



JAPAN'S CURRENT POLITICAL ECONOMY

CENTER ON JAPANESE ECONOMY AND BUSINESS

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日本 經濟 經營 研究所

*This symposium, cosponsored by the Center on Japanese Economy and Business and the Weatherhead East Asian Institute of Columbia University, combined the expertise of economists and political scientists to present a comprehensive overview, not only of the economic problems and range of policy prescriptions confronting Japan, but also to offer insight into the social and political realities that underlie them. Speakers for this symposium were **Lee Branstetter** of Columbia Business School; **John Makin** of Caxton Associates LLC and of American Enterprise Institute for Public Policy Research; **Hugh Patrick** of Columbia Business School; **Len Schoppa** of the University of Virginia; and **Gerald Curtis** of Columbia University.*

After several quarters of vigorous growth, the Japanese economy is experiencing a slowdown, leading many to doubt earlier, optimistic assertions that Japan was finally in the midst of a "genuine recovery." Was the earlier optimism imprudent? How effective are recent policy reforms? Is the Bank of Japan's commitment to avoid price deflation genuine? How serious is the current budget deficit, and what responses to the deficit are appropriate and politically feasible? How can the Japanese address inadequate domestic demand? What is the nature of unemployment and underemployment in Japan, particularly among the young? How effective has the leadership of Prime Minister Koizumi been? Will the LDP split? This report includes the full presentations and discussions that addressed these questions. All reports of the Center on Japanese Economy and Business can be downloaded at www.gsb.columbia.edu/japan.

INTRODUCTORY REMARKS



LEE BRANSTETTER

Daniel W. Stanton Associate Professor of Business, Finance and Economics Division, Columbia Business School

This is a very interesting time to reflect on Japan's current political economy. Oil prices, at least in nominal terms, are close to a record high. U.S. and Japanese military forces face insurgency in Iraq. Both the U.S. and Japanese economies, the world's two largest, appear to be slowing down after several quarters of very robust growth. We may be entering a "soft patch," to quote Alan Greenspan. This is casting a bit of a pall on the global macroeconomy, at least in the short run. In this context, we're very fortunate to hear about Japan's current economic and political situation from some experts. Our first session's panelists will be John Makin and Hugh Patrick, and in the second session we will hear from Len Schoppa and Gerald Curtis.

SESSION I: THE JAPANESE ECONOMY



JOHN MAKIN

Principal, Caxton Associates LLC; Resident Scholar, American Enterprise Institute for Public Policy Research

I would like to talk about the path of the Japanese economy over the past few years. As most of you know, the economy has struggled with a postbubble syndrome since 1990, when the stock market collapsed, land prices began to fall, and there was a substantial erasure of wealth in Japan. In the 1980s, the Japanese proved that the private sector could invest too much, and in the 1990s they proved that the public sector could invest too much as well, thereby driving the rate of return on investment to zero or below.

Having been rather bearish on the Japanese economy for a long time, about mid-year I joined the converted, who suggested that perhaps this time Japan was emerging from its very long struggle with inflation and subpar growth. I wrote a little piece called "Japan Rising" in July 2004. As I was writing it, we were finishing a quarter that would soon be reported as a very weak one in Japan. Of course, I didn't know it at the time.

I think some fundamental things that have gone on in Japan are important in generating the necessary, if not sufficient, conditions for recovery of its economy. There were problems that had arisen since mid-year, when all we had in hand was two quarters of 6–7 percent growth for Japan. I have been consistently bearish on the Japanese economy; venturing into the bullish camp was a big step for me.

I asked myself why I should be more optimistic about the Japanese economy in the middle of 2004 than I had been for almost a decade. The first reason is a simple but very important one: Japan had demonstrated over the previous year that it wasn't going to kill all of the current recovery. This is important, because in 1997, after a period of substantial fiscal stimulus, the Japanese moved ahead and raised taxes on consumption, and they killed the recovery that was under way at that time.

In August 2000, fearing inflation, the Bank of Japan raised interest rates and killed another recovery.

Since then, the leadership of the Bank of Japan was transferred to Governor Fukui, who has made a big difference in the conduct of monetary policy in Japan. He has helped make a big contribution to the conditions necessary for a sustainable recovery of the Japanese economy.

In a sense, Governor Fukui had absorbed some of the basic messages about how to run a central bank and how a central

Japan had demonstrated over the previous year that it wasn't going to kill all of the current recovery.

—John Makin



From left to right: Gerald Curtis of Columbia University; John Makin of Caxton Associates LLC and of American Enterprise Institute for Public Policy Research; Hugh Patrick of Columbia Business School; Lee Branstetter of Columbia Business School; and Len Schoppa of the University of Virginia

An economy cannot recover if its banking system is not functioning.

—John Makin

bank can help lead an economy into recovery. When the environment is such that prices are falling, rather than rising, the problem of deflation has to be dealt with. Governor Fukui also has two very strong deputy governors supporting this view. The story that Governor Fukui started to put forward very quickly was that the Bank of Japan was determined to quell deflation—the falling prices in Japan that were sapping the strength of any likely recovery. It did this by signaling it would continue to pursue this and set interest rates at zero. How was it going to convince people that prices might start rising? It put out the message that it would add very large amounts of liquidity to the banking system. It would be somewhat passive if the banks weren't lending, but the Bank of Japan wanted to communicate that it was prepared to press very hard to stop the deflation. This contrasted with the previous Bank of

Japan leadership, which seemed continually afraid of the resumption of inflation; at the first sign of any pickup in the economy, it would tighten policy.

A way to turn deflationary expectations into stable price expectations is for the central bank to say that it is committed to price stability—not only avoiding rising prices, but also avoiding falling prices. This was a huge step. (This message was consistent with that of the paper on monetary policy by Kydland and Prescott that just won the Nobel Prize in Economics.)

The Bank of Japan followed up with heavy intervention in the foreign exchange markets, allowing that to sharply increase the monetary base. It announced increases in the target monetary base and began to build the groundwork for it. This was no easy task.

This effort was helped by the then relatively new government of Prime Minister Koizumi, aided by his chief economic

adviser, Heizo Takenaka. We saw both the government and the central bank sign off on the same sheet. The Takenaka reforms, too, were directed at turning a dysfunctional banking system into a potentially functioning one. An economy cannot recover if its banking system is not functioning. (It is still difficult to get credit growth in Japan, because there's very little demand for it. Part of that has to do with the deflationary expectations in the country.) Takenaka signaled that the banking system was going to be reformed. Weak banks would be closed and consolidated into banks that would function as financial intermediaries, once the economy started to recover.

In addition to a new set of policymakers in Japan, we had fortuitous outside help from the powerful stimulus administered by the Federal Reserve Bank and the Bush Administration, in what amounted to a postbubble environment in the United

States. Ironically, when the U.S. stock market crashed in March 2000 and we experienced the 9/11 tragedy in 2001, we created some preconditions where extraordinary monetary and fiscal stimulus were required in the United States. These were undertaken with more success than those in Japan, because the United States wasn't suffering from a deflationary environment. The stimulus created a very rapid growth in demand in the United States that spilled over into Asia, including China and Japan.

Japan is ideally suited to be complemented by rapid growth in China, as Japan is very good at producing energy-saving capital equipment, and the Chinese ought to be in the market for that equipment. One of the other things that helped Japan expand in 2002 and 2003 was large growth in external demand from the United States and China.

