

Economic Policy Reform in Japan: The Role of the Private Sector, Government and Citizens

by Susumu Takahashi

The current Japanese recession, considered the worst since World War II, seems to have finally bottomed out and gradually moved toward recovery. Japan's real GDP growth rate was 0.5 percent in fiscal 1999, recovering from negative growth for the preceding two years. The last quarter in particular, from January to March 2000, reached a record high of an annualized rate of 10 percent compared with the previous quarter. It has been pointed out that behind this high growth rate were special factors, such as the leap year and last-minute demand before amended regulations were implemented in the beginning of fiscal 2000. Even with such special factors in mind, it is quite certain that signs of recovery are widely spread in the private sector, as seen in such movements as the bottoming out of the economy and a definite recovery trend in investment in plants and equipment. It is true that the recovery of the private sector is due largely to exogenous factors, such as the economic measures adopted by the

government and the recovery of exports. On the other hand, it has also been pointed out that the private sector has regained the ability to recover on its own, thanks to the completion of inventory adjustment and the recovery of profitability brought about by progress in restructuring. I would suggest, however, that the ability of the private sector to recover by itself remains insufficient, and that a full-fledged recovery will not come for some time.

Looking back on the current recession, we find that a series of tight budgetary measures, including the increase of the consumption tax in 1997, directly triggered the economic slump. A jolt of the financial system caused by the collapse of leading financial institutions since autumn 1997 seriously worsened the mindset of consumers and businesses and brought about a sharp deterioration of the economy. This further increased the structural adjustment pressure for the corporate sector, which originally has a weak constitution, and there were fears that the economy might slow down indefinitely. Various structural problems

that had been traditionally pointed out came to the surface with the deterioration of the economy and acted as factors to steadily worsen business conditions.

EFFECTS AND LIMITS OF ECONOMY-BOOSTING MEASURES

Finally, the government suddenly changed policies, hammered out the stimulus package in November 1998—whose scale is said to be the largest in history—and attempted to stabilize the financial system by rapidly expanding public works projects and injecting public funds into the banking system. The Bank of Japan adopted its zero-interest rate policy from early 1999, and the government continued to prop up business conditions through a large-scale supplementary budget. All kinds of emergency measures, including policies that had been traditionally considered taboo, were mobilized. Partly because these measures to stimulate the economy proved effective and because exports (mainly to Asia) recovered, the deterioration of the economy finally came to a stop in spring 1999. Since then, because of the progress of inventory adjustment and the increase in exports, companies have continued to recover their production and profits, and capital investment by the corporate segment is moving to recovery. In this manner, it seems likely that the Japanese economy has entered into a recovery phase from the viewpoint of economic cycles.

Turning our attention to the future, however, the effect of the government's economy-boosting measures will inevitably run out of steam and decline as a reaction. These measures have created enormous budget deficits with inevitable side effects. Moreover, although the corporate sector has

taken a turn toward recovery, the adjustment of excesses in the areas of equipment, employment and debts is still under way. The fear exists that restructuring in the corporate sector will continue to have a negative influence on the economy for the next one or two years, especially slowing the recovery of consumer spending. The government has begun to gain confidence in the recovery of

business conditions and thinks that policy-related demand will give way to private demand as the driving force of the economy. From the latter half of 2000, when policy-related demand props are expected to be unnecessary, however, there is in fact no predicting whether sustainable recovery led by private demand will be realized or not. Before the drastic expansion of budget deficit comes to the surface as a new structural issue, can the government put the economy back on a full-scale recovery track?

The government's fight against time has already started.

