively issuing government bonds to fund its spending measures, the government was driven into the worst financial crisis the country has ever seen. As it turns out, there was a more fundamental aspect to the "Japan Problem" that had been left unresolved -

Appendix1: "Heretic" in the community of capitalist market economies?
Common sense on Wall Street, Heresy in Japan? MOF's Sonoyama
Hideaki attends the US Securities and Exchange Commission's 1976
Enforcement Training Program.

Program Director : Ira H. Pearce.

TENTATIVE SCHEDULE

<u>Monday - 7/26/76</u>	SECURITIES TRADING	9:00 ~ 19:00
<u>Tuesday - 7/27/76</u>	APPLICABLE REGULATIONS	9:15 ~ 21:30
<u>Wednesday - 7/28/76</u>	INVESTIGATIONS	9:15 ~ 21:30
<u>Thursday - 7/29/76</u>	ENFORCEMENT ACTIONS	9:15 ~ 21:30
9:15 ~ 10:15	<i>Choice of Enforcement Remedies</i>	
10:30 ~ 12:30	<i>Administrative Proceedings</i>	
14:00 ~ 16:00	<i>Civil Injunctive Actions</i>	
16:00 ~ 17:30	<i>Criminal Violations of Securities Laws</i>	
19:30 ~ 21:30	<i>Important Recent Cases</i>	
<u>Friday - 7/30/76</u>	TRIALS	9:15 ~ 15:30

the enigma of Japanese capitalism. That was the subject of Part I of this series.

Van Wolferen recently (April 24) gave a speech at the Ozaki Yukio Memorial Foundation entitled "A New Millennium-What is Japan to Do?" In his speech, van Wolferen stressed his view that Japan does not have a government that is capable of establishing a new set of priorities. He argued that the fundamental cause of this situation is that "the Japanese people are not informed of how authority is exercised." He advanced the view that it is necessary to cultivate the development of political citizens, and that this task must be accomplished by the Japanese people themselves.

The Top Priority of Crisis Management - To Ring the Alarm

The present authors decided to write this article in order to do our part to help bring about the accomplishment of this task and responsibility. As securities inspectors at the Ministry of Finance, as economic journalists, and as "professionals" who have witnessed the evolution of capitalist society in Japan, this is a duty that we feel naturally compelled to shoulder.

We have always reported on the same subject matter that van Wolferen has dealt with, but from a different

perspective. Taking as our point of departure such issues as the generation and allocation of national wealth and national interests, as well as the consumption, saving, and investment of this wealth, we have always sought to report on corporate and family finances from the perspective of the competitive order. (To be sure, all of these are inextricably linked together.)

Accordingly, it is not our principal aim, in writing this article, to provide any sort of theoretical basis that might contribute to the formulation of a vision for the future of the Japanese economy. If this article turns out to be helpful in that regard, it would only be in the sense that we may be ringing an alarm about the dangerous state of the Japanese economy.

Japan's Economic "Critical Incident" - Sonoyama Delivers a Warning

One of the two present authors, Sonoyama Hideaki, has been writing a series of reports since September 1995 entitled "Pitfalls in the System of International Capital Markets." The 40th article in the series was published in September 1999, and he continues to publish new articles for the series. It was in the third article, published in October 1995, that he first discussed the subject of the Pecora Report, a document that

played a pivotal role in the establishment of today's securities exchange system.

Reading this report, which was released in 1934, one is struck by the close similarity between the situation at that time in the US and in Japan today. The report provides a scientific analysis of the causes of America's Great Depression, and the US government used the report to carry out major reforms. At the same time, the report charged the federal government with a responsibility for recognizing the dangers inherent in the capital market system and making improvements to prevent them from causing major problems.

In Japan, by contrast, there is no counterpart to the Pecora Commission. The title of this third installment in the series is "The Water Wheel and Nuclear Generators," and that is an apt metaphor for the yawning technical gap between the capital markets of the US and Japan. Sonoyama's article served as a warning that the Japanese economy had experienced a "critical incident."

