

Japan's Economy — Analysis of the Recent Situation and Future Perspectives

(Two part series – part one)

By *Tsutsumi Tomio*

Japan's Reversal of Fortune

In the 1980s, we often heard jokes about arrogant Japanese businessmen who were eager to give advice to their foreign counterparts on how they could emulate their country's economic success.

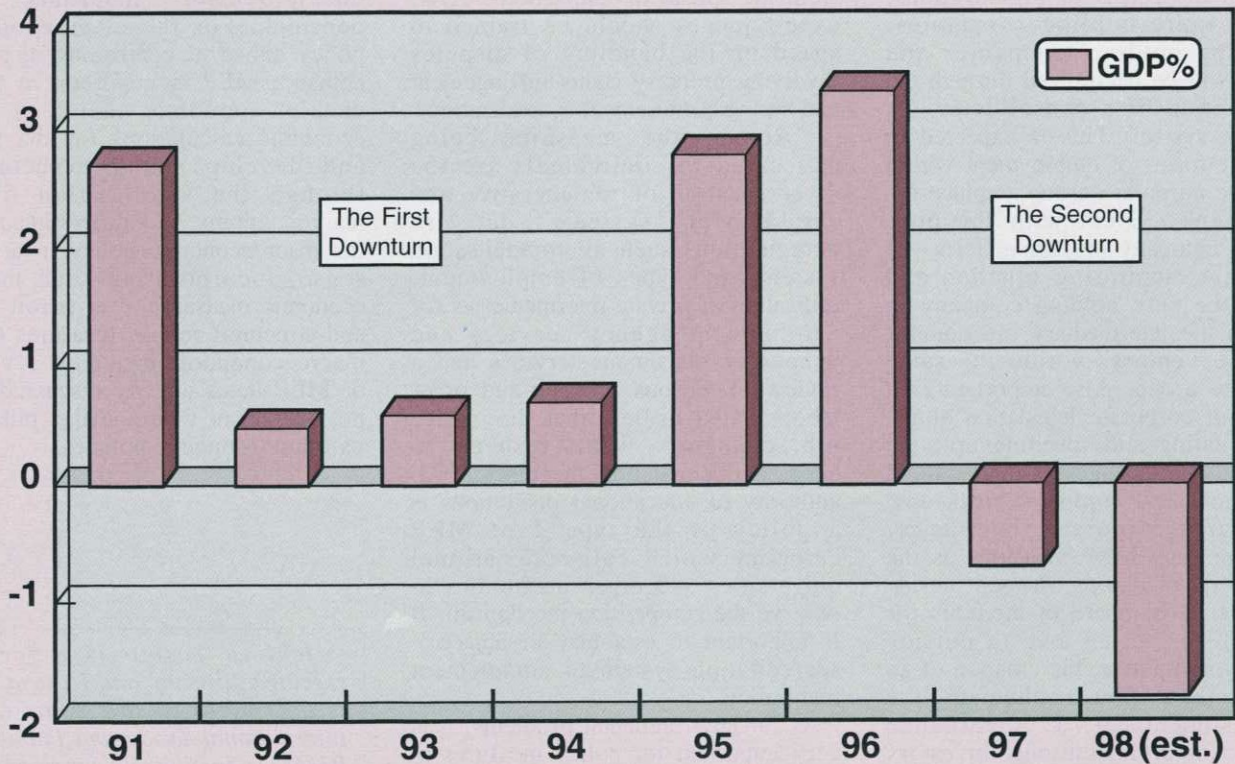
Three businessmen, a Japanese, an American and a European, were sailing together in a storm. Their ship was sinking and they were going to drown. God suddenly appeared and

asked them, "What would you like to do before you die?" The Japanese businessman told God that he wanted to give a talk on the Japanese economy. The American businessman told God that he was really bored with that topic and he would rather die than have to listen to a lecture about it. The European businessman wondered why the other people were talking about business at a time like this because he really wanted to look at some Impressionist paintings before he

died!

Nowadays, of course, the global economic situation has changed completely. In a contemporary version of this joke, the Japanese businessman would be replaced by his American counterpart. At the Denver summit meeting in June 1997, a few European leaders refused to wear cowboy hats, presumably because they were tired of being lectured about the success of the American style of management. Recently, Japan's economic situation

Recent Economic Growth in Japan



and its implications for the future have become a topic of serious concern, especially in Pacific Rim countries.

Why Has the Japanese Economy Deteriorated?

Japan enjoyed more than 40 years of favorable economic conditions in the post-war period. It is only within the past decade that troubles have emerged. The true implications of these problems have only become apparent in the past five years. Many people have become concerned about the impact of the Asian economic crisis on the Japanese economy, which entered a recession in 1997 along with the rest of Asia.

These developments raise the following questions. Will it be possible for Japan to absorb export surges from these countries? Why can't Japan boost its economy by implementing bold policies?

I find that observers of the Japanese economy fall into two camps. The first group says that Japan's economic power will return in the next century after the country carries out structural reforms. The second group predicts that Japan will become locked in a cycle of irreversible economic decline.

The graph shows the pattern of recent economic growth in Japan. I would like to pose five simple questions that should help to increase your understanding of the post-bubble economy.

1. What are the problems we face and their backdrops?
2. Why was there virtually no economic growth in Japan from 1992-94?
3. How did Japan manage to recover from its first economic downturn?
4. Why did a second economic downturn develop in 1997?
5. What strategies does Japan have for overcoming the current crisis and what kind of measures will it take?