The thing to remember, where there is a deflationary environment in an economy with tremendous excess capacity, is not that supply is scarce, but that demand is scarce. All the economic models are built on the notion that supply is scarce; you have to use scarce resources to maximize output, and the constraint is on available supply. However, in Asia, and in Japan in particular, there still exists considerable excess capacity, and it is demand that is scarce. Thus, when external demand on the order of that created by the Chinese growth surge after 2002 occurs, you get a tremendous boost for export-

driven growth. That certainly helped Japan. It is very helpful if there's a lot of excess capacity, because there is no pressure on prices. The capacity is there; supply is highly elastic, so a rise in demand creates a sharp rise in output at stable prices. Stronger demand was just what the Japanese economy needed in 2002–2003.

There was also considerable help from domestic demand growth in 2003. There are many explanations for this. One, I would suggest, was the ability of the Bank of Japan to convince people that deflation was not going to accelerate, that exchanging money for goods made sense. The insidious thing about deflation is that it's dynamically unstable, and in a hyperdeflation, the rate of return on holding money rises exponentially. You're always tempted not to spend now if you think prices will be halved sometime later on. When everybody waits, excess supply of goods becomes more and more pronounced, prices go down, and so on. You have to break that cycle.

Central bankers hadn't seriously thought about breaking a cycle of deflation since the 1930s. When Governor Fukui, the Bank of Japan, and the U.S. Federal Reserve Bank began to think about this issue, they realized that the central bank had to convince people that prices were not going to be lower next year. One way to encourage that was to send the message that the central bank would create as much money/liquidity as was necessary to make that

happen. That is easier said than done, but I think that may have had something to do with the jump in personal spending that mirrored the drop in the savings rate in Japan.

One of the problems that Japan will have to confront when the economy does recover is that interest rates will rise. I am concerned about this, because in a normal economy, the real return on ten-year notes will be about 3 percent. In 2003, the return on ten-year notes in Japan dropped to as low as 50 basis points, consistent with powerful deflationary expectations, but as the economy recovers and prices stabilize and other returns go up, interest rates will rise. For Japan, this is a problem because there's a large stock of outstanding debt, roughly 140 percent of GDP, with a deficit of about 8 percent of GDP. By comparison, the U.S. deficit is probably about 4 percent of GDP at maximum and our debt runs about 40 percent of GDP, substantially less than in Japan. Higher interest rates will create some dislocations as Japan returns to price stability.

After mid-year, we saw that the second quarter growth numbers were much weaker than had been expected. Most troubling, the growth of nominal GDP turned negative for the first time in more than a year. That means that the money value total output actually fell in the second quarter after very strong growth beforehand. One problem was much weaker domestic demand and weaker investment numbers.

In Japan there still exists considerable excess capacity, and it is demand that is scarce.

—John Makin

The health of the Japanese economy is much more in question now than it was in mid-year.

—John Makin

The only real growth was coming from some external stimulus that was still operating. Some other growth was coming simply from inventory accumulation. Clearly, as we moved into the second quarter of the year, the Japanese economy slowed sharply. As we go forward, it's questionable whether we are out of the woods. It's as though the Japanese economy were a patient: we administered some medicine, it seemed that he was up and running, but now he's having a slight relapse. (In fact, third quarter data also showed zero growth.)

The other problem for Japan, which is heavily dependent on external demand, is a possible slowdown in the United States and, by implication, in China. That may be related to the oil shock that has hit in the past six months. The price of oil has risen from an average of between \$25 and \$30 last year to a range now of \$45 to \$55. One problem is that if prices stay at this level, U.S. growth will slow, Japanese growth will slow, Chinese growth will slow, and world growth will slow. The IMF claims that if oil prices stayed at these levels, Japanese growth would probably drop by at least one percentage point, possibly more if we see that happening in the context of a slowdown of global growth. That is a serious problem.

Moreover, domestic demand in Japan seems to have weakened again. The employment situation isn't improving as rapidly as we thought. I think the health of the Japanese economy

is much more in question now than it was in mid-year, when I was a good deal more hopeful. As usual, the oil shock comes at the least opportune time.

That said, I think that the policy apparatus in Japan is still aimed in the right direction. The Bank of Japan knows it is important to continue sending the message that it's committed to maintaining stable prices. My guess is that it would be prepared in the event of another slowdown to increase liquidity even more aggressively. It certainly is committed to not allowing the currency to appreciate rapidly because that's a deflationary incident that it can't afford. It's going to be touch-and-go over the next six months. It would be a lot easier if we weren't dealing with \$50 per barrel for oil.



HUGH PATRICK

Director, Center on Japanese Economy and Business and R. D. Calkins Professor Emeritus of International Business, Columbia Business School

I thought that there might be some places where I could disagree with John Makin enough so that we could have an interesting debate, but, unfortunately, that's not the case. I want to cover three sets

of topics. First, I want to make a few comments about the fundamental transformation that the Japanese economy is in the midst of. Second, I want to turn mainly to the discussion of the current economy in the near future. Finally, I want to talk a little bit about growth in the intermediate and long run.

I think it's important to look at the current economy in the context of what is a more fundamental, longer-run transformation of the Japanese economy that's going to last two or three decades. This transformation has been complicated by the bursting of the stock market and real estate bubbles in the early 1990s. I want to emphasize three dimensions of this transformation.

The first is that Japan completed the process of catch-up growth, which was the miracle we talked about, in the 1970s and 1980s. It moved from a low income to a mature, rich economy, with high income, high level per capita GDP, and that meant, as Japan approached the world productivity frontier, that growth inevitably would slow down. Slowing growth is part of the transformation.

The second dimension is the ongoing demographic transition. This is most appropriately thought of in a 100- or 150-year time span for moving from a higher birth, high death rate gradually over time, particularly throughout the twentieth century, to an economy in which the population has long life expectancy and is aging. The fertility rate is below the rate that will maintain the popula-

tion at a flat level, and that's been true for thirty years. Japan has a rapidly aging population. This means that the number of those of workforce age, which is defined usually as between 15 and 65, has been declining absolutely since the mid-1990s. Probably, Japan's population will peak in two years to just under 128 million and then begin a slow decline. The demographic transition is another part of this fundamental transformation of the economy.

I would argue that the third transformation under way is moving from what might be called "relationship capitalism" to more "market-based capitalism." This shows up in the decline and changed nature of the so-called "permanent employment system," the main bank system, and the system of management's opaque control and power.

Let me turn to the current economic situation. Clearly, the economy is doing quite well, even though it has slowed from its peak earlier this year. The slowdown from peak is not that surprising; you can't expect it to continue forever. For me, the key issue is the one that John Makin identified: Is Japan now on a path that leads to self-sustained long-run growth, or is it simply having the best of three cyclical upswings that have been the pattern of the last twelve years?

As much as I would like to believe it, and I think many Japanese—particularly policy-makers—do, I think it's premature to say that Japan's growth process is sufficiently

strong to make itself sustaining and able to get on to the return to substantial growth. I have five reasons why I'm still worried about the economy.

The first is one John mentioned: inadequate domestic demand. The long-run structural problem has been that Japanese domestically have saved a lot more than they have been willing to invest for almost a quarter of a century now. The problem has been what to do with those savings. That is underpinned by this extraordinarily easy fiscal situation, a big budget deficit, and an extraordinarily easy monetary situation in terms of the Bank of Japan's zero interest rate policy.

In the last three or four years, the decline in the household savings rate has accelerated. Now, the household savings rate seems to be rather low, and that is a positive thing, because it means consumption has been maintained at the expense of savings. We don't understand exactly why that has happened. I think a lot of it has to do with the fact that older people who might have saved their money to give to their children are now spending that money to take care of themselves. Older people have benefited from the windfall rise in the value of their house and other assets, and now, since those values are evaporating, they're continuing their lifestyle. It's just that their children are going to inherit less.