"Face the Fact that We Have Lost the Economic War!" - Wasa's Memo to the Politicians' Forum

Wasa Takahiro was an economic journalist for the Nihon Keizai Shimbun, where he had long been writing about the warnings of the market. In March 1987, Wasa became a member of the paper's Editorial Committee, and the Nihon Keizai Shimbun published an editorial on April 1, 1987 entitled "Aggregate Land Values Soar to ¥200 Trillion in a ¥300 Trillion Economy." This was followed up on April 21 with "The Side Effects of Our Financial Policies Cannot Be Ignored." Wasa's views have often shown through clearly in Nikkei editorials over the years, and these are just a couple of cases in point.

But the Nihon Keizai Shimbun was a voice in the wilderness; few paid any attention. Appreciation of land assets started accelerating in 1987, and prices raced to a peak in 1990 before the bubble burst in dramatic fashion. Both Wasa and Sonoyama felt that the image of a "critical incident" provided an apt metaphor for the economic effect of this collapse both at home and abroad.

In an effort to find some way of reviving

our battered economy, Wasa spoke about the problem at the Politicians' Forum in February 1994. The basic thrust of his remarks was that unless we thought of our current situation as a "lost economic battle" and dealt with it accordingly, it would be impossible for anyone to take responsibility for the spreading economic losses visited upon the country. In other words, we would see a repeat of the defeat that Japan had suffered in World War II.

An "Irresponsible Nation" - Ignoring the Dangers of Capitalism

The main point of this memo was that "we cannot rely on the market economy to pull us through the tough spot we're in," because the Japanese-style market economy includes a cultural element that rejects allocation of resources by the market. Because that very same culture has achieved huge success and become a major power by learning from the example of the advanced nations, its market has raced out of control toward the least desirable of all possible allocations of the country's resources.

The market began allocating resources after the "Nixon shock" of August 1971 and the ensuing appreciation of the yen. Against the backdrop of a "strong yen," a capital buildup occurred that enhanced the international competitiveness of Japanese corporations. Blue-chip companies such as Sony saw the value of their publicly listed shares rise to new heights, and it became standard practice for such companies to procure funds by issuing new shares at market price. On both the microeconomic side (the management of individual companies) and macroeconomic side (the yen), the allocation of resources came to be determined by the market's price mechanism.

Exactly 30 years after Pearl Harbor, only a very small minority of Japan's political and business leaders had experienced capitalism and understood it. On top of that, elite bureaucrats had achieved a good degree of success in managing the economy, and the country was under the sway of an irrational belief in their "infallibility." We were not very much on guard against the downside of capitalism. As an economic power, we

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Japanese "New Deal" Seeks Economic Recovery Memo to the Politician's Forum; Feb. 1994 Searching for the Right Recovery Measures

Wasa Takahiro
Member of the Nihon Keizai Shimbun Editorial Committee

-If Japan limits itself to dealing with the aftermath of the bubble (including criminal prosecution of those who took shameless advantage of the bubble and drove the economy into its current predicament), the Japanese economy will not pull out of the doldrums simply by relying on the market economy.

-Three scenarios for assisting the victims of the bubble economy. Set up a "tribunal for economic war criminals" and an "economic recovery hospital."

Three scenarios

Number 1: Japan carried out "land reform" and "democratization of securities" in the immediate post-war period. We could now carry out a second round of reforms in each of these areas by reassessing assets.

Number 2: We could adopt a reflationary economic policy in order to: (1) revive the purchasing power of working people, who make the single biggest contribution to GNP; (2) expand domestic demand and correct the imbalance between supply and demand; and (3) liquidate and restructure bad debts.

Number 3: We could carry through with "revolutionary economic reforms" in order to establish the economic democracy with which Japan is to make its contribution to the international community of the 21st century.

had lost the ability to take responsibility for our actions.

Allocation Structure Controlled by Management - Freeloading on Unrealized Gains from Land Inflation

An article entitled "Diagnosing the Yen" (published in 1972 in the April 17 issue of *Nikkei Business*) rang the alarm about the risks we were running. This article pointed out that the Japanese style of business management - the most salient features being lifetime employment, seniority-based wages, and the retirement pension system - was encumbered by a fatal weakness. The main message of this article was that "Gobbling up Profits Before They Materialize is a Trick Practiced by Companies Headed for Collapse." That was 22 years before the Politicians' Forum.

