

Japan *on* *the* Ropes

*Has the global economic
powerhouse lost its mojo?*

BY YOSHIHIRO SAKAI

Japan's Prime Minister Shigeru Ishiba announced his economic plan on June 23, saying "You will be better off tomorrow than today." His main idea is to increase Japanese nominal GDP to more than ¥1 quadrillion by 2040. However, to accomplish this, Japan needs an economic growth rate of more than 2.8 percent annually, almost triple that of 0.87 percent over the last fifteen years. Real GDP growth could turn negative if the average of the recent six months' consumer price index increases of 3.16 percent continues.

However, the Japanese media did not accept Ishiba's announcement with a ringing endorsement. They noted calmly that the International Monetary Fund forecasts that the Japanese economy, one-fifth the size of China's, will drop to the fifth-largest in the world from the second-largest in 2009, overtaken by China, Germany, and India. The Japanese media knows many Japanese care more about the micro level of their lives than the macro economy.

The Japanese people are no longer sure how they can lead a better life in the future. Generations born after 1985, the year the unprecedented appreciation of the yen began that was the root of the current Japan's wobbly economy, cannot understand the middle-aged and older generations' nostalgia to revive Japan to be once again the most successful economy in the world as it was from the 1970s through the early 1990s. The current battle in Japanese politics mirrors this: ruling parties supported by middle-aged and older generations, versus the opposition party supported by the younger generations.



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A PROSPEROUS JAPAN JUST DECADES AGO

Japan was a frontrunner in creating the sort of global supply chain that was described in Thomas Friedman's 2005 book *The World Is Flat*. Many Japanese companies have fought to operate outside Japan since the late 1980s in order to avoid exchange loss due to the yen's appreciation from ¥240 per dollar to ¥80, and promote local production for local consumption. Their increasing operations globally multiplied the underwriting volume of Japanese banks worldwide: at the same time, they borrowed loans from Japanese banks outside Japan in foreign currencies. Therefore, both lenders and borrowers grew together globally.

These companies were in the circle of *keiretsu* (conglomerates rooted in the *zaibatsu* that dominated Japan's economy before the Second World War), where they became longtime allies and kept cross-shareholdings in order to protect *keiretsu* from being taken over by foreign competitors. This way, they could afford enormous investments in research, development, and equipment in and outside Japan. Many Japanese workers in the system, so-called Japan Inc., enjoyed lifetime employment with medical insurance and a pension plan through these companies.

Many of these companies are still vital and operate in local economies worldwide. For example, Friedman in his book discussed the example of Suzuki, a Japanese automobile company that started a collaboration with an Indian company in 1982. Suzuki established a wholly owned subsidiary in 2014, which produced 2.1 million cars in 2024, 63 percent of Suzuki's total production and twice the production in Japan. Also, the effort made a huge positive impact on the regional economy, raising the quality of life of India's people, including the education system in Gujarat, the region from which India's Prime Minister Modi comes.

JAPAN INC. IN THE 21ST CENTURY

However, this was only the first chapter of Japan Inc., which means *The World Is Flat* was followed in 2008 by *The World Is Curved* by *TIE* founder and editor David Smick. There have been a few barriers to Japanese companies moving forward since the final phase of the bubble era at the end of the twentieth century.

In 1989, with a policy mix of rapid interest rate hikes by the Bank of Japan and stringent lending restrictions to real estate-related industries by the Ministry of Finance, the

so-called "bubble *taiji*" (extermination) started. The capital adequacy regulation introduced by the Basel Committee on Banking Supervision in 1989 exaggerated it because banks had to have 100 percent equity capital for all loans to private companies and 50 percent for all residential loans.

The Nikkei 225 Stock Index dropped from nearly 40,000 points in December 1989 to less than 7,000 in October 2008. Property prices dropped to less than half of their peak. This caused the collateral value of loans to shrink, which increased the number of non-performing loans. Japanese banks faced a risk of capital shortage to satisfy the capital adequacy ratio.