The problem now is that companies continue to have rather high net savings rates

over and above their investment and actually have surplus cash flow. In the short run, they need to do that to pay off their loans, but in the longer run they're going to have to think about a system that has incentives to pay out more dividends. They need to get more of that money out of their corporate savings and into households that will spend some of it.

My second problem is the high budget deficits. I agree completely with John that Japan has to have an easy monetary policy until well beyond the point when the economy starts to recover, in order to maintain the expectations that growth will persist. The Bank of Japan says that a slight positive increase in the consumer price index is a signal that it should go ahead and start to raise interest rates. My feeling is that it should delay that, and the target should be a CPI increase of 1 percent, because the CPI has a technological bias. Price stability is really a 1 percent CPI increase.

Third, I really worry about the labor market. Japan now has a 4.8 percent unemployment rate, which by American standards is pretty good, but by Japanese historic standards is pretty bad. Still, I don't think that's the most important indicator of the conditions of the labor market. The fact of the matter is that the participation rate of those of working age is the lowest it has ever been historically. Between 1997 and 2003, employment declined by 2.4 million people; 1.2 million

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lost their jobs, and 1.2 million either never entered the labor force or left it. That is shocking. What's even more important is that almost all increases in employment we see are part-time jobs, not full-time ones. Part-time and temporary workers now constitute a quarter of the labor force. That's far too high; it hits young people disproportionately.

Those who are age 20 to 24, who are the so-called "idle labor" (people neither in school nor with a job) are 17 percent of their age group's labor force; 28 percent of young males and 35 percent of young females have part-time jobs. Surveys indicate that most want full-time jobs. One of the long-run costs of Japan's mediocre economic performance of the last twelve years is that young people are not getting the job skill training that they used to receive in the past. That's going to be costly in the longer run.

John and I agree that inadequate demand is a key problem, but there are also problems on the supply side, as well. Companies are burdened with the excess debts that they took on in the bubble, and they've been slow to restructure; the process has taken far too long. Japan has had what we've called "zombie companies" for about twelve years now, and finally they are being dealt with. *Daiei* may be taken care of, according to today's newspaper. The process has been very slow.

Banks, on the whole, have now overcome the likelihood of a systemic crisis, because

of their high, nonperforming loans, but the reality is that the capital base of almost all banks is still extraordinarily weak. Banks need more capital and better business models.

Incidentally, the supply side problems, that is to say the inefficiencies of resource allocation, are even more pronounced in government financial institutions and local government enterprises. Those are much harder to tackle, because they are political and are not subject to the same degree of market pressures that private firms are.

Finally, John has alluded to the huge budget deficit and the huge government debt to GDP ratio. These are very important issues, both economically and politically. Len Schoppa will talk a bit about the politics of it. The Japanese government's share of GDP is relatively low, in terms of its purchases of goods and services. It's more like the United States, not Europe, but it has to be the biggest financial intermediary in the world. It's a huge collector of savings and a huge lender of those savings, through various government financial institutions. When we talk about the government debt, we have to strip out those financial assets and liabilities. The correct measure of government debt is the net debt (liabilities minus assets). It turns out that about half the government bonds are held by government institutions, including the Bank of Japan. So, they are a wash on a consolidated basis. That is important.

For instance, the government has borrowed the yen equivalent of \$820 billion to buy foreign exchange reserves of \$820 billion. You certainly want to subtract that and count it as an asset, if you're worrying about the debt. Conceptually, you want a net debt figure rather than a gross debt figure, and that gets the government debt/GDP ratio down to around, 60, 70, or 80 percent, instead of 160 percent. The reality, however, is that the net debt itself is increasing very fast, the budget deficit is only beginning to slow down, and it is still very high. So, how should the debt be dealt with? There are three issues. The first is timing—how rapidly (or slowly) should the process of reducing the government deficit occur? I think the Japanese government is trying to do it too fast; it talks about a primary surplus of zero by the year 2012 or thereabout. It should think of a slower, more gradual process, so that the costs are shared over a much longer time period.

The second issue is how much taxes must be raised in the long run to meet the commitments to elderly people, such as pensions and health care. That really depends on the assumptions you make about the long-run future. The nature of the demographic transition needs to be considered. Will the Japanese population decline forever and disappear? That is very unlikely. When will it stabilize, at what rate, under what circumstances? These are key assumptions. How should

the generational costs be spread? Should taxes go up, so that you get a balance within ten years, within a hundred years, or somewhere in between? That is another kind of policy issue that's important.

The third issue is to what extent elderly people should benefit from the growth of the economy as a whole over time. Should their pensions go up as the economy rises? How could that be worked out? Given these basic variables, you can do simulations that come up with all kinds of different solutions. Our colleague David Weinstein has done a very careful analysis, with perhaps optimistic assumptions, which suggest the taxes, as a share of GDP, do not have to go up very much, and that much of the current political debate is based on misguided economic analysis. That paper is very controversial. It's a good paper, but when you're talking about the projections, you have to look at what the assumptions are. Regardless, this continues to be an important issue, probably even more politically than economically.

Japan can grow 3–4 percent a year for the next five years, if it were able to absorb its labor and use it fully and effectively; that's really an aggregate demand problem. In the longer run, as with other rich countries that are at the technology frontier, Japan probably cannot grow more than 2 percent per capita, once this surplus labor has been absorbed. No other country has grown faster than that over ten-year periods, so

it's unlikely that Japan will be able to do so. Thus, 2 percent per capita growth is the most likely long-run potential growth. Many people would say it's only 1.5 percent per capita, or something of that sort. Since the population is declining, that means the GDP growth rate will be about 1.5 percent or less.

There are a couple of positives that, over time, will accelerate the growth rate, as the adjustment occurs. One is that productivity, which is extraordinarily high in manufacturing, is extraordinarily low in many services. As Japan is able to raise productivity in services, it will obtain an additional efficiency kicker, and that will be very helpful.

The other positive is that even though the public sector is not large, it has many pockets of inefficiency: redundancy and high wages. As that adjustment occurs, Japan will achieve a more efficient use of resources. However, that's more politically difficult, because you're running up against the vested interests that are supporting the politicians.

My analysis suggests the economy could grow well for the next three, four, or five years if the policies were right. After that, the economy will grow at 1–1.5 percent a year, if the demographic pattern continues. The only thing that would change that and increase the GDP growth rate would be a major change in immigration policy. Ten or fifteen years from now, Japan will have to decide on this issue.

DISCUSSION

AUDIENCE QUESTION

Could you expand on your comment about Japan thinking about its immigration policy? Also, Japan is lending a lot of money to the United States to support the war in Iraq. What do you think of that?

HUGH PATRICK

The Japanese don't think they're lending money to the United States to support the Iraq war. They're lending money, because they don't want the yen to appreciate. It's very simple. They want to maintain foreign demand in a situation in which domestic demand has been fairly dicey. I agree with John's point that the yen is not likely to appreciate very much. I think the real kicker there is China. If the Chinese exchange rate did appreciate vis-à-vis the dollar, it would make it easier for all the Asian countries to have their currencies appreciate. They may want to have greater stability to the Renminbi than to the dollar. I don't see that coming about any time soon.

As for immigration, of course Japan is thinking about it a lot and discussing it privately. Nothing has been talked about in public because it's such a taboo, difficult subject. One scenario is that Japan will engage in five-year contracts, as it did in the late 1980s and early 1990s. This would have the understanding that the immigrants don't bring their families and that they leave at the end of five years. That could be done extensively for

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—John Makin

the provision of health services to young Filipino or Thai women. You might do the same things for unskilled workers. The question is, how do you prevent them from becoming permanent immigrants? I'm thinking of this from a very Japanese view, because the basic issue here is that Japan is such a homogenous society. Is it prepared to give up that homogeneity for the sake of meeting labor shortages? My guess is no, but I don't know. I'm not Japanese. This is going to be an issue that the Japanese are going to have to decide.

