

CHAPTER 4

JAPAN—ON THE EDGE OF CHANGE

Economies are not static; they perpetually change. Changes in [an] economy cause deviations from predictions in supply and demand, and in the long run economic frameworks like institutions and customs no longer mesh with reality. In response to these changes, private enterprise, households and the government make adjustments, which then induce further changes in the economy. In this way, the real world economy continues to change, repeating the adjustment process from disequilibrium to equilibrium, and from a state with problems toward an optimal state.

Economic Planning Agency of Japan, 1994¹

The Japanese economy

4.1 Japan has reached a critical juncture in its development. For a number of years, its customs and institutions have ‘no longer meshed with reality’ and, even with the recent indications of an economic revival, it is yet to make that adjustment ‘from a state with problems toward an optimal state’.

4.2 Despite the many experts who have applied their minds to solving Japan’s economic problems, the country is still struggling, after many years of stagnation, to rehabilitate its economy and restore it to robust health. The implementation of initiatives on a number of policy fronts could not prevent Japan sliding further into recession in 1998. At the beginning of 1999, there were loud and strident calls for bolder action.² As the year progressed, the economy rallied but some analysts still held serious reservations about the soundness of the recovery. In October 1999, Keidanren, for example, declared that the Japanese economy was ‘undergoing the gravest crisis since the war’.³

4.3 The previous chapter chronicled the numerous measures taken by the Japanese Government to address the problems besetting the economy. In this chapter, the Committee looks behind the numerous recovery initiatives, rescue packages and the reform programs introduced after the asset-price bubble burst in 1990, to gain a better understanding of the forces driving economic change in Japan and the obstacles impeding its progress.

1 ‘Economic Survey of Japan (1993–1994)—A Challenge to New frontiers Beyond the Severe Adjustment Process’, Economic Planning Agency, Government of Japan, 26 July 1994, <http://www.epa.go.jp/e/doc/summary.html>.

2 OECD, ‘Japan Outlook’, *Observer*, no. 215, January 1999.

3 Keidanren, ‘Keidanren Urges the Government to Resolutely Carry Out Sweeping Regulatory Reforms’, 19 October 1999, <http://www.keidanren.or.jp/english/policy/pol107.html> (20 October 1999).

4.4 Between 1992 and November 1999, the government put in place several economic packages featuring fiscal spending measures and structural reform initiatives to help lift the economy from its slump and place it once again on a healthy growth path. At the beginning of 1999, eight years after the bubble economy collapsed, the outlook continued bleak with ‘four straight quarters of negative growth; two straight years of contraction of the macro economy; the steadily worsening disintegration of what used to be vaunted systems in the corporate sector; and growing anxiety about job security among the public’.⁴ Even with the encouraging signs of a recovery during 1999, the country has not yet set itself on a clear and determined path to economic growth.

4.5 Over the years, financial experts and politicians have had no difficulty in identifying broadly what needed to be done to return Japan’s economy to vigorous health and have called repeatedly for decisive action. In 1995, Mr Ryutaro Hashimoto, as Minister for International Trade and Industry, stated in general terms that ‘in order to stay ahead, an advanced economy must make constant efforts to respond to changing economic environments and explore unknown technological frontiers so that it may continue to find new sources of economic vitality’.⁵ Despite this observation and its wide acceptance, Japan has been unable to find that source of ‘economic vitality’.

4.6 In the same year, the Financial System Stabilization Committee and the Financial System Research Council recognised the need for Japan to construct a transparent financial system under which market mechanisms and the principle of self-responsibility of both banks and depositors would come fully into play.⁶ Again, despite the implementation of structural reform programs designed deliberately to restore credibility to Japan’s financial system, the country has been unable to rebuild an effective and vibrant financial sector able to win back the trust and confidence of the Japanese people.

4.7 The evidence shows that officials have a sharp appreciation of what needs to be done but they seem unable or reluctant to map out and put in place a workable strategy that would achieve their stated objectives. In brief, Mr Peter Hartcher told the Committee that the Japanese have a clear understanding of all their own dilemmas going back a long way. He noted, however, that despite the acute diagnosis, the highly developed dialogue and debate, the accurate perceptions and prescriptions—‘The

4 Economic Research Department, ‘The Third 18-Month Economic Forecast Using the STP Method’, NLI Research Institute, 1999, No. 124.