Then, in an issue entitled "An 'Income Counter-revolution' is Now Under Way" (published on December 25, 1972), Wasa wrote an article that "Huge Unrealized Gains are Sowing the Seeds for a Big Problem with the Yen." The capital gains enjoyed by corporations were mostly coming on the strength of rising land prices, but accountants were refusing to disclose these as unrealized

gains. Because these gains thus did not figure into calculations of the ratio of labor cost to gross profit, management was able to keep the capital gains for itself.

These unrealized gains were not even disclosed to stockholders, who were the owners of these companies. Because management was able to keep unrealized gains to itself, it inevitably tended to rule like a "despot" and treat the market as its "imperial palace."

20-year Land Bubble Generates ¥2,200 Trillion in Unrealized Gains

The economic bubble that arose in the latter half of the 1980s was of unprecedented proportions, and it marked the climax of the Japanese-style market economy - very flashy, to be sure, but just a flash in the pan. The first signs of a reaction appeared in August 1992, when stock prices in Tokyo took a steep dive. For 20 long years, ignorant and arrogant corporate management was able to ride roughshod over the interests even of its own stockholders, but when the chicken finally came home to roost, it laid a very big egg indeed.

Wasa was a speaker at the 1994 Politicians' Forum. In his presentation he

stated, "We cannot rely on the market economy to pull us through the tough spot we're in." He called upon the politicians there to recognize that Japan had lost an economic war. In so doing, he was attempting to relay the warning signals that were emanating from the market. Corporate management throughout Japan was able to cheat its shareholders for 20 long years because everyone believed that land prices would keep going up forever, and that unrealized gains would thus naturally keep going up too.

When the bubble peaked in 1990, the aggregate value of all the land in Japan had risen to ¥2,420 trillion. According to the Annual Report on National Accounts (a comprehensive survey of the state of the Japanese economy by the Economic Planning Agency, prepared on the basis of the annually compiled System of National Accounts), this same figure had stood at ¥173 trillion in 1970. The proper goal of sound economic activity is the generation of added value, something from which land prices had become quite divorced, resulting in ¥2,200 trillion of illusory value.

A Lurch toward Normality, and Politicians Join the Fray - a Japan-Style New Deal

Japan's nominal GNP for 1990 was ¥433 trillion. Over a period of 20 years, normal economic activity generated a bubble equivalent to five years' worth of spurious land inflation. This bubble should not have occurred. The systemic irregularities that gave rise to it should not have existed. If we assume that it was Japanese culture that had allowed these irregularities to go unchecked (up to that point), then this culture represented a threat to the market economy. When one considers the fact that this culture represented a threat to Japan itself, then it should hardly come as a surprise that Japanese culture would be perceived as a hostile entity by other countries, which had been drawing into closer relations with Japan and were by that time much more subject than they had been in the past to Japanese influence.

This hostile view even took root in the United States, which can reasonably be regarded as the leviathan of the 20th

Appendix 2-2

Resources began to be badly misallocated in the 1970s.
A warning about problems with the Japanese-style market economy
(Wasa's writings)

Diagnosing the Yen (published in 1972 in the April 17 issue of *Nikkei Business*)

- Because of Weakness the Mechanism that Has Forced Japan to Allow the Yen to Appreciate Again
- Gobbling up Profits Before They Materialize is a Trick Practiced by Companies Headed for Collapse Exports are Driven by Corporate Weakness
- Background of Strong International Competition Misconceptions Fostered by the Seniority and Pension Systems
- A Prescription for Dealing with these Problems Reassess Assets to Break the Vicious Cycle

century. The proponents of this view are called revisionists, who have accepted the label of "Japan bashers." This was a warning proceeding from civil society. It preceded the market warning, and there were a few leaders in the Japanese establishment who understood it as such. The fact that we are able to write the sort of article you are now reading is due to the fact that there are some enlightened globalists in Japan.