AUDIENCE QUESTION

Won't Japan's budget deficit become a huge burden that will adversely affect the Japanese economy, especially when interest rates go up? Won't Japan become another Argentina financially?

JOHN MAKIN

You've hit on an important point: why is the big budget deficit a problem for Japan? In one sense, it's very tempting for the Japanese government to borrow, because they can borrow short-term at ridiculously low interest rates, like seven or ten basis points. It's almost like printing money; government bonds are interest-bearing liabilities, and money is a non-interest-bearing liability of the government. Deficit financing for the Japanese government is also almost like printing money.

A problem arises if you have a large stock of debt out-

standing that is short-term debt, but you still have to refinance it, because you are not in a position to pay it back. The terms on which you refinance may be that you have to start paying 2–3 percent instead of virtually zero on the new financing. The classic way in which debt finance booms end is that when it comes time to roll over the debt, if the economy has picked up or inflation has returned, instead of borrowing at 5/10ths of 1 percent you borrow at 1 percent. Your borrowing costs go up so rapidly that you have to actually raise taxes to cover it. It's easy now. The problem arises with a large stock of outstanding debt at a time when the economy recovers. The cost of financing gets a lot higher.

Suppose you are tempted today to take out a one-year floating mortgage to buy a house worth three times your income. It sounds great. Suppose next year it's time to refinance the mortgage and the interest rate has gone up to four percentage points. The cost of continuing to maintain the borrowing could absorb all of your disposable income. The same thing can happen to a government.

HUGH PATRICK

John is certainly correct that once interest rates rise, they will increase the government's cost of servicing its debt as it rolls over. However, the Bank of Japan's policy is not to raise interest rates until deflation ends and good growth is being

achieved. That will increase tax revenue and reduce the need for large-scale deficit financing. Unlike households or corporations, the Japanese government can always borrow, in effect printing money if necessary. It will not default on its debt.

LEE BRANSTETTER

In terms of the Argentina comparison, there are two important points. First, all the Japanese bonds are issued in yen in the domestic currency, so there's no exchange rate problem. Second, almost all of them are held by the Japanese. Very little of the Japanese government debt is held abroad, so that means it's an internal problem. This is much different from the case of Argentina or other countries that have huge external debts. Japan is the largest net creditor in the world; it's not just foreign exchange reserves—Japan owns all kinds of other assets.

AUDIENCE QUESTION

How can the Bank of Japan guarantee that deflation will end in the future? Suppose it doesn't. What can the Bank of Japan possibly do?

JOHN MAKIN

It is very difficult. If the Bank of Japan fails, let's say the economy slows down and people become convinced that deflation is going to continue and accelerate. It's dynamically unstable, because they'll spend less money, and the Bank of Japan can only cut interest rates to zero, and the real

interest rate rises as the deflation rate picks up. It is a challenge. Based on the research that has been done at the Bank of Japan and the Federal Reserve, and the policy options at the so-called “zero bound,” my guess is that if deflation started to run away in Japan, the Bank of Japan would undertake huge purchases first, then maybe investment grade corporate bonds in the long-term government bond market. Then, perhaps it would buy stocks and/or real estate.

HUGH PATRICK

If the problem became extreme, you’re asking, what are the ways the Bank of Japan can convince the market that they are committed to reflation? The basic way would be to do something highly unconventional. Certainly, purchasing stocks or land would be unconventional, but it would be the right thing to do to avoid deflation. Studies have been undertaken at both the Bank of Japan and the Fed to cover this contingency. There’s more they can do by broadening out the scope of the assets that the Bank of Japan is willing to purchase, essentially by printing money.

I am not afraid of the government deficits. I’ve been saying this for several years—macropolicy, in fact, consists of both monetary and fiscal policy—Japan should engage in a short-term fiscal stimulus to get out of deflation and to get the economy back. After that is taken care of and the economy is growing again, the govern-

ment could end that fiscal stimulus. I’m one of the few people who think that the government should cut taxes. I wouldn’t increase government pork barrel expenditures on more public works in some politician’s neighborhood. My statement is theoretically correct and politically impossible.

We can understand it conceptually, but I think fiscal expansion is politically so unlikely that we just have to say it’s not in the range of feasible policy. That says something about the ignorance of Japan policymakers about macroeconomic policy. Professor Hamada of Yale spent two years as head of the research institute in the Cabinet Office. On his return to Yale he said, “You know, I can understand microeconomic policy in Japan, because it’s all vested interests, but macroeconomic policy—it’s amazing politicians don’t understand it. Well, that’s okay, because we don’t expect politicians to understand very much, but bureaucrats don’t understand macroeconomic policy, and a lot of academics don’t understand macroeconomic policy.” Hamada was very scathing in his comments.

I would argue it’s more than that. The Ministry of Finance gives primary emphasis to the autonomy of its various bureaus. The Tax Bureau says, “Never cut taxes!” The Budget Bureau says, “Never raise expenditures!” When you have such a strong mind-set in the Ministry of Finance, it makes it very hard to have a sensible macroeconomic policy.

SESSION II: JAPANESE POLITICS



LEN SCHOPPA

Associate Professor, Department of Politics, University of Virginia

I will talk about what I consider to be the fundamental feature of Japanese policy debate and politics today and for the foreseeable future, the characteristic of fiscal stress. It’s something we’ve already been talking about, with the discussion of how so many Japanese are preoccupied by the public debt and the fiscal problems, regardless of what a number of Columbia economists are telling them. It is a real preoccupation. I got a real personal sense of that a couple of years ago, when I was interviewing a senior Ministry of Finance official, and he started lamenting on how the Ministry of Finance had lost control of the budget. It was a time when the Ministry of Finance had been caught up in a number of scandals, and it was spending loads of money on public works projects. The official was convinced that the Ministry of Finance had lost credibility and would never have a chance to bring Japanese public finances back into order.

As can be seen from the presidential debate last night

I’m one of the few people who think that the government should cut taxes.

—Hugh Patrick

Japanese tax revenues currently cover only half of what the government is spending.

—Len Schoppa

on television, what we hear from American politicians is tax cuts, tax cuts, tax cuts on one side, and government spending, government spending, government spending on the other side. This way of American politics is quite naturally a very common feature of politics around the world. What politicians like to campaign on is offering lots of goodies on the spending side and, if possible, cutting taxes at the same time. It's an incredible contrast to the situation in Japan.

Koizumi became incredibly popular in Japanese politics when he first came into office in 2001 under a slogan that said, "structural reform with no sanctuary." He seemed to be saying, "we're going to cut a whole lot of government spending, we're going to get our books back in order, and we're going to have a more neoliberal kind of economic policy." He got 80 percent popularity ratings with this slogan.

We also have talk from the big business community for the last year about the need for tax increases, with the leader of Keidanren coming out about a year-and-a-half ago with a proposal to raise the consumption tax in stages, from its current 5 percent level to 16 percent. An 11 percent tax increase over eleven years is what he was calling for. Just imagine in the American context the business roundtable calling for a 10 percent tax increase on everyone and everything.

We have talked about spending cuts and tax increases dominating the politics of

Japan, and we heard from Hugh already about how there seems to be a sense of urgency in that Japan needs to bring its fiscal position into a primary balance by the year 2012. Koizumi talked about this in his speech a couple of days ago. The Ministry of Finance has been talking about this also. This seems to be where many people are going in terms of budget policy.

