Japan's *New Opportunity*

An economy cannot be competitive without competitive firms. TIE *Editor David Smick interviews noted analyst Rick Katz about his outstanding new book on how Japan can free itself from its "lost decades."*

Smick: The first thing that struck me about your new book, *The Contest for Japan's Economic Future,* was how well written it was. And how cogent and approachable for the average person. Could you talk a little bit about why you're optimistic about Japan's entrepreneurial future?

Katz: I did not intend to write a book about Japan and its need for a new wave of entrepreneurialism. I was writing an article arguing that what makes an economy dynamic is that markets need to be contestable. You cannot have competitiveness without competition. Japan's markets, which used to be very contestable, now are not. In many sectors, a few companies dominate. In more contestable sectors, companies are much more dynamic and competitive.

So I began researching startups in Japan, and saw a very different Japan than the one I've been looking at for most of my career. In the past, I'd met with the elites, the bureaucrats, the politicians, and the executives at the largest companies. But now I was meeting younger people in their twenties and thirties. Some spoke English, but not all. And it's a whole different vibe. You walk in and there's a buzz. There's a liveliness, there's ambition. The young men who took over companies in the 1940s because the older managers had been purged by the Occupation forces had a very similar kind of spirit and willingness to bet the farm on an innovation. This latest generation has a confidence born of talent, not

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Richard Katz is the editor of Japan Economy Watch *at https://richardkatz.substack.com, and Senior Fellow at the Carnegie Council for Ethics in International Affairs.*

THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
220 I Street, N.E., Suite 200
Washington, D.C. 20002
Phone: 202-861-0791
Fax: 202-861-0790
www.international-economy.com
editor@international-economy.com

bravado. Many of the new entrepreneurs have studied or worked abroad, or worked for a foreign company.

After meeting these people, I visited a big company that's a household name to talk about innovation. And there was this middle-aged "salaryman" just sitting there waiting for the days to pass when he could retire. The tedium was palpable. I was back in that old Japan.

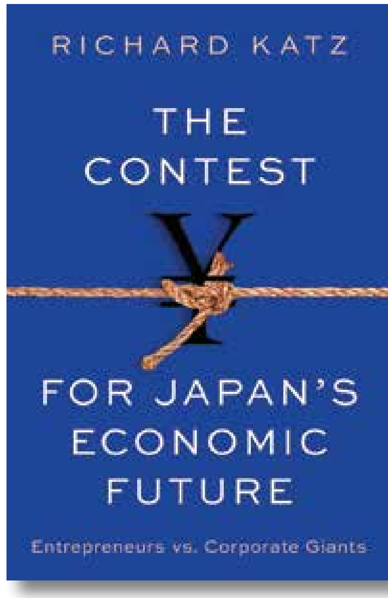
In Japan, younger people are now starting companies and younger people are working for them. Men in their forties will leave a big, prestigious firm after their kids have finished school, when they are finally able to take a risk. I talked to a hiring manager and asked why these men were coming to that firm. The answer is because this is their last chance to do something interesting in their careers. It's a generational change in attitudes. All of this has helped overcome what had been one of the biggest impediments to new firms: being able to hire experienced staff.

Smick: In the mid-1980s, about a fifth of my consulting clients were Japanese, mostly big banks. My father, who fought the Japanese in the South Pacific in World War II,

In the past, I'd met with the elites. But now I was meeting younger people. And it's a whole different vibe.

had been reading about Japan taking over the world. He asked whether I felt comfortable working for Japanese companies. And I replied, "Japan's not taking over the world." "How do you know?" he asked. I described a big Japanese bank. When I visited their offices, a guy was waiting to greet me when the driver dropped me off. We took the elevator up to the chairman's offices. The door opens and maybe thirty young women all wearing bright yellow were bowing at me. Then we went into a big conference room and a dozen young men in blue suits were running around, obsessing over name cards and serving green tea. The whole process was absurd. These people were officially employed but doing nothing useful or productive. I told my father, "Japan might have a good run. But don't worry. They won't take over the world."

Katz: It's a shame because Japan does have an entrepreneurial past. Look at the Meiji Restoration, a period of rapid industrialization beginning in 1868. In forty years, Japan went from a feudal country to an industrial powerhouse that defeated Russia in a war. Then after World War II, when Japan was a truly impoverished country, it was able to roar back. It's a soap opera country. It's up, it's down, it's up again. The people who created Japan's post-war miracle were very ambitious young men. They were entrepreneurs and innovators.