Civilization demands normalization. Market warnings are a sign of this same thing, but the irregularities in Japan continued for far too long, and the problem grew far too big. When we finally made a move toward normalization, the shock waves were inevitably tremendous. But when such conditions arise, it is possible that the shock waves themselves could in some cases destroy market mechanisms. This was true in the United States 70 years ago, and it is every bit as true today in Japan. And when that happens, it soon becomes time for politicians to get involved. History tells us that we should be considering the option of a Japanese-style New Deal.

A National Economy Based on Land Prices, and the Tax Policies of the Ministry of Home Affairs

A Japanese New Deal would focus on the "myth of ever-spiraling land prices." This economic system was so uncivil that Ryu Shintaro described it as the economy "on a binge." Yet it lasted for over 30 years. We must analyze the influence of this system. It would be difficult to understand this problem using sociological theories born in the West. We have a responsibility to explain what

happened.

Japan's land problem involves the rights and responsibilities that accompany land ownership. It has to do with the nature of our national economic system. The land problem calls to mind a sordid chapter in Japan's 20th-century history. Under Japan's pre-war imperial system, the nation's rulers made it taboo to talk of the Emperor as a mere organ of the state, which is in fact a very natural aspect of constitutional monarchies. The military forces, calling themselves the army of the emperor, abused the ideology of the monarchy in order to wrest the country away from civilian control.

Let us look at the history of taxes, which constitute the economic responsibility that comes along with private property rights. There is an imbalance between respect for absolute private property rights, on the one hand, and the long-standing reduction of the attendant responsibilities. This imbalance cannot be completely justified in rational terms. Fixed-asset taxes on land are levied by prefectural and local governments. They are a tax on fixed assets, and policy in this area is set by the Ministry of Home Affairs, which bears an obligation to base its actions on the philosophy and rules of the market economy, and to provide an explanation thereof. If a ministry lacks the capability to carry out the function assigned to it as an arm of the state, it should at the very least bear responsibility for informing the public of this fact. If we are in the midst of an economic war, then the performance of the Ministry of Home Affairs qualifies it as a Class A war criminal.

Japan's Market Economy - Keynesian Policies Bring Fiscal Ruin

Under the fiscal and monetary policies of the 1990s, Japan's liberal expansion of public spending has qualified it as one of the most faithful believers in Keynesian economics. But the land problem, which is very much affected by public spending, is totally different in Japan and the United States. For that reason, the land problem has given rise to an asset gap between landowners on the one hand and rank-and-file laborers and taxpayers on the other, which the latter cannot possibly make up through their own efforts.

Furthermore, a large proportion of public spending has been used for the purchase of land, which has mitigated the beneficial effect of the government's economic stimulus measures. As a result, Keynesian policies have exacerbated the government's financial crisis even as they have funneled enormous incomes into the hands of landowners. These policies have been the main cause of the government's worsening financial situation and the nation's worsening social and economic disparity.

It was in 1994 that the Ministry of Home Affairs decided to apply market principles to fixed-asset taxes on land. And that was two years after the Ministry of Finance had begun levying a 0.3% tax on land. Taxation criteria stipulated that the new 1.4% tax would be levied upon land whose assessed value had been reduced to between 1/10th and 1/5th of market value. The system continued for 30 years after 1964.

Shift to Current Value Accounting and Reassessment of Land Values

Throughout the history of its administration of land taxes, the Ministry of Home Affairs has enjoyed a sort of "extraterritorial" exemption from the rules of the market economy. The standard explanation has been that this had to be so in order to "ease the tax burden upon landowners in a time of rapid change (rising land prices)," which would seem undeniably to be an indication that the ministry's policies were rooted in a "culture" that abhorred change and placed high priority on consensus.

Table 1: Is Japan's economy based on land prices?

Land tax system enjoys a sort of "extraterritorial" exemption from the rules of the market economy for 30 years.

