

Shock Therapy

By Nakamura Jin

The arguments about whether the former Soviet Union and eastern Europe should choose shock therapy or gradualism have still not come to an end. However, to use the same expression, the administration of Prime Minister Hosokawa Morihiro has chosen shock therapy to reorganize Japan.

Three trade policy issues face the Hosokawa administration—restructuring of the market economy, restructuring of economic relations between Japan and the U.S., and restructuring of the global economic system. However, there will be no progress if these are not backed up by domestic policies concerning the issues of electoral system reform, administrative reform and easing of regulations, and structural reforms for the economy.

Successive LDP administrations took the outward stance that they were grappling with domestic reform, but in reality they postponed it. But since the inauguration of the Hosokawa administration, a series of reforms have come closer to fruition and this has been the Japanese version of shock therapy. If domestic reforms are successful there is also a strong possibility this will trickle down to trade reforms.

Three types of developing nations

Surveying the global economy following the end of the Cold War, I believe that new classifications are required for nation states. The traditional classifications were "advanced nations," "socialist countries," and "developing nations." I propose the following categories—developing countries that are reforming their market economies; developing countries that are shifting to a market economy; and traditional developing countries. In other words, there are three types of developing countries around the world.

It follows then that successful market economy reforms have been an histori-

cal theme for Europe, Japan, and the U.S. It certainly was not a coincidence that both the Hosokawa administration and the Clinton administration in the U.S. made "change" their catch phrase—reform is a common theme for each country.

The advanced nations, Japan, the U.S., and the countries of Europe, are all plagued by the symptoms of inferior nations and the vigorous image possessed by developed nations has become a thing of the past. America's economic growth rate has rebounded to 3%, but it is economic recovery without employment. Moreover, Japan has zero growth, and the EC minus growth, which is to say the scale of their economies is shrinking. "Developed nation" has become synonymous with "low-growth nation."

According to American public opinion surveys, there are many people who predict that their children's generation will be worse off than their parent's. The vestiges of the American Dream have grown hazy. The Japan that was praised in *Japan As Number One* is now seen to have been a lie and with the extended recession that followed the collapse of the bubble economy has completely lost confidence, while publications about honest poverty have become bestsellers. The EC has been dragged down by a plague of high level unemployment and enveloped in pessimistic arguments regarding the dream of economic and monetary integration.

The economic growth rate of developed countries was 5% in the 1960s, 4% in the 1970s, 3% in the 1980s, and since the beginning of the 1990s has dropped to 1%. There is no denying the long-term downward trend.

Even though socialist economics have headed down the path of destruction and it is said that the age of market economy has arrived, it is ironic that the U.S., and Europe are suffering and sinking in a sea of economic stagnation. The phrase that we continually recite to for-

mer socialist countries and newly-developing nations is "reform and self-reliance are the most important things of all." I think that these statements have now been turned back toward us.

If Japan, Europe, and the U.S. do not extricate themselves from this extended slump they cannot boast about the "century of market economics." I do not know whether or not the prime minister is aware of it himself, but I believe that the reforms with which his administration is grappling are linked to major surgery for the declining functions of market economics.

Consider the factors in the failure of market economics to demonstrate its expected functions. The main reason is that the political system that should support market economics has degenerated from democratic principles to popularity contests, with a lack of financial standards.

Analyzed from the standpoint of economics the cost of social security, labor welfare, and other policies that support democracy is tremendous. Society is aging as economic development proceeds, birthrates are declining, and the population of people who do not work is increasing. Market economics is a system that is stimulated by consumption, and the savings rate that is the source of growth is declining. Increasingly, there is excessive competition in the buying and selling of entire companies while in agriculture, textiles, and other under competitive sectors protectionism is increasing.

Attempts by Europe, Japan, and the U.S. to heal economic ills with political strength have been accelerated by popularity contest politics.

The Hosokawa administration is trying to reduce the role of government in market economics and revive competitive principles with its policies for easing regulations. Automotive, household appliance, and other vanguard manufacturers who boosted productivity with "just-in-time" systems and quality con-



Photo: Kyodo News Service

The December 15th Diet plenary session to decide upon a 45-day extension, boycotted by the LDP.

control have reached the limits of their abilities and have become unable to carry agriculture, distribution, finance, insurance, and other low-productivity sectors on their shoulders. Regulatory relaxation places a heavy emphasis on consumer profits in its aims and in addition should reform these industries' new two-tiered structure.