What I want to talk about today are the reasons why Japanese politics are so focused on this fiscal stress situation. I will look at the issues that are in the policy debate in this area, and, finally, how that relates to the prospects for Prime Minister Koizumi and the Liberal Democratic Party (LDP).

This focus on fiscal stress means that the policy debate, and politics as a whole, is now concentrated on at least zero-sum conflict, or, you might even say, diminishing-sum conflict. For many, many years Japan had rapidly rising tax receipts, rapidly rising budgets, and the LDP thrived in a day when it could offer goodies to everyone and tax cuts, too. Suddenly, Japanese politics are operating in an environment in which they need to raise taxes and cut spending every year, just to avoid putting the budget deficit into worse shape. The questions are, what should we cut and what should we raise?

I'll talk later about some of the political reasons why fiscal stress has become the dominant theme of politics, but there are underlying economic reasons for this as well, which we've

already started talking about. One is that Japanese tax revenues currently cover only half of what the government is spending. How can we go on indefinitely in this kind of situation? Of course, the economists can tell you that if you just get your economy growing again, and inflation going again, the tax revenues should go up. Disturbingly for the Japanese, however, they've had a couple of quarters now of 3 to 4 percent annualized growth, and their tax revenues haven't gone up yet to the degree that would have been expected. They're getting quite nervous about this.

Second, spending is being pushed up rapidly by aging. This is almost an automatic annual increase in spending that the Japanese government has to absorb on health care and pensions, because the population of older people is growing.

Third is Japan's interest rate burden. What Japan needs to pay in interest every year has gotten about as low as it can. The Japanese have been able to increase the size of the public debt through the 1990s, while actually keeping their annual interest payment burden stable, because interest rates have been so low. They kept rolling over old debt that they may have financed as much as 6 percent or 5 percent at new rates of .5 percent or 1 percent. As long as you could do that, you could increase the budget deficit without having interest payments going up, but they've exhausted that opportunity, and from this point, interest

rates can't go any lower. As they continue to increase the size of their debt, eventually they will see portions of the budget that have to go toward paying the rising interest, and that makes people concerned.

Let's talk next about the political reasons. The Japanese, with a lower house and upper house, have staggered election cycles. They seem to have an election almost every year. There's always something to talk about. Finally, they've exhausted their elections, and they've gotten to a point where they could go three full years with neither a lower nor an upper house election. This has not happened in Japan since 1986–89. In the period since 1989, they've had an election nearly every year or every other year, and this has kept politicians focused on keeping the voters happy, first and foremost. They wouldn't raise taxes and wouldn't cut spending. Finally, they have an opportunity. Many people think the politicians have no excuse now; they're not facing the voters for another three years. Now is the time to really push this agenda of tax increases and spending cuts, while we have this political opportunity.

The political opportunity is also there because of Prime Minister Koizumi's position. Usually, the Japanese prime minister is fighting to hold onto his job. Rarely is he able to last more than two years, and the term limits don't even become an issue for most prime ministers. The last time this became an issue was in the 1980s.

However, Koizumi has reached the point where he's been re-elected. He has two more years in his current term as LDP Party president, and he can't be reelected again as its president. He doesn't need to worry about catering to the LDP and keeping the factions and the backbenchers happy. He, too, is relatively free to promote an agenda of tax increases or spending cuts during his remaining two years.

With the election cycle and the prime minister operating in this way, and the Ministry of Finance trying to take advantage of it, everybody is pushing to do something about the budget deficit now.

These are the issues on the agenda and they all have to do with spending cuts and tax increases. The first issue that Koizumi has started to tackle is cuts in public works spending. Koizumi gained a lot of popularity by delaying public works projects and showing the voters that he's not going to continue the old LDP ways. Still, the Japanese government continues to spend more on public works than any other advanced industrialized country, and especially for a mature economy, it's inappropriate to continue spending at these levels. This brings us to the next two terms, *privatization* and *fiscal decentralization*.

These are buzzwords that Koizumi has been talking about for the last two years, as he tackles the more difficult structural issues that are behind the high spending on public works. If you're going to bring public works spending in Japan down

further, you've got to get the postal savings system under control. The postal savings system sends a huge amount of savings into inefficient public works projects and other kinds of public investment. If you've been following Japanese politics, you know that Koizumi's new big issue is postal privatization. He's been talking about it since the beginning of his term. He had one big push a couple of years ago that didn't go very far, and now he's pushing it again. He's also talking about the "trinity reforms" in public local government finance, which are supposed to bring spending by the local governments under control.

Let me also introduce the issue of pension reform. This was the big issue last year. The Japanese government was obliged by its pension calendar to tackle a pension system that was unbalanced. Every five years, the government has to bring its books into some sort of balance by, if necessary, raising premiums and cutting benefits. This situation became so dire that it had to do both last year. Koizumi and the LDP passed a plan that involved premium increases. Every year for the next ten or twelve years, the pension premiums the Japanese pay are going to be going up starting this month by .35 percent. Next October it will be another .35 percent. So by the year 2017, the Japanese will be spending 5 percent more of every paycheck on their pension premiums.

At the same time that Koizumi asked the public to

Japanese government continues to spend more on public works than any other advanced industrialized country.

—Len Schoppa

Voters are not particularly enthusiastic about postal privatization.

—Len Schoppa

absorb this tax increase, he also asked them to accept a pension benefit cut. The Japanese government convinced the public to accept the plan, which involves a new indexing system for pension benefits. It used to be that pension benefits were linked to inflation and wages, so that they increased every year except during deflation. The architects of the pension system realized that the population shrinkage was going to make this unsustainable. They came up with a new system that indexes pension benefits to the total wages produced by the Japanese economy.

That sounds reassuring, if you live in a country where there are always more workers, so as everybody's average wages go up, it seems the total wage is bound to go up, too. However, in Japan's situation, even if average wages continue to go up a little bit, because the number of workers is decreasing so fast over the foreseeable future, they know this is going to result in a pension benefit cut. As the total wage earnings of the Japanese population go down, Japanese pensions earned in the future will also decline. This was passed by Koizumi last year, and it was the big issue in the upper house election this summer. It didn't make Koizumi very popular.

How, exactly, is this affecting politics, Koizumi's popularity, and the LDP's popularity? Well, what's interesting about Koizumi's tenure is that he was amazingly successful for the first two years of his term in building up his popularity,

even as he talked about spending cuts. In fact, by taking on the public works issues, he was able to do, arguably, the right thing economically and still gain a lot of popularity. He took on his opponents in the LDP who wanted to continue spending money on public works, especially those who are heavily invested in political careers that depend on construction spending. Koizumi gained popularity by taking on these people and refusing to accept their arguments.

The problem was that after a few cuts in public works spending, once he began tackling these structural issues, his LDP backbenchers started standing up and challenging him. There's nothing like zero-sum politics to get the losers fighting like mad, and that's what the Hashimoto faction did when Koizumi tried to push postal privatization about a year-and-a-half ago, and it came to the legislature. They inserted enough compromises in there to ensure that it became relatively meaningless in terms of affecting the flow of savings through the postal savings system into public works projects.

Koizumi tackled a big public corporation called "Japan Highway," which spends huge sums of money on building highway networks and toll roads. He tried to argue for privatizing this company, and some people working for him tried to design this reform so that spending on highways would go down. When this came before the legislature, Koizumi's backbenchers and

his party inserted enough compromises into the legislation so that there has been no reduction in the planned size of the highway network, despite all of Koizumi's rhetoric. He's come up against the limits of what he can do with his own party.