The Contest for Japan's Economic Future: Entrepreneurs vs. Corporate Giants *by* **Richard Katz** *(Oxford University Press, 2023).*

But in the post-war era, once all these dynamic companies like Sharp and Sony got on top, they wanted to stop anybody from challenging them. They were able to do that in Japan's political system.

In every country, these decades-old companies at some point lose their mojo. A company cannot be superb for decade after decade. At some point, it becomes merely good. And in certain industries such as electronics, where things move very quickly, good is not good enough. Sony, for example, is no longer what it was. The problem is how to replace a company like Sony with a more dynamic company.

Smick: You make the point that Japan's problem is not cultural. I was surprised, because it would be very easy to assume that. In dealing with Japanese clients, I noticed how the elite went to the University of Tokyo and then Tokyo Law, and then the best joined the Ministry of Finance or the Ministry of Economy, Trade, and Industry for many years. It was a whole system that prized memorization, not critical thinking or creativity.

Katz: Japanese companies were actually very creative back in the high-growth era. The lithium-ion battery that's the basis for cell phones and electric vehicles was originated by a Japanese company. Sharp invented a type of C-MOS computer chip that later on helped Toshiba invent the laptop PC.

But the promotion system within Japanese companies began to change in the 1970s. They began to develop a system called *genten shugi,* which sort of means "negative assessment." If you did something really good, you were just doing your job. But if you made a mistake, you were penalized in terms of your evaluation—an asymmetrical system. As a result, people were, in effect, trained to avoid making mistakes.

It's a generational change in attitudes.

Smick: Your family reputation was penalized too. It was a disgrace if you had failure.

Katz: Well, the person who doesn't make a mistake doesn't make anything. But for entrepreneurship to succeed in any country, it has to be safe to fail. If you don't have enough failures, you're not going to have enough successes. My book includes surveys of MBA students from the United States, Japan, France, and India. Answers by the Americans and the Japanese were closer to each other than either were to their French or Indian counterparts. And they said things like, "I like to fight against the conventional wisdom. I like to fight against the crowd. I like to make change in the world."

But in a big-company system, these sentiments don't have an outlet. I spoke to a professor whose brother was working with Sharp before it was taken over by Foxconn. In its earlier years, Sharp was a pioneer in the electronics industry and developed a host of new products. But by the 2010s, the creativity, ambition, and elan had been taken out of Sharp's employees and they had become salarymen with boring, tedious jobs. Then Foxconn came in and the new management prized making an effort. If you made a mistake, the attitude was, that's okay. We'll figure out why it's a mistake and move on from there. Foxconn challenged their employees, who became excited again, including my friend's brother. Because of different management, their behavior changed. Japan's salaryman culture has not been deeply ingrained for centuries. It was the product of a screwed-up promotion system.

Smick: In the post-war period, Japan grew at extraordinary rates and enjoyed huge productivity gains. How did they become so risk-averse?

Katz: The promotion and screening system, *genten shugi,* started with the banks. But a big part of Japan's problem is that they're not good bankers. They want to lend to companies based on their collateral rather than projecting their cash flow. So new companies get left out.

It began during the 1970s with the first oil shock, when suddenly economic growth halved. Then, instead of government policy being used to promote future winners, it began to change to preserve today's losers. Japan at the time didn't really have a government-funded social safety net. The social safety net was your current job at your current company. So in the name of the saving jobs, government policy wanted to preserve companies that were moribund.

Yet every country needs a turnover. The inferior leave and make room for a continuous influx of new companies with fresh ideas, nicknamed "gazelles" by an American consultant. These gazelles find a way to create a new product, improve an existing one, or deliver a service more efficiently than existing companies. There are tens of thousands of these small young companies. They provide an inordinate share of the job creation and dynamism and innovation, and they drive out the inferior firms. In the United States in the 1980s and 1990s, 60 percent of the growth in factory productivity came from companies under five years of age.