5 Ryutaro Hashimoto, Minister of International Trade and Industry, ‘Challenges for the World Economy in a Transitional Period and Development in the Asia-Pacific Region’, Vancouver, 2 May 1995, <http://www.jef.or.jp/news/challenge.html> (19 October 1998)

6 The Summary of the Final Report of the Financial System Stabilization Committee, the Financial System Research Council, 22 December 1995; Ryutaro Hashimoto, ‘Challenges for the World Economy in a Transitional Period and Development in the Asia-Pacific Region’, Vancouver, 2 May 1995.

problem is that nobody does anything about it'.⁷ In a similar vein, other commentators have spoken of an administration with a wait-and-see attitude and a policy of forbearance.⁸ Despite this perception of an administration unable to act decisively, the Japanese Government has taken numerous measures to rehabilitate the economy.

Stimulus packages

4.8 The efforts of government to boost the economy are most evident in the introduction of numerous well publicised rescue packages. In summary, between 1992 and the first half of 1998, the government put together a total of seven economic packages featuring fiscal spending and tax cuts for projects amounting to 80 trillion yen. In addition, in November 1998, the government approved an economic stimulus package of approximately 17 trillion yen, the largest in Japan's history. On cue, the government introduced more fiscal stimulus measures 12 months later. Unfortunately, the contribution of these fiscal stimulation initiatives to economic growth has not been as effective as hoped. Although the economy rallied during 1999, there is no current evidence to suggest that the stimulus packages have produced a return to solid and sustainable growth.⁹ Throughout the decade, domestic demand, despite the fiscal stimulus measures, has remained flat and unable to provide the necessary boost to reignite the economy.

4.9 Indeed, in October 1999, the Economic Planning Agency stated clearly the wish to see 'a smooth baton pass, toward full-scale recovery, from public to private demand'. But, while the government waits with baton in hand, there is no firm indication that the Japanese consumer is preparing for the hand-over. As late as May 2000, the Dai-Ichi Kangyo Research Institute observed that, although personal consumption was emerging from the 'free-fall' at the end of 1999, 'a full-fledged recovery in personal consumption is unlikely in view of the grim employment conditions and the restrictive stance taken by corporations toward personnel costs'.¹⁰

4.10 Clearly, Japan has yet to reach a stage where private-demand supports autonomous economic recovery.¹¹ Japanese consumers, by refusing to spend, have kept domestic demand depressed. There are a number of reasons why the stimulus packages have not provided the expected necessary impetus to economic growth.

7 Peter Hartcher, *Committee Hansard*, 15 April 1999, p. 335. See comments also by Professor David Reid, *Committee Hansard*, 25 February 1999, pp. 193 and 195; Professor Teresa Morris-Suzuki, *Committee Hansard*, 24 May 1999, pp. 606–7.

8 For example see Dr Christopher Rawlings, QCT Resources Ltd, *Committee Hansard*, 16 April 1999, p. 503, who stated that business was also reluctant to acknowledge the reality that the economy was turning bad.

9 For example see Bank of Japan, Reports and Statistics, *Monthly Report of Recent Economic and Financial Developments* (March 2000) (The Bank's View), 10 March 2000; Dai-Ichi Kangyo Research Institute, *DKR Economic Report*, vol. 3, no. 3, 15 March 2000, p. 2.

10 *DKR Economic Report*, vol. 3, no. 5, 15 May 2000, p. 2.

11 Economic Planning Agency, 'Outline of the Policy Measures for Economic Rebirth', (summary), 11 November 1999, <http://www.epa.go.jp/99/b/19991111b-taisaku-e2.html> (18 November 1999).

Inflated/overstated estimates of the size of the stimulus packages

4.11 Some analysts argued that despite the fanfare accompanying the announcement of the stimulus packages, the impressive sums quoted were misleading and the overall contribution made to invigorate the economy was, in practice, not as substantial as the figures would first suggest. Mr Adam Posen maintained that all announced fiscal packages were far smaller than claimed and, indeed, many budgets acted to reverse the effects of these programs. He stated:

Total public investment in all seven stimulus packages from 1992 through to spring 1998 was 23 trillion yen, about a third of the total amount announced, or 4.5% of GDP. While not a small sum, it seems hardly adequate after taking into account that there have been over 7 years of recession with an output loss in excess of 9% of GDP and that the claimed total public expenditures was 65–75 trillion yen.¹²