The year 2001 saw a peak in fear among the Japanese people due to the increasing bankruptcy of banks. Goldman Sachs wrote in a 2001 report that the volume of bad loans was ¥237 trillion, 37.8 percent of total loans in Japan, and the IMF reported the real amount of bad loans was more than three times the amount officially

The Abe Blues

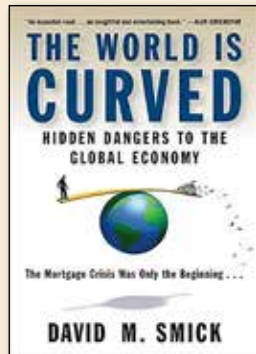
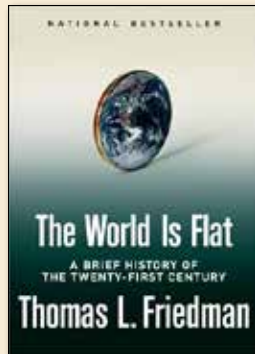
The most potent force of Prime Minister Shinzo Abe's Abenomics was the massive purchase of Japanese government bonds by the Bank of Japan. It bought 90 percent of the new issuance in the peak year and holds ¥567 trillion, almost half the total outstanding. The purpose was to erase the deflationary mindset of the Japanese people and lift Japan out of its decade-long deflationary situation. The current governor of the Bank of Japan, Kazuo Ueda, is struggling to reduce the holding amount by degrees, but he has not been able to do so smoothly due to the noise made by Japanese politicians who worry it could lead to rising interest rates.

Because of this, the Bank of Japan has become an outspoken commentator on the need to maintain the losing policy until the fundamental inflation rate is over 2 percent. It could not clarify, however, what the definition of the fundamental inflation rate is, as the consumer price index has already remained over 2 percent for three years. It cannot control the volume of JGB holdings purely based on inflation management, because even tiny movements and minor comments stimulate the Japanese bond market, making it nervous.

—Y. Sakai



Shinzo Abe served as Japan's prime minister from 2012 to 2020.



The World Is Flat: A Brief History of the Twenty-First Century by Thomas Friedman, and
The World Is Curved: Hidden Dangers to the Global Economy by David M. Smick.

Flat or Curved?

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Abenomics, beginning in 2012, succeeded in raising Japanese real GDP growth from -0.28 percent on average over the preceding five years to +0.93 percent on average over his term until 2019. However, during the same period, the real GDP of the United States increased by an annual average of 2.49 percent, the United Kingdom by 2.12 percent, and Germany by 1.62 percent, which led to a widening gap in real GDP growth.

The main reason for the divergence in GDP growth was that Japan's population declined by 4.08 million by 2024 after peaking in 2008, and the total labor force decreased by 2.16 million after peaking in 2010. There was another reason the world is curved: Half of Japanese women still want to keep their traditional lifestyle.

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declared by the government (¥43.4 trillion). Also, the Bank of Japan insisted that Japanese banks had to calculate reserves using the discounted cash flow method (calculating the market value of loans based on the amount collectible from each lender's expected future earnings), as in the United States.

In contrast, the head of the banking bureau at the Ministry of Finance at the time, Yoshimasa Nishimura, believed that many banks would have plunged into insolvency if they had used the discounted cash flow method. He later concluded that the real amount of bad loans was ¥109.6 trillion, including those from 2001 to 2007.

Because of this shocking situation, the Japanese people lost the ability to make an appropriate decision; instead, they jumped on Prime Minister Junichiro

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Koizumi's sensational announcement in 2001 that Japan needed to undertake painful structural reforms. Koizumi hastened to begin, and Japan protected its financial systems by using the taxpayers' money. The privatization of Japan Post was supposed to create a transparent and accountable institution.

However, it is unfortunate that the reforms' negative aspects are more significant up until now. They were too quick and too hasty, which caused the shedding of critical Japanese armor to boost Japan Inc., but then stopped in the middle. Koizumi's reform could not create a new structure for the Japanese economy to flourish again.

ABENOMICS FAILED TO ACCOUNT FOR JAPANESE WOMEN

Abenomics, Prime Minister Shinzo Abe's economic plan which began in 2013, succeeded in raising Japanese real GDP growth from -0.28 percent on average over the preceding five years to +0.93 percent on average over his term until 2019. Abe succeeded Koizumi as prime minister after serving as his chief Cabinet secretary. However, during the same period, the real GDP of the United States increased by an annual average of 2.49 percent, the United Kingdom by 2.12 percent, and

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The main reason for the divergence in GDP growth was that Japan's population declined by 4.08 million by 2024 after peaking in 2008, and the total labor force decreased by 2.16 million after peaking in 2010. By contrast, the female labor force has increased by 4.37 million since 1985, when the Equal Employment Opportunity Law was passed.