A few of them do become giants like Google or Tesla. An economy needs a balance between gazelles and the "elephants," which are huge decades-old companies. Depending upon how rapid technological change is within an industry, the elephants may disappear or downsize or just be pedaling along. In the auto industry, a car is a car even with different technology, so GM and Toyota are still around. But in the electronics industry, the companies that made radios and televisions don't exist anymore. The cameras and smartphones are being produced by different sorts of companies. In every country, as companies get older and older, they get set in their ways. They don't recognize that times have changed.

Once companies like Sharp and Sony got on top, they wanted to stop anybody from challenging them.

Japan is not unique in the sense of older companies becoming set in their ways. What makes Japan's situation different is its tremendous difficulty in nurturing new companies that could replace these older firms. That's where Japan falls down. It now has an opportunity to change.

Smick: The Japanese electronics firms were thriving during the analog era, but digitalization was like a foreign language to them. They couldn't operate in the same way and still dominate the electronics market. Why is that?

Katz: This is the most fascinating thing to me—the relationship between technology and business institutions. The change in technology from analog to digital really changed business institutions. In the analog era, the vanguard of innovation was actually not entrepreneurs but big, capital-rich, vertically integrated companies that did everything from soup to nuts. They had lots of cash on hand, and they could do research and development and fabricate new inventions efficiently. They did not collaborate very much with other companies. They didn't need to. Everything was done in-house. That became the way of thinking.

Even in that era in the United States and in Europe, the companies that were dominant in an old technology were not dominant in a new technology. The companies that made radios were not dominant in televisions, for example. But in Japan, these big *keiretsu* [corporate conglomerates] would create a new division to handle the new technology. As long as operational efficiency was the name of the game, they were on top of the world.

But the digital era is a very different system. The digital era is really about networks rather than self-sufficient companies. At Google, for example, Gmail was invented by another company with which Google collaborated. Pfizer's covid vaccine was not invented by Pfizer, but by a German startup that was founded by a married couple who were immigrants from Turkey. In the laser diode field, the inventor filing for a patent will list dozens or even hundreds of companies that collaborated on different aspects of a system. About forty companies from twenty or thirty different countries are involved in making an Apple smart phones.

Japanese companies were very creative back in the high-growth era.

For entrepreneurship to succeed in any country, it has to be safe to fail.

Networks and collaboration are really the name of the game between big companies and startups. But for Japanese companies, collaboration goes against the grain. They always thought that if they use the same stuff anybody else can use, what makes them unique? If Honda's parts are bought from somebody else, then what makes the car a Honda?

For Japanese companies, collaboration is very hard. The problem is not a national culture, but a culture that was developed in the 1970s and 1980s as these big companies were forged. They have not changed the way that they operate, which is very hard for any big company to do. IBM almost failed as it changed.

In Japan, a lifetime employment system promotes people from within who are trained to think like their bosses. Maybe your boss worked on televisions, but you see TVs are no longer what the company should be doing. But if you abandon the TV, then you're betraying the person who promoted you. The whole internal sociology of promotion from within and no fresh blood reinforced that go-it-alone, Not-Invented-Here syndrome.

Smick: How much of the reason for Japan's lack of gazelles is due to an inability to get financing?

Katz: Traditionally, there were three big problems for gazelles. The first is the difficulty recruiting staff because of Japan's lifetime employment system. With generational change, this is becoming less of a problem. Women are leaving big companies to flock to these startups where they can get promoted. In the traditional companies, they can't.

The second problem was gaining access to customers. In the traditional distribution system controlled by the big incumbents, it was very hard for a newcomer to get its product on the shelves. Ecommerce is changing that. With Rakuten, Japan's biggest internet mall, there's fifty-seven thousand small and medium-sized companies that are selling about $40 billion a year worth of stuff. Some of them have grown ten-fold or a hundred-fold even.

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The third and biggest problem is not being solved: access to capital. Japan does not have business angels who provide the seed money that a startup needs to grow from fifty to two hundred employees, or venture capital for firms that hope to get listed on the stock market. The tax incentives for angel finance are not in place in Japan as they are in the United States or France or the United Kingdom. Once the company hits a certain size, it should be getting bank loans. But banks don't finance startups. They finance growth later on. However, Japanese banks, which are often part of the same big conglomerates as the big companies, want to lend to the same people they've had relationships with for decades. A ten-year-old company is still considered a newcomer. The banks will actually charge a ten-year-old company with a good credit rating a higher interest rate—if they lend at all—than they will charge a fifty-year-old company with a poorer credit rating with which they've had a relationship. It's even harder for newcomers with female founders.