4.12 In supporting this view, senior economist, Jon Choy, pointed out that the actual increases in government spending often have fallen far short of the amounts pledged when the initiatives were announced. When comparing the stated value of the six stimulus packages between August 1992 and September 1995 with the actual supplementary budgets passed to implement them, there is a significant discrepancy. He argued that as a result of the modest contribution made by the stimulus packages:

Japanese financial markets as well as consumers and businesses have learned to discount what is announced and to look closely at actual spending and tax change—what is called *ma-mizu* (pure water, or the real amount of new stimulus)—to evaluate the potential consequences of a package.¹³

4.13 Despite the boast of a 16 trillion yen infusion of funds, the April 1998 package appears not to have carried the fiscal clout it supposedly was going to bring to the economy. In assessing this package, Professor Nariai Osamu found that ‘the effect of the stimulus package on the real economy comes to some ¥3 yen from public works, ¥1 yen from tax relief, and ¥2 yen from other measures, for a total of about ¥6 yen. This is only slightly over 1% of gross domestic product.’¹⁴

4.14 While the fiscal stimuli failed to encourage spending and thereby raise domestic demand, it did succeed, however, in increasing the short-term growth forecasts and kept the economy afloat. Some analysts saw merit in this approach. They argued that, by simply allowing the economy to tread water, the packages prevented the economy from sinking further. As Peter Hartcher noted:

12 Adam S. Posen, *Restoring Japan's Economic Growth*, Institute for International Economics, Washington, 1998, pp. 6, 28–32, 41.

13 Jon Choy, ‘Japanese Fiscal Policy: One Foot on the Gas, the Other Tied to the Brake’, *JEI Report No. 16A*, Japan Economic Institute, April 1998, pp. 8–9.

14 Nariai Osamu, ‘Restructuring in a Deflating Japanese Economy’, *Japan Echo*, August 1998, p. 39.

If you look at the various simulations that have been done concerning what might have happened to the level of activity in the Japanese economy without that fiscal stimulus, the chart would fall at a fairly depressing rate. GDP growth would decline fairly steeply. It would have been a bit of a train wreck if not for that stimulus. So it has had some utility.¹⁵

4.15 On the other hand, some were highly critical of this approach. Many analysts pointed out that the packages served more as a band-aid measure than a building block for sustained growth. They did not win back the confidence of consumers who refused to loosen their hold on the purse strings and they did not seize the imagination of the business community, which still balked at embarking on new enterprises.¹⁶

4.16 They maintained that by not providing the impetus needed to carry the economy out of troubled waters, it has languished while consumer confidence, already shaky, has been further eroded. Mr Adam Posen argued emphatically that ‘stimulus attempts that are solely intended to be sufficient to keep growth non negative are setting far too paltry a goal’.¹⁷

4.17 The most recent stimulus package of November 1999 followed the pattern established by its predecessors. The Economist Intelligence Unit suggested that the amount of spending was far less than the headline figure of around 18 trillion yen and was closer to 6.5 trillion yen, with the remaining sum largely repackaging of already allocated spending.¹⁸

4.18 Putting to one side the argument about the actual size and value of the stimulus packages and whether they were overstated or not, there were other factors that have undermined the effectiveness of the government’s fiscal stimulative policy. While the public funds injected into the economy may have prevented it from sliding further into trouble, many argued that the short-sightedness in planning and poor decision-making blunted their effectiveness and, overall, failed to provide an impetus to solid recovery.

Funding concrete

4.19 A considerable number of analysts, especially among the witnesses appearing before the Committee, criticised the lack of strategic economic planning in allocating the funds from the stimulus packages. At a time when the economy clearly needed a

15 Peter Hartcher, *Committee Hansard*, 15 April 1999, p. 329. DFAT argued that the Japanese economy would have contracted more sharply if not for the packages. Ms Karen Gilmour, DFAT, *Committee Hansard*, 15 February 1999, p. 10.

16 For example ABARE stated that ‘The consensus remains that this package (April 24) may only be sufficient to prevent the Japanese economy from slipping further into recession’, submission no. 21, p. 3.

17 See also, Jon Choy, ‘Japanese Fiscal Policy: One Foot on the Gas, the Other Tied to the Brake’, *JEI Report No. 16A*, 24 April 1998; Hiroko Ishii and Erika Wada, ‘Local Government Spending: Solving the Mystery of Japanese Fiscal Packages’, Institute for International Economics, Working Paper 98–5, <http://www.iie.com/98-5.htm> (15 October 1998).