Officially announced prices and fixed-asset taxes since the 1960s

Fiscal year	Officially announced price [a] trillion yen	Fixed-asset taxes (on land) [c] trillion yen	1.4% in tax law [c] / [a] %	Amount of forgiven taxes (to relieve taxpayer burden) trillion yen	Degree of tax relief beyond the legally allowed amount %
1964	55.6	0.064	0.12	0.711	92
1970	178.7	0.15	0.08	2.35	94
1976	394.1	0.78	0.20	4.74	86
1982	855.8	1.37	0.16	10.61	89
1985	1007.7	1.78	0.18	12.33	87
1988	1838.3	2.18	0.12	23.57	92
1991	2180.8	2.60	0.12	25.99	85
1992	1968.0	2.86	0.15	24.69	90

Note: Officially announced prices are based on the Annual Report of National Accounts
Source: Tax Commission

Japan's financial policy is driven fundamentally by Max Weber's "ethic of conviction." Because land taxes are levied by prefectural and local governments, which are closest to local communities, we could hardly expect it to be driven by the general populace, which is capable of leveling direct criticism at the tax policies of the Ministry of Home Affairs. However, professional ethics in the realm of politics require that government bear absolute liability for its actions. For this reason, the government must heed the warnings of the market.

The most important thing is to adopt the current value accounting that is demanded by international accounting standards. The government has already announced this as the whole macroeconomics. If that is applied to the Securities and Exchange Law or to commercial law, it would amount to a de facto reassessment of assets. In other words, it would constitute a reassessment of land assets to reflect the reality of unrealized gains.

A "Medical History" of the Bubble Economy Based on Market Economic Principles

If we could succeed in using the criterion of market prices to give a detailed description of the overall

allocation of resources in the Japanese economy, we would be able to analyze our economy and compare it with a properly functioning economy. If we extended the scope of our analysis to cover the bubble period, we would in effect be creating a "medical history" of Japan as economic leviathan. The most famous surgeons only operate at modern hospitals with the most up-to-date equipment.

This medical chart would include numerical data showing the exact degree to which the Ministry of Home Affairs, in the name of "relieving the tax burden" of landowners, has abandoned fixed-asset taxes on land. It would also include hard data showing just how badly we have departed from the principle of fair competition. If Japan's "Big Bang" economic reform program forces observance of the principle of everyone taking responsibility for their own economic behavior, it would throw the markets into a state of anarchy. No, wait! It would be more accurate to say that our markets have been in a state of anarchy ever since the bubble economy, and the Big Bang would simply be forcing the disclosure of that fact.

The only thing that can head off such an occurrence is the political process, because that process is the leviathan that wields absolute power. If our political process seeks to carry out this role, there

is little reason why we should not be able to find a solution, because it would be impossible for the world's largest creditor nation to spark a worldwide recession, even if it set out intentionally to do so.

Controlling the Market System-Democracy and the Rule of Law in America

If land were reassessed to reflect current values, both corporations and households would have to disclose their unrealized gains. Enterprises, whose main focus is economic activity, would be able to take the reassessment gains and use them to support the government's effort to put itself back on a sound financial footing. Individual citizens would be able to pay taxes at the time of land inheritance to make up for the free ride they've enjoyed for so long.

That is the minimum degree of authority that the government must exercise if it is to establish its credentials as an economic leviathan. Hobbes wrote: "To describe the nature of this artificial man, I will consider...the matter thereof, and the artificer; both [of] which is man." The question for Japan is this: Do the masters of the Japanese economy (i.e., rank-and-file wage earners) have the will, as the "matter," to become the leviathan's "artificers?" Will our rational side guide us in that direction? The answer to this question depends on whether we can develop a democratic political system, which is what we must use to control the market economy. In this respect, as well, we must learn from America's democratic political system.

Political Authority Exists to Maintain Economic Security

The bubble collapsed in the early 1990s and an unprecedented mountain of bad debt subsequently came to light. The government misread the causes of the problem as well as its effects, and this further exacerbated the crises in the banking sector and government finances. To resolve the problem, the Hashimoto cabinet decided in November 1996 to launch the so-called "Big Bang," a package of six major financial reforms.

The Big Bang program was without a doubt a significant contribution to the

international community on Japan's part, but it only added to the confusion in Japan. If we adjust our thinking and recognize this fact clearly, we can come up with a clue to help us arrive at a structural explanation of the root cause of the crisis - the issue of economic security.