The remaining reforms that Koizumi has are much less popular. As you go forward to the next issue of postal privatization, this is not the kind of issue that wins 80 percent popularity ratings. Japanese newspapers have been asking the voters what issues they care about, and postal privatization is down at the bottom. Very few people think this is important. They value the post office; delivery is reliable. Japanese letters get there the next day. Postal banks are incredibly convenient, and your money is safe. Voters are not particularly enthusiastic about postal privatization. Koizumi has not been able to explain clearly how privatization is going to trim public works spending.

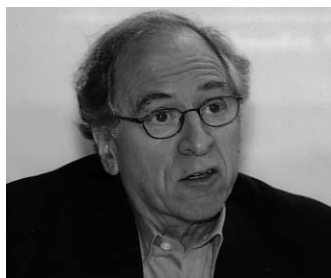
All this talk about spending cuts, postal privatization, and fiscal decentralization might threaten the structural reforms that would make it difficult for the Hashimoto faction to get the pipeline of money flowing again to its districts. This has increased tension between Koizumi and his opponents within the LDP. There is always talk about whether or not there will be another split of the LDP because of this tension. While I certainly agree that there is a lot of tension, for a split to happen, one party needs to see the advantage in pushing the issue

to the point of a split. Right now, it gains political advantage by playing up its arguments. The Hashimoto faction gains popularity with its voters in the countryside by taking on Koizumi. Koizumi gains a lot of popularity in the urban areas by saying he's fighting the Hashimoto faction and will stop the flow of money to the pork barrel. They both gain popularity by fighting. I don't think Koizumi's opponents will benefit from a split. If they split the party right now and make Koizumi the victim of some sort of Hashimoto coup, Koizumi becomes a hero, and they don't have a popular leader who can take him on. They're not going to push it to a split.

Koizumi, on the other hand, could have done this two years ago when he was very, very popular. He could have pushed things to the point of a split and been at the head of a popular anti-old LDP movement. He didn't do it then, and now all he's got is postal privatization. It's really hard for me to see how he could say, "I'm going to split the LDP over the postal privatization issue" and expect large numbers of voters and politicians to follow him.

The one possibility is that Koizumi decides to go down in a blaze of glory. He only has two more years; he cannot get reelected LDP president and continue as prime minister in that role. It's possible that as his term is approaching its end, he might see a moment where he can say, "Okay, you're not going to go with my postal privatization; I'm going to bring

down the LDP with me and quit the party, make no plans to lead an alternative movement, and just leave the Hashimoto faction to fend for itself against the Democrats and whoever else enters the political arena."



GERALD CURTIS

Burgess Professor of Political Science, Columbia University

I will have something to say about this administration and some of its policies, but first I want to step back and give some historical context to the current situation. It's very important to understand that a lot of what is happening in Japan today is the result of the cumulative impact of changes that occurred in a period that the Japanese refer to as the "lost decade," the 1990s. It was not a lost decade, however; it was a watershed era in modern Japanese history. So much changed in the 1990s: values, lifestyle preferences, and institutions, including the government bureaucracy. There were changes in terms of a substantial breakdown of traditional social networks, which has both positive and negative aspects. There has been a kind of growing personal isolation and anomie, for example, reflected in the pitiful spectacle

of people searching for others over the Internet with whom they commit group suicide.

There were changes in the impact of globalization on Japanese companies. Why are strong Japanese companies stronger today than they were a decade ago? No doubt it has to do with booming exports to China and a new sense of confidence in the financial system, in part, because there's now a head of the Bank of Japan who conveys a sense of competence, which his predecessor did not. Also, it is because there has been a decade of efforts to streamline, to rationalize, and to become more efficient. I want to stress that we cannot understand what is going on in Japan today if we dismiss the past fifteen years since the bursting of the bubble as simply a "lost decade." What was lost was the opportunity to grow the GNP faster, but in the process, many other things were gained.

Now, when we look at politics there does not seem to have been much change over the past decade, at least at first glance. In 1993, many observers believed that the LDP had no future. More than a decade later, it is still in power, albeit in a coalition. Not that much has changed on the surface, but there are undercurrents of change. There has been a serious weakening of the structural supports for the political system, the economic system, and, in many ways, the social system in Japan. As these pillars have eroded, a process has been put in place to create new struc-

The 1990s was not a lost decade; it was a watershed era in modern Japanese history.

—Gerald Curtis

The Japanese have made a public social choice for preserving the social order.

—Gerald Curtis

tures, but there is an inevitable lag effect, so we can see what is weakening but not what is going to replace outdated institutions. I have no doubt, however, that this is a major transformative period in Japanese history, the third great transformation in modern history after the Meiji Restoration and the post–World War II U.S. Occupation.

Another example of change that is of long-term significance, though its effects are not yet apparent, involves higher education. The privatization of the national universities may not be all its boosters have claimed for it, and there surely will be problems with its implementation, but it is a very significant reform, one that is going to introduce a degree of competition into the higher education system that has been lacking. Moreover, reforms in the higher education system reflect and are a response to changes in Japan's social structure and its governmental and economic institutions. There has been a rush to create graduate school programs in law, public policy, accounting, and the beginnings of graduate programs to train journalists. These developments are a response to the breakdown in many traditional ways of training people and are a response to the need for new skills and new methods for instilling them in young people today.

Even if we recognize that the 1990s were not “lost” and that there were important changes, the question remains: why did not change occur

faster and why was it not more far reaching? Some economists seem to believe that it is the fault of ignorant or corrupt politicians, since, obviously, if Japanese political leaders had been rational they would have done precisely as the economists prescribed. That is not the reason. Yes, there are a lot of ignorant politicians, I'm not arguing with that. There also are a lot of politically ignorant economists. Why was change slow? It seems to me that the most important reason is that the Japanese public insisted that change be slow. Every society has to strike a balance between considerations of preserving the existing social order and emphasizing economic efficiency. The United States and Japan are at opposite ends of the spectrum in terms of the values they attach to these two important objectives. In the United States, people generally accept the proposition that sustaining economic efficiency sometimes requires painful dislocations, including, most prominently, the firing or layoff of redundant workers. The Japanese have made a public social choice for preserving the social order, even if it means that efficiency gains are denied or are accomplished only over an extended period of time. Lifetime employment is not disappearing, even though it is being modified. This is not because Japanese fail to understand what needs to be done, but because preserving the social order in a large company characterized by lifetime employment is considered to

be essential for the continued effective functioning of this institution. It is rational in Japanese terms, and it means that things take a long time to change.

The same observation can be made about fiscal policy. Whether it's Koizumi as prime minister, or Mr. Okada, the head of the Democratic Party, Japan will have to raise social security premiums and reduce social security payouts. Public works expenditures will have to be cut. One way or another, the government will move in the direction of reducing the yawning gap in government revenues and government expenditures. Yet, this problem is going to be dealt with in a relatively slow and gradual manner, rather than in the shock treatment way that some propose. Although analysts may predict an imminent fiscal crisis, this issue is not going to drive the voting public.

This reality of Japanese preferences helps explain Koizumi's popularity. Koizumi promises change, which the public knows is needed, and he actually does much less than what he proposes, which the public finds reassuring. Basically, Koizumi has been saying that there will be some pain but that it will not so sudden or drastic that people will want to scream, rather than just say “ouch.” That is basically what the public seems to want. I do not believe that there is any chance that Koizumi is going to take a tougher position on this fiscal deficit problem.