Who gets to start a new company in Japan? People who are already affluent, or younger people from an affluent family.

Why do banks do this? For so long, Japanese banks were regulated, and interest rates were set. They didn't really have to do credit evaluations. When the banks began to become deregulated, they based lending not on the cash flow prospects of a company, but rather on collateral. In addition, the borrower had to provide a personal guarantee. If the company failed, the individual borrower was responsible, and could lose their house, their insurance, their savings, everything.

So who gets to start a new company in Japan? People who are already affluent, or younger people from an affluent family. Those with talent and ambition but no money are locked out. So the share of the male labor force who own businesses with non-family employees is just 2.5 percent, compared to 6 percent in the typical OECD country.

The consequence is that too many founders start off too small. Without enough capital equipment and talented people, they grow more slowly and they're more likely to fail. Many of these companies need to reach a certain critical mass to really survive. So with too little startup money, the life expectancy of these companies is worse, and their ability to grow and thrive is limited.

Aside from politics and government policies, finance is the single biggest remaining obstacle to an entrepreneurial takeoff in Japan. And that problem is not being solved. We don't know which side is going to win.

Smick: How would you reply if Japan's Liberal Democratic Party brought you in and said, "We need outside advice. You have written a very interesting book saying that Japan need not change much to set a significant recovery in place." I suspect that if they were asking for advice, you would point to France and say Japan could make the transition to a culture of entrepreneurship just as easily as the French. I've always thought the Japanese and the French mindset and their system of governments were very similar. What would you say?

Katz: I'd give them my phone number! So many experts in Japan already know exactly what's wrong and know the solution. A group within the Council for Science and Technology Policy, which is part of the Cabinet Office, prepared a superb report for Prime Minister Fumio Kishida to promote entrepreneurship, looking at the obstacles and what needed to be done. But despite Kishida's vow to create 100,000 new startups by 2027, basically, the report was ignored.

France offers an example of an effective policy change to increase startup financing. French leaders realized they had these excellent large companies. But they really didn't have a lot of entrepreneurs, and the key reason there was finance. So policymakers set up tax credits where a middle-class couple could invest up to about $24,000 in an angel fund—not individual companies, but in a fund, like a stock market mutual fund. It's less risky. The people who invested got a huge tax break. In a typical year, 100,000 people invested an average of $10,000 each. In a couple decades, France developed something like 38,000 startups whose value was almost $300 billion. The culture didn't change. France was still France.

In Japan, only 15 percent of CEOs have worked overseas.

A big part of Japan's problem is that they're not good bankers.

Japan tried to copy what they thought was the American system for providing startup capital, but they copied it badly. Instead of a fund, you had to invest in an individual firm. Well, most of these firms fail. Angel funds can triple your money in a few years. But if you invest in individual companies, you're likely to lose your shirt. Most of the companies a fund invests in fail, but the successes make so much that the funds earn huge profits. So a fund is far less risky. Well, Japan didn't offer the fund option. If I were a conspiracy-minded person, I would say Japan designed the policy to fail. I'm not, so I don't think it was deliberate. A lot of money could have been available to potential startups, and a lot of talented people who are graduates of prestigious universities would have been able to start companies and employ people, and yet policymakers chose not to do it.

Smick: Japan's government seems to dump a lot of money into the economy in hopes of achieving some kind of productivity bounce. Is that a lesson for the United States? The U.S. Congress has recently passed bills providing investment in new technology and research. Will the United States see the same kind of disappointing response as the Japanese government?

Katz: One of the companies that got U.S. government money was Tesla. Private markets should be supplying these funds. But some things are so risky and have such a long time frame that the government needs to play a role. For example, we have commercially viable solar power today because Japan developed solar power through government investment beginning in the 1970s. Tokyo also invested in electric vehicles and the first commercial EV was put out by Nissan.

Governments should be able to invest in these very risky things with long time horizons, and recognize the majority are going to fail but the few that succeed can really change things. Private money is now moving into green energy all around the world, and so the government can help catalyze the way the private money eventually moves.