18 The Economist Intelligence Unit, *Country Report*, Japan 1st quarter 2000, p. 19.

boost in economic activity that would provide the platform for future growth, the stimulus packages should have channelled money into areas best targeted to secure those foundations. As shown in the last chapter, business people, politicians, and academics recognised the need for innovation; for better managed and targeted research and development; for new enterprises that would take Japan into the next century. In the government's own words, it was looking to create new ventures that would lift the Japanese economy and carry it forward, moving from a manufacturing age to an information age. From all quarters, the business sector was being urged to think boldly, to show initiative and to be innovative: but funding available for new ventures was limited.

4.20 Many analysts pointed out that public works spending was not necessarily dedicated to projects that were either economically sound or productive in the long run. As late as November 1999, some were calling for an urgent reassessment of the current allocation of projects which 'no longer correspond to the changes in the economic environment and needs of the people'. They insisted that more emphasis must be given to cost-effectiveness and efficiency.¹⁹

4.21 Some highly critical analysts, such as Professor Gavan McCormack, argued that the characteristic of the public works agenda had been 'the capacity to think up a steady flow of projects of sufficient scale to warrant gargantuan outlays of public moneys'.²⁰

4.22 Thus, although the government did direct funds from the rescue packages into spending programs, the funding was funnelled into areas that did not address the pressing problem of consumer demand. Many people cited the large amounts of money that were squandered on the construction industry as the most glaring example of the misguided use of public money. Professor Robert Steven argued '...the big government expenditure program is going into concrete—Japan produces concrete...'.²¹

4.23 Professor Steven suggested that the government should ensure that the packages give priority to consumption rather than investment demand. He explained that the funding going into public work stimulates a whole range of industries related to construction, such as iron and steel, but not 'the white goods industries, which would be consumer goods industries'.²²

19 For Example see Atsushi Takeda, 'Japan Needs More Public Investments and Another Economic Stimulus Package', *DKR Economic Report*, vol. 2, No. 11, 15 November 1999, p. 9.

20 Gavan McCormack, 'Is Japan Facing Financial Armageddon?', *New Asia Pacific Review*, vol. 3, no. 2 1997, p. 13.

21 Professor Robert Steven, *Committee Hansard*, 14 April 1999, p. 289.

22 Professor Robert Steven, *Committee Hansard*, 14 April 1999, p. 299.

4.24 Mr Peter McGill observed that national development and Keynesian pump-priming have long been cited as justifications for the injection of public money into the economy. He pointed out, however, that critics now charge that:

...public works projects are increasingly ineffective as economic stimulants, and serve largely as fodder for construction companies and as reward from politicians to their constituencies in a brazen exchange for votes. The visible result is that the Japanese archipelago has been inundated with public works of questionable utility. At vast expense of labor, technology and money, tunnels, suspension bridges, high-speed railway lines, expressways and airports have been built to connect small communities.²³

4.25 According to Mr McGill, the construction lobby in Japan was so powerful that it shrugged off even the most vociferous and well-founded criticism.²⁴ In Mr David Hale's words, fiscal stimulus in Japan meant 'just a lot of public works spending...basically campaign contributions to the Liberal Democratic Party.' Put succinctly, 'A lot of concrete has been poured into a lot of silly places...'²⁵

4.26 This policy of funding industries, such as the construction industry, not only propped up an industry unlikely to provide the necessary boost for economic recovery but also absorbed limited funds that could have gone toward areas with the potential to lift and sustain economic growth.

4.27 Mr Bradley Treadwell pointed out that domestic pump priming, particularly into areas such as construction, did not foster a vibrant efficient and competitive market and moreover it worked against change. He stated 'What you find traditionally under the current political system is a propensity to spend money on construction; new roads going nowhere, new shinkansen lines going up all over the place, and new mammoth bridges being built in particular areas.' For him there was no incentive for change.²⁶

4.28 Professor Osamu also noted the unnecessary wastefulness in not providing encouragement to areas with the potential to reinvigorate the economy:

When we look ahead to the twenty-first century and think about which industries will have the capacity to maintain a sustained expansion once again, we find that the construction industry will not be among them. But it is this industry that benefits when the government opens its purse, whether

23 Peter McGill, 'Paving Japan—the Construction Boondoggle', *Japan Quarterly*, October–December 1998, p. 40.

24 Peter McGill, 'Paving Japan—the Construction Boondoggle', *Japan Quarterly*, October–December 1998, p. 40.

25 David D. Hale, Global Chief Economist, Zurich Insurance Group, 'The Financial Crises in Japan and Asia: A Financial Insider's View', Japan Economic Institute Report, No. 36A, 25 September 1998, p. 3. See also Christopher Pokarier, *Committee Hansard*, 16 April 1999, p. 428.