For one thing, the Big Bang was adopted at least ten years too late, for the Maekawa Report was completed in April 1986. Prior to that, the G-5 adopted the Plaza Accord and the Reagan administration announced a new trade policy. The United States became a debtor nation that year for the first time in 71 years. Japan had lost far too much in the 14 years since the "Nixon shock." There had been ample time for a "critical incident" to occur.

Shift to a Market System and Self-Responsibility for Capitalism - the Government's Responsibility

Ten years passed between the completion of the Maekawa Report and the Hashimoto cabinet's adoption of the six major financial reforms. The first five years after the Maekawa Report saw the emergence of a bubble like none before, fueled primarily by the climax of the economy "on a binge," the out-of-control system based on spiraling land prices, as mentioned in Part I of this series. During the latter half of the post-Maekawa decade, after the bubble burst, the full extent of the impact of over-inflated land prices upon the market's resource allocation gradually became clear.

That brought into sharper focus a second problem. The key concept underpinning the Big Bang reforms was the idea that enterprises and private households must take responsibility for their own economic solvency, but these had by then been driven into a predicament where it was practically impossible for them to shoulder this responsibility, and this was true not just for the laborers and average taxpayers who had been getting the short end of the stick under the tax policies of the Ministry of Home Affairs; even those who had reaped massive windfalls during the bubble economy - especially large landowners, for example, as well as banks, securities firms, and other listed companies - had become much less able

to assume responsibility for their own financial solvency, for they were exposed to unprecedented amounts of bad debt.

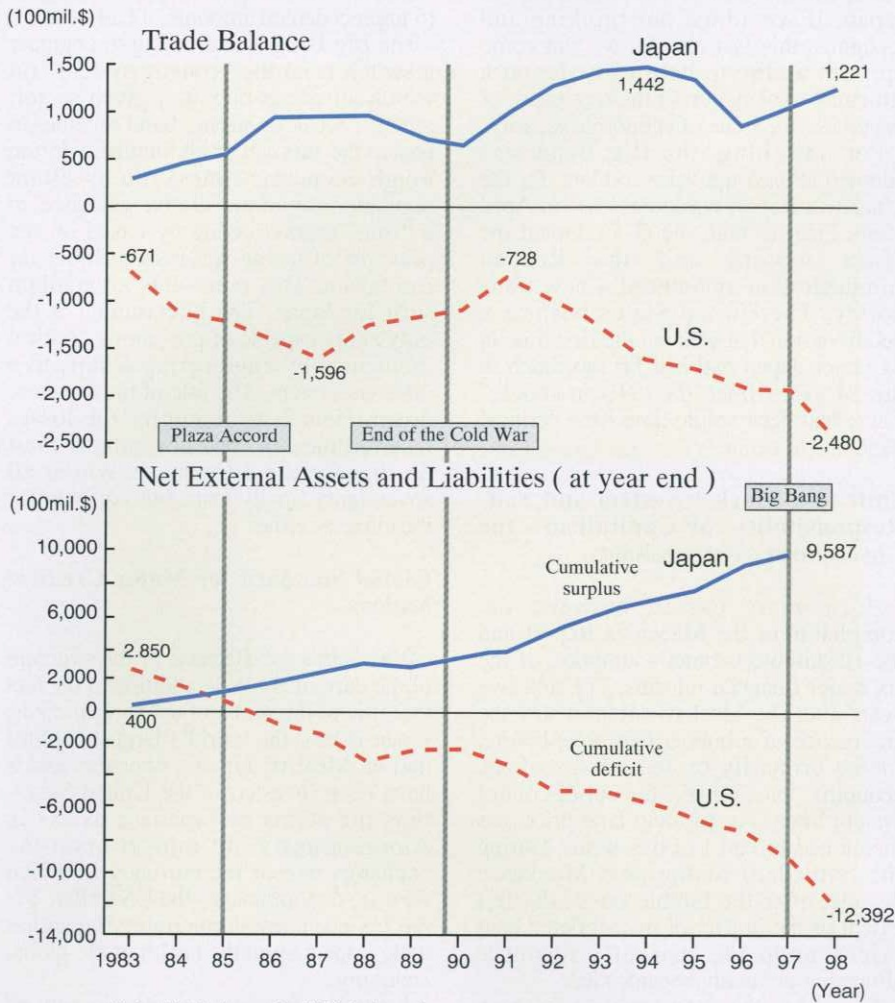
The Big Bang is attempting to engineer a switch from the "convoy system" (in which all companies in a given sector, whether weak or strong, band together to ensure the survival of all members during tough economic times) run by either regulations or administrative guidance, to a "true" market economy based on the principle of taking self-responsibility for capitalism. This represents a paradigm shift for Japan. The government is the only entity capable of preventing "critical incidents" by engineering a shift to a different system. The role of the Japanese government is to minimize the losses incurred thereby. The government must do this for the citizens, in whom all sovereignty finally rests, but not only for the citizens, either.