Also, when Japan's government thinks about business reform, it thinks, well, if we do some corporate governance reforms for the few thousand giant corporations, this is going to revive Japan. This is necessary, but not sufficient. The top five thousand companies in Japan employ only 10 percent of the labor force. To revive the economy, policymakers need to deal with the other 90 percent of the work force.

Smick: How is a younger, more outwardly focused generation of Japanese changing the country's business culture?

Katz: A lot of Japanese entrepreneurs have overseas experience. In Silicon Valley, there's about two thousand high-tech companies. In the entire United States, in any given year, there's 50,000 high-growth small and medium sized companies—U.S. gazelles—that grow 20 percent a year for several years. Silicon Valley contains just a very small but necessary sliver of these companies.

One Japanese entrepreneur invented a company like Uber before Uber even existed. Yasukane Matsumoto was a graduate of Keio University, one of the most prestigious private universities in Japan. Matsumoto saw that because parcel delivery trucks were usually only 40 percent full as opposed to 60 percent full in Europe, the 30,000 small delivery companies were making very little money per package. He created a system of auctions where suddenly companies could go a little bit out of their way and pick up yet another package, and carry a lot more parcels per trip. Not only did the driver make about 30 percent more money per year, but the customer could pay less and there were fewer carbon emissions per parcel. Raksul is now listed on the stock market with revenue of almost $300 million, and Matsumoto hopes to have a billion dollars in sales in the next several years.

Smick: It's very exciting to see these young Japanese entrepreneurs using the latest technology to revolutionize existing businesses. I remember talking to former European Central Bank President Jean-Claude Trichet. He said France has a lot of entrepreneurs and innovative talent, but what's frustrating is that as soon as they have any success, they head to Silicon Valley where financing is easier and they can hang out with their peers and exchange ideas. You describe young Japanese success stories. Do you sense any creation of a broad culture of young innovators who want to stay in Japan?

Katz: Japan has a growing number of young entrepreneurs. The problem is that there are not yet enough of them to really turn around the country. Moreover, obstacles are so big in Japan that many would-be entrepreneurs with more brains than money move to other countries, like Singapore, where it's easier to create a high-growth company. The question is not whether some people can get rich and create really interesting companies. It is whether Japan can recover. These companies need to reach a certain critical mass and they cannot do it unless these positive trends are amplified by the government.

What are the positive trends? I mentioned a whole generational change of attitude toward companies and toward work. Here's what the government could do. One problem is that, because of the lifetime employment system, 40 percent of the workforce are called non-regulars who are paid much less than half of what regular employees get. If regular employees leave a good company to work for a startup and it fails—and most startups do fail—the employee could never get their old job back again. So leaving to work for a startup is very risky. The law in Japan says that non-regular and regular employees should get the same wage for the same work. If that were really the case and you returned to a non-regular job after working for a failed startup, you wouldn't sacrifice as much money. But the government does not enforce the law.

The second big mega trend is technological change. I mentioned how technology really alters power structures. One of my best examples of this is the simultaneous birth of Elvis Presley and the transistor radio. Sony built the transistor radio when no one else had a commercial use for transistors. But the killer app for the transistor radio was Elvis Presley. His music made kids want to buy radios. The transistor radio didn't need to be plugged into an outlet, so parents could no longer control what their kids listened to.

Today, the development of e-commerce is again breaking down the ability of incumbents to control the market and who has access to technology.

The third mega trend is demographics. This is a double-edged sword. On the one hand, because of Japan's aging population, there are fewer people in the right age range for starting companies—generally age twenty-seven to forty-three. Company founders need to be old enough to have some experience managing people before they start their own company, and after age forty-three they don't have the energy or the ambition. Economically, fewer workers for every older person makes it harder to do things, but on the other hand it creates more pressure for an economic recovery to be able to sustain this sort of aging.

A final mega trend is globalization. I mentioned the inordinate amount of international exposure for some of these founders. Here's an example. Mitsuru Izumo founded a company called Euglena, based on a type of algae. Izumo had been a student at the University of Tokyo. On a visit to Bangladesh, he saw that people were suffering malnutrition even though there were tons of rice and their stomachs were full. They were malnourished because they didn't have the access to micronutrients. As an agronomist, he wondered if there was a way to make a cheap but extremely nutritious food using an algae called euglena. He then spent a year at Stanford where everybody said, "Great idea. You should create your own company to do this." It never would have occurred to Izumo to create his own company if he hadn't been to Stanford. Getting financing was tough but he finally found a partner, and they've created these nutritious cookies based on euglena for Bangladesh.