What about raising taxes? Koizumi has made it quite clear there will be no consumption tax increase on his watch. He's not going to change his view on that. What about spending cuts? Yes, there will be some, including, interestingly enough, given popular assumptions about an expansion of Japan's military role, cuts in defense spending, and no big spending increases.

What Koizumi is doing that is really important in the long term is changing the rules of the political game in Japan. I have been critical of him for compromising too easily and not using his power to see his major policy initiatives through to their conclusion. Koizumi has a short attention span; he gets really excited about an issue, jumps in with both feet, and then leaves it to others while he goes on to the next issue. Still, you have to give Koizumi a great deal of credit for having the courage to change the rules of the political game. I don't believe that the Japanese media grasps yet this important contribution that Koizumi has made. The mindset of Japanese political reporters is pretty out of date; they interpret everything within the framework of the old political rules. Newspaper predictions a few weeks ago of Koizumi's impending cabinet reshuffle are a good case in point. There was a great deal of speculation about how many Hashimoto faction members would be brought in, about how Koizumi would compromise with the important party bosses, and the

like, but Koizumi does not play by those rules. He plays by the rules he believes in. In his view, it is his government and his cabinet, and if the LDP does not like it, it can make someone else prime minister. This leaves his LDP opponents apoplectic, but it leaves Koizumi very much in charge. He is changing the rules of the game and he is blocking the LDP politicians' access to the kind of resources they've had in the past, especially public works. Koizumi is not eliminating it, but he has made it much more difficult for the politicians and the LDP to get that pork barrel and roll it down to their constituencies.

Koizumi has moved the center of gravity of the policy-making process out of the LDP and into the prime minister's office. This is very important in the long term. The policymaking process cannot go back to what it was before; there's now a real conflict between the prime minister and the LDP over control of policy. This is the theme of my talk today, that the 1990s were not "lost," but were, rather, a "watershed" decade in Japanese history. Wherever Japan goes in the future, it's not going back to what it was before the early 1990s.

Takenaka's role in financial reform has been mentioned, but what has not been noted is that, in addition to forcing the banks to clean up their balance sheets, he also, to some extent, has reformed the way that bureaucracy operates. This is part of a much bigger, very important

story in Japan. The role of the government in the economy has been shrinking. At the same time, the relationship between the bureaucracy and the private sector has become more formal and transparent. The informal mechanisms of elite coordination, which is the key characteristic of Japan postwar politics, coordinating bureaucrats and politicians, the business community and the state, the opposition parties and the LDP, are all being undone. They are eroding and being replaced by more transparent rules. The way the FSA relates to the banking community is fundamentally different from the way the Ministry of Finance had related to the banking community. In the old system, bank officials who were tagged with the job of interacting with Ministry bureaucrats, on the golf course, over dinner, and in other informal settings, could coordinate with the bureaucracy and keep the convoy system in formation. You don't need many regulators in that kind of system. Today, the relationship is more distant, more formal, more rules-based, and there are no longer the *MOFian*, the bank executives whose job it was to interact with the bureaucrats, and there are a lot of regulators. The irony of the shrinking of the government role in the economy is an increase in rules and in the number of people needed to enforce those rules. This is a very different system from the one Japan had in the past.

The irony of Koizumi's success is that he has slowed

You have to give Koizumi a great deal of credit for having the courage to change the rules of the political game.

—Gerald Curtis

*Today, the option
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—Gerald Curtis

the process of political change in Japan. Just imagine that if Mr. Hashimoto had become prime minister two years ago, chances are quite good that it would have provoked a split in the LDP and major political change. Koizumi has been so popular that he brings votes to a party, the LDP, which can no longer get those votes on its own. The LDP is like a very impressive edifice sitting on a weakened foundation; serious fissures and even collapse can happen at any time, and in my view it will do so when Koizumi is gone. I do not mean to say that Koizumi has not done important and useful things. He has done good things for the long-term future of Japanese politics, but in terms of the party system, he has prevented the inevitable change that has to occur, sooner or later.

One of the issues for the LDP is that Koizumi will be out of office in a couple of years, and then there will be an election. How do you win that election? Well, the way to win the election in Japan now is very different from the way it was fifteen or twenty years ago. The machine that turns out the votes cannot be relied on to keep the LDP in power any longer. To win the election now means finding a leader who can appeal to the public, rather than one who can manage power relations within the party, which used to be the major qualification for leadership. There is no one like Koizumi in Japanese politics, and anyone who tries to mimic his style will look like a poor

shadow of Koizumi. One possibility is that the LDP will try to find someone it can put forward as a symbol of the “new” LDP. This has been done in the past, for example when “clean” Miki was made prime minister in the wake of the scandals involving Prime Minister Tanaka. Today, the option might be to make a woman party president. The name of Noda Seiko has been bandied about by senior party leaders who believe someone like her might just be popular enough to help the LDP win the election and compliant enough not to challenge the party bosses.

What difference would it make if the Democrats come to power? Not much, in terms of policy, in my view. The Democrats and the LDP represent different shades of gray on most issues, rather than a black and white choice, which is understandable in a society bereft of deep and antagonistic social cleavages. The Democrats are now trying to reach out into rural Japan, because you have to win the rural seats if you’re going to get a majority. The LDP, on the other hand, has to reach the urban voter more than it has, if it hopes to stay in power. Koizumi understands, but the party is very resistant to moving away from its rural base.

In terms of the policy process and the general thrust of domestic policy, there is a shift of gravity to the prime minister’s office, the *kantei*, but it has not yet established itself as the undisputed center of the policymaking process. Members

of the Council on Fiscal and Economic Affairs often express frustration at the lack of implementation of their proposals, because of the power of the line ministries to sabotage what they do not like.

Nonetheless, the process is becoming more centralized in the *kantei*, and the direction of policy is toward supporting greater privatization and competition, shrinking the role of the state in the economy, restoring the health of the financial system, getting the fiscal deficit under control, and shifting priorities toward the urban voter.

Reform of the government structure and of politics will continue, but how you evaluate them is pretty much a matter of whether you want to see the cup as half full or half empty. There’s a new system of vice ministers, for example, which was supposed to constrain the power of the bureaucrats. Maybe it will, over time, but it has not done so yet. These vice ministers are chosen by the party on the basis of times elected and factional affiliation, unlike the ministers themselves, whom Koizumi chooses without regard to seniority or faction. Perhaps that will happen to vice ministers over time, but for now, this position has none of the importance comparable posts have in European parliamentary democracies.

The pace of change is slow—too slow perhaps—but is proceeding in the right direction, and anyway, it is a pace and direction that the Japanese public seems to support.

Japanese politics and government are giving the Japanese public, for better or worse, what it is asking for. That may disappoint economists and foreign businessmen and political leaders who believe they know what is best for Japan, but Japanese leaders listen to their voters far more intently than they listen to a lot of well-meaning advice from others.

DISCUSSION

AUDIENCE QUESTION

Is the topic of immigration in Japan off the table completely, or is there any prospect of this becoming a real issue?

LEN SCHOPPA

I recently saw that a business group actually talked publicly about the need to plan for increased immigration in the future. I was quite surprised to see that. As we heard earlier, we almost never hear anybody in public talk about how immigration has got to be part of Japan's solution to its demographic challenge. I have yet to hear politicians talking openly about immigration. I watched the specialized agency within the Ministry of Health and Welfare that is responsible for demographic projections, and which had to come up with something to put into its projections about immigration, take recent trends, which were about a net 50,000 people coming in each year, and it was willing to project double that. Eventually, it projected that 100,000 net new immigrants would come into Japan

each year, whereas the United Nation's numbers were in the range of up to 3 million immigrants each year. This is more like the kind of numbers Japan would need, if it wanted to keep the size of its work force stable. Nobody is going to talk about the numbers needed to make a real dent in the declining working age population.