1. What are the Problems?

● Basically Slow Growth of Economy

92-94—almost no growth

97-98—negative growth

(1) different (slow) recovery pattern

(2) no vigorous economic activities; there are fewer start-up firms and more firms are closing down

The recent recovery pattern is extremely slow compared with the previous one. There is no leading sector that can act as a locomotive to boost supply and demand. In the past, private investment, private consumption and exports could grow quickly enough to lead Japan's economy as a whole. Now there is a conspicuous lack of vigorous activity in the private sector with the exception of a few firms such as Sony or Toyota. This is shown by the fact that the number of new companies is decreasing while the number of companies that are closing is increasing. As a result the number of companies as a whole is now declining. This phenomenon began in the early 90s.

The Backdrops for Japan's Problems

We have entered an era of severe international competition in which many developing countries are industrializing rapidly. I believe that the magnitude and pace of this development is unprecedented in world history. We also need to face the consequences of rapid technological innovation and a revolution in information technology. If Japan cannot cope with these changes, it will fall into a kind of mezzanine trap in which it cannot go down because of high wages and it cannot go up to the second floor because of its lack of technology. Another name for this situation is the sandwich phenomenon. Japan is also

aging more rapidly than any other industrialized country. The working population faces the prospect of drastic change because people will be living longer and having fewer children. The Japanese system is not well suited to cope with these new economic environments, which are especially unfavorable for business.

2-1. Causal Factors of The First Downturn

● Cyclical Factor

The economic bubble induced a deep and long recession.

● Mid-term Factor

The bad loan problem prolonged the recession.

● Structural Factors

(1) high-cost structure

(2) system not favorable to new industries

The Three Main Factors Behind The First Downturn

Cyclical Factors

A business boom is always followed by a recession, the magnitude of which usually depends on the size of the previous boom, as demonstrated by the cliché, the higher the mountains, the deeper the valleys. The economic bubble that we experienced from 1989-91 induced a long and deep recession.

Mid-Term Factor

This refers to the bad loan problem. This was also created during the economic boom, but it will take longer to solve. The problem has had a negative effect on the economy for some time and has prolonged the recession. In my view, this factor's effect is still rather limited at this stage.

Structural Factors

Japan's high-cost structure and a system that does not promote the growth of new businesses and industries are the two main factors that explain why its economy has lost its ability to recover in recent years.

2-2. Structural Problems

● High-Cost Structure

- (1) dual structure of industries: tradable goods & services non-tradable goods & services
- (2) high public burdens (corporate tax, social security insurance premiums)

● Economic Systems not Favorable to New Industry & Business

- (capital market, education, R&D institutes, etc..)

High-Cost Structure

A. Private Sector

Japan is well-known for its notoriously high prices. High hotel rates, taxi charges and food prices are a problem for both consumers and businesses. Office rents, construction costs, energy costs, and other types of services are very expensive by international standards. How can a high-cost country like Japan export many goods to other countries? The answer is quite simple. In Japan, there are two types of industries. One group deals in tradable goods, the other focuses on services or non-tradable goods. The first group is efficient and productive because of its exposure to international competition, which helps to keep prices at a reasonable level. The second group of companies focus on the domestic market and are regulated or protected from severe competition. Naturally, their productivity is very low and their efficiency ratio is about half that of the first group. The first group can be described as "one hundred yen to the dollar industries" and the second group as "two hundred yen to the dollar industries"

What are some of the problems created by this type of dual industrial structure?

1. The second group tends to stay in Japan and tries to emulate the prosperity of the tradable goods and services industries. They pay similar salaries despite their

inefficiency, which is why their prices tend to be high by international standards.

2. The group of efficient industries cannot endure these high costs in an atmosphere of global competition, so they try to find more cost-effective locations for their plants or offices.
3. The so-called "hollowing-out" phenomenon has a negative impact on the economy in a dual sense: a) the potential for economic recovery or growth is lost; b) new industries are unlikely to emerge in such an environment.

B. Government Sector

The economic burdens that the public sector imposes on business are another cause of Japan's high-cost structure.

1. Corporate Tax

In 1980, the corporate tax levels in the major industrialized countries were about 50%. Today, the rate of corporate tax in Japan remains about 46% while the levels in other countries have fallen to around 40%. Corporate tax levels in other countries are much lower, ranging from 15 to 30%.

2. Social Security Premiums

Japan's rapidly aging society means that younger generations will have to pay higher social security premiums than the present generation of workers. Even the government predicts that premiums will have to double at the very least.

Repeated increases in premiums will place a heavier burden on individuals and businesses, which are required to pay half of their workers' social security costs. This will of course increase companies' operating costs.

What other economic structural problems exist ?

An analysis of the various problems in the recession reveals that some parts of the economic system in Japan are inadequately developed, malfunctioning, or are unsuitable for future development. As a result, the

present economic system prevents new industries or businesses from emerging as vigorously as they have in the past.

No NASDAQ

Japan has money and technology, but unfortunately there are no appropriate places where they can meet together and create new businesses. There is no equivalent of NASDAQ to help raise the capital needed to finance new businesses. The Japanese financial system is heavily dependent on indirect finance or finance through banks, which are too conservative to be an adequate source of capital for venture businesses.

The closed nature of universities and government-run research institutes

These have been accused of conducting research for research, and do not care how the results of their research are utilized. The cooperative relations between universities, public research institutes and businesses need to be enhanced.

Lack of flexibility in employment practices and the education system

Japan's employment practices and its education system are considered to be the main factors behind the country's economic success in the post-war period. But recently these systems have been criticized because they stress equality and uniformity while discouraging the development of creativity and individual talent. **UJI**

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