The importance of overseas experience is not knowing how to operate globally, but rather learning that there are many different ways to skin a cat.

Globalization gives people ideas about how to do things. Eighty-five percent of C-suite executives in the United States and Europe have had some overseas experience. The importance of this is not knowing how to operate globally, but rather learning that there are many different ways to skin a cat. Minds become more fluid and more open to trying new things. But in Japan, only 15 percent of CEOs have worked overseas. That handicaps the big companies because they are less fluid in their thinking.

The globalization experience is a key source of ideas for startup founders.

Smick: Entrepreneurial, risk-taking capitalism can be transformative for any economy.

Katz: Unless Japan has an entrepreneurial revival, its economy is not going to recover. And if the economy does not recover as Japan faces the crunch of supporting an aging population, life is going to become tougher. The government has already cut social security by 20 percent per senior in the last twenty-five years while raising taxes on consumers. Japan's not going to fall into the ocean, but its situation will continue to corrode. The tragedy is that it wouldn't take that much to turn Japan's economy around.

We discussed the French tax system for angels. Most gazelles are not high-tech companies. They operate in very mundane fields, but they use technology to do something better. Unless Japan develops the entrepreneurship culture, its economy will not recover. That creates the pressure to do something. Prime Minister Kishida promised he was going to do something, but he did not keep his promises.

Smick: Can you talk about how the productivity issue fits into Japan's future success? Economies measure their future success on their ability to achieve higher rates of productivity. How does Japan increase its productivity? They've thrown a lot of money at it, but it doesn't seem to have worked well.

Katz: There are two ingredients to productivity. The first is to give each worker more tools. The second is to give them smarter tools. People are more familiar with the concept of labor productivity, which is how much output each worker produces in an hour. But there's also total factor productivity, which measures the combined productivity of labor and capital. For example, somebody using a 2024 personal computer can do an awful lot more than someone who's using a twenty-year-old PC. A $2,000 computer today can do things that a $200,000 computer could not have done twenty years ago thanks to the internet, the cloud, and other advances.

Tesla is not winning because it has more machinery than other companies. It's winning because it has a better idea, and that's part of total factor productivity—adopting a winning business strategy. The key is not how much you invest, but how smartly you invest and your technological improvement. So companies that work with open innovation and collaboration are far more productive than those who try to go it alone like they did in the 1960s.

The big companies are also very poor at mastering digital technology. You can use digital technology simply to automate tasks you're already doing, which is okay, but not really taking advantage of digital's potential. Or you can use it to do things you never could have done in the first place, including following customer buying patterns and developing new products. In a ranking of sixty-four countries in terms of how much benefit in sales and profits did they get from each dollar invested, Japan came in, believe it or not, sixty-fourth.

The digital divide between the big companies and the small companies is worse in Japan than elsewhere. Europe spends a lot of money consulting with small and medium-sized companies to help them understand what benefits digital technology can bring them. Japan spends a pitiful amount, it doesn't have enough people trained in digital technology, and its schools aren't teaching it. Companies have become very stingy with training.

Japan needs new challengers to give the stodgy old big companies a kick in the pants. It also needs more foreign direct investment. In every country that has a lot of inward direct investment, growth takes off because people bring fresh ideas. American car companies improved when the Japanese transplants came, produced great results using American workers, and thereby showed American automakers what could be done. So the latter improved.

There are sound, healthy, profitable small and medium-sized companies in Japan that are going to go out of business because their owners are retiring and their children don't want to take over. Part of that is because a successor has to take on this personal guarantee for the company's bank loans that I mentioned, and that's really risky. So why not let foreign investors come in and buy these companies?

Smick: Do you want to comment on the Krugman contradiction?

Katz: Sure. For years, *New York Times* economics columnist Paul Krugman said basically that Japan was doomed unless it got over deflation. Falling prices were the root of all of Japan's problems. Then five or six years ago, he suddenly changed his mind. Japan's doing great, he said. Japan's terrific. If you measure it right, Japan's got productivity growth. But it still had deflation. For years he's said Japan couldn't do anything unless it conquered deflation. Then he says it's doing really well, despite not having conquered deflation. But he never explained why he changed his mind.