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MEDIUM-TERM POLICY TASKS

As we look back at the post bubble Japanese economy, we find it has been unable to break out of the long-term slowdown phase, though repeated small-scale business cycles have occurred. Factors driving the long-term economic slump include not only the delay in dealing with the aftermath of the bubble bursts, but also the structural fatigue accumulated for 50 years after World War II and the delay in keeping up with the changing global tide in the 1990s. The delay in response and reform in various fields caused the stagnation of industrial activities, the decrease of economic vitality, and strengthening of the cooped-up feeling in society. During this time, although the government came out with a

succession of measures to boost the economy, it could not put it on the road to a full-scale recovery, and there was an increasing understanding that structural reforms were necessary for the revitalization of the Japanese economy. The Hashimoto government submitted proposals for structural reforms in six key areas (the economy, public finance, administration, finance, social security, and education) and displayed a new resolve towards their full-scale implementation. The government achieved a certain result with the relatively drastic financial reforms called the “Japanese Big Bang.” But it failed in the fiscal reforms, thereby causing the economy to worsen and forcing the Hashimoto administration to resign without fulfilling its resolution. The incoming Obuchi government shelved the structural reform, instead giving priority to boosting the weak economy through economic stimulus measures. Although signs of economic recovery have appeared, the Obuchi government and its successor, the Mori administration, which learned a lesson from the failure of the Hashimoto government, have given priority to the economic recovery and maintained a prudent attitude toward structural reform.

The post bubble era of the past 10 years is called the “lost 1990s.” During this time, the Japanese government was been unable to implement necessary reforms to restart an economy that still has negative legacies of the bubble era. Furthermore, this also reflects widespread impatience over the government’s inability to even achieve consensus on the procedure and pace of reforms. In the twenty-first century, Japan is required to promote the growth of new sectors, including IT, and to deal with the rapidly aging population. If this inertia in the face of a changing environment continues, however, Japan is very likely not only to fall behind other advanced nations in the growing fields, but also to lose economic dynamism along with its aging society.

So that the first 10 years of the twenty-first century will not be a lost decade, the Japanese government must achieve consensus on necessary structural reforms as soon as possible and actually implement them. The

fields most in need of reform have already been clearly identified by the Hashimoto government. These fields can be roughly classified into three areas, as follows. The first area is reform to recover the private sector’s vitality. It is natural that an industrial revival should depend on companies’ self-help efforts. Many tasks remain, however, that the government should address to improve the environment for industrial revival. If industrial revival is the task that should be addressed by the private sector, required next is reforms by the government itself. Besides administrative and financial reform, it is also the government’s second task to reconstruct the current universal health insurance and social security programs into a new system suitable for the aging society. Finally, their third task is to deal with the reconstruction of regional communities that are losing vitality under the widespread feeling of malaise. Reforms in this third area are themselves also predicated on reforms of the private sector. The government will be required to develop specific policies to accomplish the reforms in these three fields. Although these reforms are beyond the traditional framework of economic policies, such efforts are necessary for economic revival.

RECENT PRIVATE SECTOR REFORMS

In the current recession, the financial system has been jolted wildly, which cast a big shadow over the actual economy. Since public funds were injected and the real economy began to rally, the financial system has recovered stability. However, the survival of individual financial organizations depends on whether they can strengthen their profit-earning capacity through restructuring and reorganization and whether they can respond to the new financial environment brought about by the IT revolution. In the ongoing financial reorganization process, the division between winners and losers will become increasingly clear. A similar process has already started in the general industrial world. Through the latest recession, companies are forced not only to settle negative legacies of the bubble economy, but also to withdraw from

unprofitable segments, to narrow down business fields and to drastically strengthen the financial situation in order to respond to the globalization of standards in the accounting system. Corporate restructuring has led to a surge of reorganization in the Japanese industrial world, regardless of sector, corporate size, or even national boundaries.

This surge of reorganization throughout the entire Japanese industrial world is a sign that the Japanese economy has finally started to escape from the prolonged 10-year economic slump. So that Japan will break down the current closed situation, however, it is essential to shift capital and labor from mature fields to new and growing ones in response to the changing economic structure. Because business reorganization has become more pervasive means that necessary shifts have finally started in the private sector.