26 Bradley Treadwell, Osborne Associates, *Committee Hansard*, 19 February 1999, p. 68.

the spending is called public works investment or dressed up in fancier terms, such as ‘industrial infrastructure installation’.²⁷

He made the point that such spending would only coddle an industry that desperately needs restructuring and went on to explain:

New demand-side measures designed to deliver short-term stimulus will make no contribution to the reforms Japan is most in need of. All they may do is preserve firms that have little competitive power. What is needed today is a clear sense of where Japan needs to go, along with a coherent set of policies for getting there.²⁸

Stimulus fatigue

4.29 The Japanese Government clearly articulated its intention to lift demand through its stimulus packages but its application was not supported by clear and well-directed plans. A distinct pattern emerged where, despite the short-term boost to the economy, the effects of the fiscal stimulus soon faded, enthusiasm waned and the economy relapsed into low or negative growth.

4.30 Thus, the credibility of the government’s fiscal policy was brought into question with the introduction of each stimulus package. Exaggerated statements concerning the real amount of stimulus, the inflated expectations generated by the overblown rhetoric and the concentration on public works construction that had become increasingly unproductive—roads, railroads, bridges to nowhere—had little effect in lifting consumer demand.²⁹

4.31 This loss of faith in the effectiveness of stimulus packages was very evident with the announcement of the April 1998 package. Despite being the largest fiscal stimulus package to that date, its reception was lukewarm. The Economist Intelligence Unit suggested that, by this time, the Japanese markets were suffering from ‘stimulus fatigue’. It noted that, even as the Prime Minister was announcing the package, the Nikkei average of 225 leading stocks listed on the first section of the Tokyo Stock Exchange dropped around 50 points and the yen fell against the dollar. Put bluntly, the investors were ‘simply no longer willing to accept the government’s statements at face value and wanted to hear details regarding how the money would be spent’.³⁰

27 Nariai Osamu, ‘Restructuring in a Deflating Japanese Economy’, *Japan Echo*, August 1998, p. 37. See also Comments of Professor Kazutoshi Kase, Tokyo University and Kenneth Curtis, transcript of ‘Dateline’, 5 June 2000.

28 Nariai Osamu, ‘Restructuring in a Deflating Japanese Economy’, *Japan Echo*, August 1998, p. 39.

29 Hugh Patrick, ‘The Causes of Japan’s Financial Crisis’, *Pacific Economic Papers*, no. 288, February 1999, p. 1.13. Just before the announcement of the November 1999 stimulus package a number of economists were calling on the government to introduce another stimulus package as the effect of the earlier ones would begin to taper off. See *DKR Economic Report* vol. 2, no. 11, 15 November 1999, pp. 8–9.

30 The Economist Intelligence Unit Ltd, *EIU Country Report*, 2nd Quarter, 1998, p. 19.

4.32 Keidanren also drew attention to a public and market place growing increasingly weary with the announcement of each record breaking stimulus package despite the mounting sense of urgency. It pointed out that these economic policy packages have remained powerless and their ineffectiveness has led to observations abroad that Japan is suffering from ‘package fatigue’. It pointed out that ‘The policy packages introduced up to now in 1998 have swollen to the size as large as ¥16 trillion, but the continued fall of the yen and share prices is indicative of how strong distrust of such packages has grown’.³¹

4.33 Clearly enthusiasm for the packages soon fizzled and people were becoming increasingly cynical with the government, and stale, recycled policies together with a lack of imagination and aggression in tackling the difficult economic situation. Jon Choy observed:

Fiscal stimulus plans have appeared with such clockwork regularity in the 1990s that each successive package somehow must be bigger or better to achieve the desired level of attention. Clearly, there is an upper limit to how much can be added to public works budgets. The ¥16 trillion edition may have hit this ceiling.³²