GERALD CURTIS

Several business leaders are now quite outspoken about the need for Japan to have a more open immigration policy. What Len is referring to is the chairman of Keidanren, who is also the chairman of Toyota. There is increasing talk in the business community about the need for immigration.

Another point is that there is a lot more immigration in Japan than most people realize. There are probably more than a million illegal or disguised immigrants in Japan. There are, particularly, Chinese and other Asians who are on student visas. The restrictions on work are relaxed in Japan; you can work twenty hours a week on a student visa.

Some prefectural governments have had programs to bring workers from Southeast Asia in "on-the-job training." Well, it's not on-the-job training; it's on-the-job *working*, six months cycling in and out. Now, does that mean that Japan is going to have changes in immigration policy that make it look like Germany, France, Britain, or the United States? No, I don't think that's going to

happen any time soon, but market demands for the importation of labor are bound to increase, and with them government policy will change to accommodate more immigrants within strict bounds.

So, there's change under way. It's not going to turn Japan into an immigrant society, but it's going to move a little bit further in that direction than I think many people tend to believe. I get a sense that Japanese attitudes about non-Japanese in Japan are much more relaxed and accepting today than they were before. It's considered to be natural that there are a lot of foreigners doing lots of things in Japan, including things that, in the past, only Japanese were expected to do. The direction of change is there. The pace, yes, is slow. I would emphasize, however, that the aging of Japan's population, which is not going to be affected by immigration, is the major reason to expect relatively low growth in the future.

HUGH PATRICK

One difference between economists and political scientists, I think, has to do in terms of what we think is a good society or something of that sort. Maybe we think similarly, but from the economist's point of view we're really interested in GDP per capita. We're interested in the welfare of each individual, and we don't care so much how many individuals there are.

If you're interested in power as the nation-state, then

*I have yet to
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—Len Schoppa

There has been a decline of the kind of traditional social networks that make possible the informal coordination that characterized the postwar system.

—Gerald Curtis

you're interested in total GDP and the growth of total GDP, because that's a measure of power. I would say there's a contrast here. From the viewpoint of economists, it's not necessarily a bad thing to have a decline in population, if it goes about at the same time with a continued increase in income per capita. In that sense, Japan might be a more pleasant country if everybody living in an apartment could knock out the wall to the apartment next door and take it over, because there's half as many people and they have a lot more space and the subways would be less crowded, and so forth. You could make an argument that having a smaller population is not necessarily a bad thing for any country. It's true of every advanced country except the United States that the population is on an inexorable trend of decline. This is going to be the exciting new sort of social issue of the next thirty years—how do societies respond to this?

AUDIENCE QUESTION

Can you explain what it is that has led to what you have called a new emphasis on transparency and formal rules?

GERALD CURTIS

At the heart of it are the changing values that come with affluence and urbanization and so on, compounded by the difficulties of the 1990s. In terms of social structure, there has been a decline of the kind of traditional

social networks that make possible the informal coordination that characterized the postwar system. The change is captured in a signboard you can see around downtown Tokyo. Put up by the local ward police department, its title says in large letters, “manaa kara Ruuru E,” “from manners to rules,” or, more freely, “from informal understandings to formal rules.” The sign tells people that is illegal to throw bottles in the street and so on, behavior that was earlier thought to be constrained by informal understandings but that is now regulated by law.

Obviously, when you rely more on law than on informal and implicit rules, you are creating a situation that requires lawyers, certified public accountants, and other specialists. It is no coincidence that there is now a boom in graduate programs in law, accounting, and so on. I am talking about a trend, not a sudden shift. The process is evolutionary, not discontinuous. However, there is no doubt that there is an interesting institutional evolution going on in Japan that is creating new kinds of formal institutions that are more flexible and more transparent than in the past and obviating the need for many of the informal mechanisms that were so important previously. This is a long-term process, but a very important one.

Finally, on the domestic economy, it is interesting to note that external economic developments, particularly the development of the regional

and bilateral free trade agreements (FTAs) in the Asia region, are creating pressure for domestic change in Japan. In order for Japan to forge such agreements with other countries in Asia, it needs to liberalize agriculture to some extent and provide opportunities for labor to enter Japan from such places as the Philippines, which is interested in getting access to Japan for nurses, and Thailand, which wants to be able to have people work in Japan's care of the elderly and household care industries.

In the past year or so, the tenor of the debate over agricultural protection has shifted quite sharply. There seems to be growing support for the idea that Japan should shift away from reliance on high tariff walls and adopt an incomes support policy more akin to what is common in Europe. The Democratic Party has been pushing this approach, but so, too, have important voices in the LDP, and even within the bureaucracy. Rather substantial change in agricultural policy is likely, even though this poses risks to the LDP's core support. It is being driven by outside events and is a commentary on how profound the domestic political consequences of globalization are.

シンポジウム:日本の政治経済の現状

2004年10月14日、コロンビア大学の日本経済経営研究所は、同大学ウェザーヘッド東アジア研究所との共催で、日本経済の現状を分析するためのシンポジウムを開催しました。このシンポジウムでは経済学者や政治学者をお招きし、日本が直面する経済問題や政策的処方のみならず、その根底となる政治的・社会的現実に対する洞察について議論が交わされました。以下はシンポジウムの抄訳です。

日本経済の現状

数期に渡り順調な回復基調を見せた後、日本経済は再び減速しており、日本は遂に「本物の景気回復に突入したのだ」という楽観の見方を裏切る格好となった。そんな中、第一部は「日本の経済状況」をテーマに、アメリカン・エンタープライズ公共政策研究所 (American Enterprise Institute for Public Policy)、カクストン・アソシエイツ (Caxton Associates, LLC)のジョン・マーキン氏とコロンビア・ビジネス・スクール 日本経済経営研究所所長、ヒュー・パトリック氏の間で議論が交わされた。マーキン氏は前半に日銀の価格デフレ回避政策について、後半は外需すなわち石油価格の上昇と、米中両国での成長減速などに見られるような波及効果について講演した。パトリック教授は、家計貯蓄率が低下している一方で、日本企業の一部は未だ貯蓄率(純投資)が高いことに言及した上で、いくつかの問題点に焦点をあてた講演となった。財政赤字については、日銀が消費者物価指数の上昇に合わせて金利を引き上げるといふ誓約を守るために、やや強引になっているのではないかという見方を示した。また日本の隠された不完全雇用も重要な課題とし、特に若年層が結果的に前世代が享受できたような職業訓練を受けられない現状を問題視した。労働力の高齢化による影響についても議論され、特に人口学的推移のより正確な特質を括り出し、適切な政策対応をとる必要性が語られた。

日本政治の現状

「日本の政治状況」をテーマとした第二部では、バージニア大学のレン・ショッパ教授、コロンビア大学のジェラルド・カーティス教授が講演し、財政赤字についてさらに掘り下げた議論を展開した。小泉首相が年金制度改革と郵政事業改革を筆頭に、公共事業費用を調整しようとしていることにも言及し、両教授は小泉首相が真の日本改革の貢献者なのか、それともその妨害者なのかという疑問を投げた。結論として、変革の速度は減速するものの、伝統的社会組織は崩壊してきており、縁故社会から離脱、より形式的でルールに基づいた社会へと移行しているという見方を示した。

このレポートは本シンポジウムの講演・討議を完全収録。日本経済経営研究所(CJEB)発行の本レポート、またその他のレポートについても、CJEBウェブサイトwww.gsb.columbia.edu/japanにてご覧頂けます。

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