China is in serious trouble.

I think Krugman was wrong both times. Deflation was a symptom of Japan's problems, not the cause. And Japan's not doing great productivity-wise because Krugman uses a very screwy measurement: output per working-age person. Under that method, if the unemployment rate goes up, suddenly productivity falls and vice versa. Or you're not counting all the people over sixty-five who are working. By the way, Japan now has inflation and its GDP today is no higher than it was five years ago in 2018.

Smick: Japanese exports to the United States and Europe have been flat. Is it part of a much bigger issue for

what was formerly a high-growth region? China's economic growth has been slowing, too.

Katz: A lot of Japanese exports to the United States no longer arrive directly bearing the label "Made in Japan." A Japanese computer chip might be inside an electronic device that was assembled in China, and the device also contains components from Malaysia and Thailand. Our statistics will show it coming from China.

The IMF is now producing statistics where we could actually break that down and see how much of China's exports to the United States were actually value-added from another country.

I think China is in serious trouble, and that will certainly have an impact on the rest of Asia. But the rest of Asia is doing okay. A lot of what Japan exports to China goes into products that are then exported to the United States or Europe. If the United States or Europeans place restrictions on imports from China, that's going to affect Japanese exports to China. We live in a world of intra-company trade and networking where products cross borders dozens of times before they're finally finished. About twenty countries are involved in producing an iPhone.

Smick: If you were a Martian and landed on Earth four years ago, and you were watching China's President Xi Jinping, you'd think he was the least competent leader in history. Everything he does seems to be foolish, whether it's centralizing at the worst possible time or completely mismanaging China's real estate boom. Xi sided with Russia on Ukraine just when he didn't need to be that aggressive.

Katz: China's angering people and governments throughout East Asia. The Xi regime is arrogant and does not play well with others. The arrogance of ignorance knows no national boundaries. Xi's blinded himself to the economic consequences of what he's doing. He only talks to national security people who follow his line, not the economists. Xi's always sacrificed the economy to his political ambitions to strengthen the power of the Communist Party at home and increase China's power abroad. He reversed the very successful policies initiated by Deng Xiaoping.

Instead of government policy being used to promote future winners, it began to change to preserve today's losers.

Smick: Is Japan trapped by its potential failure to be able to raise interest rates fast enough and high enough to avoid capital outflows? The sovereign bonds of many industrialized countries beat the rate on Japanese government bonds.

Katz: We have to look at the short-term reasons for the weak yen and also the longer-term structural reasons. There's a 95 percent correlation between the gap between interest rates on the ten-year U.S. government bond and the Japanese ten-year government bond. If the gap is bigger, money leaves Japan and comes to the United States, and investors have to sell the yen to do it.

But the longer-term picture is that the weak yen reflects a weak Japanese economy. For any given size of the gap in interest rates between the United States and Japan today, the yen is about 20 points weaker than it would have been fifteen to twenty years ago. Even if Japan was able to raise interest rates enough to make the gap very narrow and the United States dropped its interest rates, the yen's not going to go back to ¥100–¥110.

Why? Japan's economy is fundamentally weaker now in a couple of ways. First, its companies are performing poorly. The Japanese electronics industry once dominated the world and ran huge trade surpluses. Now it runs a chronic trade deficit. Between 2008 and 2018, every single one of the top ten Japanese electronic hardware companies saw a drop in sales, whether they produced in Japan or produced overseas, at a time when the world demand for electronics was exploding.

In autos, China has now beat out Japan as the top exporter, largely because the Japanese are resistant to electric vehicles. But 80 percent of Japanese auto sales outside Japan are not through exports from Japan, but rather through overseas operations. The cheaper yen doesn't really boost the exports that much because they're producing overseas. Japanese companies are no longer producing premium products for which they can charge a premium price. To sell things, they've got to charge lower prices and that requires a weaker yen.

So while the financial market side is important, these economic fundamentals are more important for the long-term picture. That cannot be changed without increasing competitiveness, which requires contestable markets, part of which is the entrepreneurial revolution. If there are a greater number of successful entrepreneurs, then the big companies will be forced to change because of the challenge. ◆