The unity of the political, bureaucratic, and economic spheres, referred to as the "iron triangle," should pretty well be dissolved by political reform and a relaxation of regulations. This is an attempt to reinstate former democratic principles and market economics.

However, it would be dangerous to heap too much praise on the Hosokawa administration. Looking at the reverse side of its uncommon 70% approval rating among eligible voters, it faces the paradox that it cannot turn its back on the opinions of the public that supports it.

Attempts to reform the old system will certainly cause pain to the nation's citizens, workers and industry. That the support ratings do not decline is not that the pain has not been actualized up to now. Whether or not the Hosokawa administration will refuse to strike the flag of reform even if its ratings drop is an unknown quantity.

Touching upon the income tax reductions and consumption tax rises that will be needed for economic reform and an equitable tax structure, if the consumption tax is raised 1% support will drop 10%, or in other words it will drop up to 30% with a three percent rise, and rough estimates are that support will fall

below 50%. The question is whether they will ignore this and continue with the reforms.

If they actually carry through with an easing of regulations, inefficient companies will be liquidated and employment worries will arise. If across the board administrative reforms proceed there should be less and less need for bureaucrats, but the problem is how far they can carry the struggle if they turn the bureaucracy into an enemy.

Further, once the bureaucrats who are most aware of actual economic and administrative conditions have gone to the chopping block it is also an uncertain issue whether or not a coalition government full of novices can take the political initiative to formulate and execute appropriate policies.

Japan's equation: $B = C + D + R$

The U.S. is placing its hopes on the Hosokawa Cabinet's ability to carry out a variety of reforms. Since the start of the administration it has taken the position that it will pursue reform. However, there has been a steady shift from a waiting game to the stance that successful efforts should be demanded.

The basis for Japan's foreign policies is that international responsibilities should be allocated equitably. This will also result in improved Japan-U.S. relations. Searching for the fundamental reason for the friction between Japan and the U.S., it comes down to Japan's failure to fulfill its international responsibilities.

"Burden sharing" has long been demanded of Japan, but there have been a variety of claims regarding the substance. I attempted to break down the contents of the "burden" in various ways: $B = C + D + R$.

Let us refer to this as the equation for Japan's foreign policies. "C" refers to cost sharing, "D" is decision sharing, and "R" is risk sharing.

As far as costs are concerned Japan is sharing a fair amount of the burden. During the Gulf War, Japan's capital

contributions to the multinational force exceeded US\$10 billion and Japan contributes the highest amount of funds in official development assistance in the world. Japan's capital burden is also second to that of the U.S. with regard to international organizations such as the U.N., the World Bank, and the International Monetary Fund (IMF).

Japan lags behind when it comes to decision sharing, though. There is considerable international criticism that Japan is just going through the motions of supporting the world order. What Japan lacks, first of all, is positive initiative in the planning process for global decision making. Japan has been a type of "observer" nation, noting the actions of big, powerful countries like the U.S. and the European nations with great caution and trying as much as possible to adapt to decisions that are made.

On its own, Japan does not take the lead in decision making. In the case of the Uruguay Round as well a resolution of the issue of liberalization of the rice market has been hard to come by and Japan has watched the shifts in negotiations between Europe and the U.S. Former Prime Minister Miyazawa Kiichi said, "We will wait and see what the U.S. and Europe do before making concessions," while Prime Minister Hosokawa has noted, "We will not take the first step." It is easy to believe that statements such as these demonstrate that Japan's foreign policies are purely spontaneous.

Risk sharing is another issue. Japanese with any spirit have no reply to the criticism that Japan takes up positions in secure locations and gives its undivided attention to making a profit.

At the time of the structural talks during the Bush administration the U.S. repeatedly stressed that American demands would actually benefit Japan's consumers. Increased imports of inexpensive agricultural products, rationalization of distribution systems, the strengthening of anti-monopoly measures to promote competition among companies, reforms related to land-use issues—there are many cases of benefits accruing equally to both sides.

The end result of the Hosokawa

administration's emphasis on the consumer, easing of regulations, and correction of the differences between foreign and domestic prices will be the creation of an environment in which it is easier for foreign companies and products to enter the Japanese market.