The government established the Industrial Revitalization Plan in 1999 and promoted a system to facilitate business reorganization, revision of the taxation system and technological transfer to the private sector. The government also started addressing the need for technological development to create new industries through government disbursements (e.g., the so-called Millennium Project) and the establishment of infrastructure suitable for the twenty-first century. These efforts by the government represent a big step forward. To support the reforms in the private sector which have just started, the government needs to provide an environment that enables the smooth transfer of resources to the new economy through such measures as deregulation, the promotion of competition, fluidity of labor markets, job training and re-

education. Moreover, when the United States and Europe have started aggressively promoting the IT revolution, it is also indispensable for Japan to systematize its efforts in this sphere.

THE NECESSITY OF GOVERNMENT REFORMS

Full-scale reform is progressing in the private sector, and thus the next step, the reform of the government, is currently being undertaken. By reexamining the structural reforms developed in accordance with the six major plans for structural reform advocated by the Hashimoto administration, it has been confirmed that financial and economic reforms are, at last, progressing. Although the reorganization of central ministries was developed by the Obuchi administration, a drastic reform involving the whole realm of administration, as well as the promotion of decentralization, has hardly made progress. It is often pointed out that the whole social welfare system, including the medical and nursing care systems and pensions, needs to be redesigned to respond to the needs of an aging society. At present, however, minor reforms of existing systems are the only measures developed by the government. The situation is even worse in the structural reform of public finance; specific reform methods are totally undecided. Although financial and economic structural reforms have been successful and can be entrusted to the private sector's independent efforts, reforms related to government remain undeveloped.

Although the reforms of the administration, public finance and social welfare may look like three separate spheres, the three are

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interrelated. The course of these reforms will significantly impact the private sector's economic activities. To rebuild public finance, which has deteriorated most seriously by far among the industrialized nations, it is necessary to reduce expenditure and increase revenue. If, however, measures focusing on increasing revenues are taken, such as tax increases and the increase of social welfare premiums, the result may be exhaustion of the national economy. To reduce expenditure, the main components, public works and social welfare, need to be thoroughly examined and drastically reformed—as the domain of administration does. In the social welfare system, the citizens' burden of payment will continue to increase, and the services they can receive will become more limited. This is inevitable under conditions of a rapidly aging society.

Before the social welfare system is reformed, it is essential to achieve a consensus among the citizens concerning the appropriate size of the required safety net. Furthermore, the services citizens expect from their government may shift in response to the growing trend of the aging society. Because of these circumstances, it is essential to establish an administrative system capable of efficiently providing the citizens with the necessary services without raising the premiums. As such, the reforms of the administration, public finance and social welfare are closely connected with one another because they are mutually affected by the expenses paid by citizens and the services they receive. Therefore, if the reforms of these systems are carried out separately, it will be difficult to measure their effect on the national economy as a whole. What kind of system will be necessary in order to properly respond to citizens' demands, while preserving the vitality of private entities? It is important to comprehensively examine each system from this point of view. Based on this examination, the systems should be redesigned, followed by comprehensive reforms to realize the desired system. Because it is difficult for the administration to drastically change itself, strong political leadership will be necessary to promote reform of the government.

DEVOLVING AUTHORITY TO THE PEOPLE

Behind the slumping Japanese economy is a decline in the industrial vitality and a delay in implementing proper policies. Now it is required to adjust and reform this situation. Those who neglected their responsibility, however, are not only corporate managers and executive authorities. The Japanese people themselves forgot that they constituted the electorate; the public and the regional community devoted themselves to their own businesses and companies, and left decision making and the maintenance of social order to the government. This is also a factor behind Japan's current slumping economy, social ruin and loss of people's own values. The solution to problems in many fields like education, declining birth rates, nursing care and environmental problems requires people's voluntary involvement. With all these problems we should note that efforts by the central government have their limits, and that these problems cannot be solved only by the power of the government. Furthermore, it is necessary for local residents to recognize these problems as their own and to address them in their activities. To change the awareness of people overly accustomed to being dependent on the government, it is necessary to decentralize the power concentrated within the government into the market, regional community or Non Governmental Organization (NGO) activities, and to again implant the awareness of choice and responsibility in the populace.

Not until reforms in the three areas of the private sector, government, and the citizenry progress simultaneously will Japan be able to recover the lost decade and to make the first 10 years of the twenty-first century a "decade of reform."

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