There was another reason the world is curved: Half of Japanese women still want to keep their traditional lifestyle.

Many Japanese women can work in competition with men now. However, the number of female part-time workers is 12.48 million, 53 percent of all female workers in 2024, according to the Ministry of Health, Labor, and Welfare. These women want to be under the umbrella of their husbands' pension fund, and therefore they work less so as to keep their annual compensation under ¥1.3

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million, the maximum limit to be under the umbrella. In the meantime, there are 5.08 million housewives who are also under the pension umbrella.

Therefore, even when the female labor force increases, the effect has remained small compared to changes in the male labor force.

KURODA'S LEGACY

The most potent force of Abenomics was the massive purchase of Japanese government bonds by the Bank of Japan. It bought 90 percent of the new issuance in the

The Collapse of Japanese Culture

Instead of good Japanese customs, American-style individualism and the principle of self-responsibility have taken root in the Japanese mind. The younger generations especially have learned these traits during their decades-long education in school. Unfortunately, American customs are suitable for Americans but not for the Japanese. What both Koizumi and Abe did was to destroy not only the economic and business protocol of Japan Inc., but also the good customs and culture of Japanese people.

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Because of this, the Bank of Japan has become an outspoken commentator on the need to maintain the losing policy until the fundamental inflation rate is over 2 percent. It could not clarify, however, what the definition of the fundamental inflation rate is, as the consumer price index has already remained over 2 percent for three years. It cannot control the volume of JGB holdings purely based on inflation management, because even tiny movements and minor comments stimulate the Japanese bond market, making it nervous.

Also, a legacy of former Bank of Japan Governor Haruhiko Kuroda is that the Bank of Japan had bought roughly ¥70 trillion in Japanese stocks through the exchange-traded fund until 2022 and kept them, which is 7 percent of the total market cap of the Prime Market of the Tokyo Stock Exchange. The Bank of Japan definitely has a positive impact on Japan's stock market through stealth. It has, however, transformed the Bank of Japan into the guardian of stock prices, which has caused it to not sell Japanese stocks for fear of pushing the stock market down. The Bank of Japan is not a pure inflation fighter, but is stuck with Kuroda's legacy for now.

WHAT SHOULD ISHIBA DO?

Prime Minister Shigeru Ishiba must restore the chaotic Japanese economy that came about after Koizumi's

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half-finished reform and Abenomics, along with the Bank of Japan, which has been reduced to functioning as a price watchdog, and the Ministry of Finance, which has become unable to engage in aggressive fiscal policy due to the excessive issuance of Japanese government bonds.

When Harvard Professor Ezra Vogel wrote his 1979 book, *Japan as Number One*, Japan was the most successful country in the world. Vogel's analysis was that the sincere attitude of the Japanese to study other countries, the Japanese custom of group-directed quest for knowledge, and Japanese traditions of meritocratic guidance by the government and private initiative for higher interests and fair shares have been continued due to the diligence of the Japanese people. He added that Japan has also kept fair social welfare and reasonable crime control in his book.

It was, however, dependent on the culture and lifestyle of Japan many years ago. Instead of good Japanese customs, American-style individualism and the principle

of self-responsibility have taken root in the Japanese mind. The younger generations especially have learned these traits during their decades-long education in school. Unfortunately, American customs are suitable for Americans but not for the Japanese. What both Koizumi and Abe did was to destroy not only the economic and business protocol of Japan Inc., but also the good customs and culture of Japanese people.

Japan failed to ride the wave of digitalization because the once hard-working Japanese, with high hopes for the future, became pessimistic after three decades of deflation and recession. Today, the Japanese government has expanded the country's tourism industry. Although the number of people working in tourism has increased, their income is lower than that in manufacturing, and this too has not given the Japanese people high hopes for the future.

It is clear what Japan needs to do, but it will take a long time to make the necessary changes. And who can lead these changes? ◆