Global Standard for Major Creditor Nations

Why is this so? Because of the structure of the current crisis. In addition to the fact that it is in the midst of a financial crisis, Japan is also the world's largest creditor nation. Most of Japan's overseas assets have been invested in the United States, thus the status of Japanese assets in America has a big impact upon the exchange rate of the currency in which they are denominated - the US dollar. Via the US economy, furthermore, Japan has a big impact upon the health of the global economy.

Japan has been an "economic nation" since the mid-20th century. (We call Japan an "economic nation" in reference to the fact that it is the only developed nation in the world that has included a provision in its constitution renouncing warfare.) As such, the "experiment" with a Japanese-style market economy constitutes a shared asset for all of mankind as we seek to build a global economic order for the 21st century. If we look upon communism as *The Grand Failure* (to quote the title of a book by Zbigniew Brzezinski), then we could perhaps think of the dismal resource allocation of peacetime Japan as another "Grand Failure." This is a chance to build upon what mankind learned 70 years ago from America's "Great Crash."

Graph II : Japan is the largest creditor nation, while the US is a debtor nation. Misallocation of resources becomes an international problem



Note: Net balance for USA is based on current value assessment
Source: WRI Graphic Report No.57

Biggest Gift to the 21st Century - Mankind's Collective Effort

After World War II, Japan was more influenced by the United States than by any other country. In our rush to imitate the US we set very ambitious goals, and we became so confident that at one time we began to believe that we had overtaken and surpassed America.

Where the capitalist market economy is concerned, however, Japan has understood almost nothing of America. Indeed, we have misunderstood America very badly. This misunderstanding is

closely related to the fact that in Japan we have forgotten the concept of national wealth that includes such aspects as culture and tradition. In other words, we have misunderstood America because we have failed to build a national consensus concerning the definition of national interest, something that we should pursue as a sovereign state, and cannot be handed over to any third party.

Now we must learn from Alexis de Tocqueville, who wrote: "In America, I saw more than America." If Japan, a non-Western European nation that has close ties with the United States, can learn

successfully from de Tocqueville, the know-how we gain in the process would be our biggest gift to the 21st century.

Vision for a Market-Based Civil Nation - the "Japan Experiment"

In order to succeed in this quest, it goes without saying that Japan will have to put forth a great effort. In particular, we will need a vision and a mission. That, by itself, is not enough, however. We must obtain the understanding and cooperation of the United States, with whom we have severe disputes and economic conflicts of interest.

De Tocqueville's "in America, I saw more than America" is an approach that we should adopt as our own. We must also get other countries to share with us a diverse range of images and visions regarding capitalist market economies. We need this kind of cooperation from Europe, of course, but also from countries outside of Western Europe as well.

It is essential that a 21st-century cultural nation have the ability to control the market civilization (philosophy and technology) that forms the framework of national interest with which economic value is associated. In the Japan-style market economy, the market has allocated resources in the worst of all possible manners. Japan has been experiencing the "Grand Failure" for 30 or 40 years now. The present writers have been on hand as witnesses to this incident, and we are very prepared to "take the witness stand" to help our country achieve the ability to control the market civilization. We intend to discuss these issues further in the next installment (Part III).

WJI

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