The prime minister's personal advisory committee, the Economic Reform Council, chaired by Keidanren head Hiraiwa Gaishi, suggested that if the Hosokawa administration is successful in cutting the current surplus it will lead to investments not in overseas markets but in domestic ones, meaning reduced friction and enriched domestic social capital.

EC castle, North American house, Asian tent

A global system suffering from systemic fatigue was also the impetus for the reforms at the end of the Cold War. The U.N. is struggling with reforms through a strengthening of its peace-keeping activities, an increase in the number of nations acting as permanent members of the Security Council, and other measures. The General Agreement on Tariffs and Trade (GATT) has also embarked upon major rebuilding of its house during the Uruguay Round talks. All of these efforts are directed toward the construction of a system appropriate to the global structure following the Cold War.

Many other system reforms are needed. Japan should be able to play an important role in reforming the Asia-Pacific Economic Cooperation (APEC) forum and the so-called Bretton Woods organizations, the International Monetary Fund and the World Bank.

At this fifth conference in Seattle in the U.S., APEC's status rose in a stroke, for the reason that the U.S. became aware of its important interests in the region and tried to make APEC the pillar of its economic strategies. It was also the first time for the president and the prime minister to hold a summit level conference in the Asia-Pacific region and served as a site for top-level diplomacy between the two countries.

There has been no framework such as the EC or NATO for pan-regional efforts in the Asia-Pacific area, neither has there been an experience with promotion of cooperation throughout the region historically. APEC served as a stage for the beginning of efforts to achieve this and without doubt the various countries in the region are attempting an historic experiment.

During this occasion Japan served first of all as an interlocutor between the U.S. and Asia. APEC's recognition level rose so quickly because the U.S. took the initiative and, moreover, without the presence of the U.S. Asia-Pacific regional development would be unstable. Although the countries of Asia understand this there is the difficulty that a U.S. presence that was overly strong would draw a backlash.

Looking at the economic aspects alone many countries maintain that Asian economic development is not necessarily purely thanks to America. In reality, there is no doubt that Asian exports to the U.S. and the direct investments by American companies in Asia have greatly contributed to the region's development, but there are deep sentiments in Asia that this should not be clearly acknowledged.

America's style of action also differs from Asia's. The U.S. proceeds by setting goals, deciding upon clear-cut policy steps in line with them, and verifying results. Asia, on the other hand, prefers everything to develop as if spontaneously and desires gradual reforms, not abrupt reorganizations.

Even if we use the word "regionalism" the reference varies greatly, from the EC castle, to the NAFTA house, to the Asian tent. A tent consists of tent poles and flaps, allowing free entry and exit, with little power to constrain. Particularly when compared with Europe, Asian political systems, ethnic groups, and stages of economic development vary greatly on all levels. In order to tie this type of disparate region together a tent-like cooperative relationship is realistic.

However, the U.S. has great difficulties understanding this. Regarding the nature of APEC, the U.S. stresses trade

negotiations over economic cooperation and binding agreements in place of charters without obligations, against which Asian rebels say, "The U.S. is too hasty. We can't keep up."

Shock therapy will not work with APEC. Japan must mediate with regard to the gap across the Pacific. As the only Asian summit, G-7, and Organization for Economic Cooperation and Development member, Japan should be able to serve as a bridge between the developed nations and Asia.

As Japan now tries to promote this type of balanced regionalism it must strive to strengthen global organizations such as the IMF, World Bank, and GATT. Of these, work has yet to start on reforms of the IMF and World Bank, both of which will celebrate the 50th year since their founding in 1994. These organizations, which have promoted aid and currency progress and stability since the end of World War II, are lapsing into functional paralysis.

The IMF is now losing its role as the guardian of international currency stability and its impotence in the face of currency fluctuations has been revealed. There is talk that even though Europe was buffeted by the winds of currency instability there was no contact with the IMF. This is the extent to which the IMF has fallen into disrepute.

For the World Bank as well, funds are held by the private sector as well as the government sector in this day and age and it is difficult to procure capital. On top of this, the electric power, communications, and railroad companies to which it lent large sums have been privatized in many cases, which is to say that the aid functions that were its original purpose have declined and there are questions about the meaning of the bank's existence. However, Europe is completely enthralled by regional integration and has its hands full from the standpoint of capital. Today, when Europe has lost interest in strengthening international organizations, Japan and the U.S. must cooperate in trying to revive them.

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