4.34 It did not. The November 1998 package, with the inclusion of a tax reduction measure, reached the record amount of over 20 trillion yen. Twelve months later, in anticipation that the effects of this package would taper off, the government announced its ‘Economic Rebirth Package’ worth close to 18 trillion yen. It was to be a breathtaking initiative that ‘responds to the expectations of the people of Japan and can be fully comprehended both in Japan and abroad’.³³ But one editorial greeted the initiative with disdain stating, ‘Removing the make-up, however, reveals a parade of the same old public works projects.’³⁴ In brief, the constant flow of stimulus packages not only reduced their ‘novelty and impact’ but also eroded the public’s trust in the competency of the administration.³⁵

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- 31 Keidanren, ‘A Prescription for the Revitalization of the Japanese Economy’, 23 October 1998, The 21st Century Public Policy Institute, <http://www.keidanren.or.jp/21ppi/english/policy/19981023/recommendation.html> (2 February 1999). Mr Manuel Panagiotopoulos also commented on the lack of enthusiasm for the packages—‘Even some of these meagre growth rates were achieved through massive injections of public funds, which, however, proved to have mainly short-term effects. It is more than likely that the latest such package, a combination of temporary tax cuts and public works will have a similar fate’, submission no. 9, p. 3.
- 32 Jon Choy, ‘Japanese Fiscal Policy: One Foot on the Gas, the Other Tied to the Brake’, *JEI Report No. 16A*, 24 April 1998, p. 11.
- 33 Policy speech by Prime Minister Keizo Obuchi to the 146th session of the Diet, 29 October 1999, <http://www.kantei.go.jp/foreign/souri/991029policy.html> (15 November 1999).
- 34 Editorial, *Asahi*, 12 November 1999, p. 5 in Daily Summary of Japanese Press, 16 November 1999, American Embassy Tokyo, <http://wnsv.iuj.ac.jp/subscription/DailySummary/0544.html> (18 November 1999).
- 35 Jon Choy, ‘Japanese Fiscal Policy: One Foot on the Gas, the Other Tied to the Brake’, *JEI Report No. 16A*, 24 April 1998.

4.35 While the implementation of fiscal stimulus packages since 1992 saved the economy by enabling it to mark time, the failure of these initiatives to put the economy back on a steady growth track fed scepticism about the continuation of this approach. This disenchantment with government policy, fuelled the already serious problem of low consumer confidence which translated into weak domestic demand.

Low consumer confidence

4.36 By adopting a fiscal expansionary policy, the government hoped to encourage and sustain domestic demand. To date, the policy has not worked. The lack of success in boosting consumer spending is not, however, attributable solely to shortcomings with the packages. Highly sceptical and with their confidence in the future shaken, people have deliberately chosen to save and not spend.³⁶ Mr Jim Storey summarised the situation:

As quickly as new money is introduced into the economy, consumers save it and capital-strapped banks refuse to lend out the new deposits, preferring instead to purchase government bonds.³⁷

4.37 Consumer confidence is fundamental to any economic recovery; it provides the necessary incentive for business to expand and grow. Once lost, it is difficult to rekindle and moreover to sustain but, once firmly in place, it is a very powerful and positive force.³⁸ Consumer confidence has been falling in Japan since the bubble economy burst. But even with some encouraging indications of an economic revival, the Bank of Japan concluded as late as March 2000 that there were no clear signs of a self-sustained recovery in private demand.³⁹ Two months later, the Bank reported that a rally has been observed in some areas of private demand but that 'it may take some time for households' income conditions to improve and, in turn, for private consumption to recover'.⁴⁰

4.38 This collapse in consumer confidence has created a strong reinforcing cycle of lower demand, falling sales, rising inventories, shrinking profits, lower wages and fear of unemployment which, in turn, breeds greater insecurity, further eroding consumer confidence. The cycle feeds upon itself. The more anxious the Japanese people become about their future, the more tightly they hold on to the purse strings and the longer domestic demand remains depressed.

36 See Professor David Reid, *Committee Hansard*, 25 February 1999, p. 192.

37 Jim Storey, Asia Pacific Foundation of Canada Round-table Report, 'Japan at the Crossroads?', March 1999, no. 9, p. 2.

38 See the ideas of Dr Helmut Sohmen, 'PBEC in a Changing World', 17 May 1999, PBEC: Speeches & Editorials: 1999, <http://www.pbec.org/speeches/1999/990517helmut.htm> (20 September 1999).

39 Bank of Japan, Monthly Report of Recent Economic and Financial Developments, January and March 2000, <http://www.boj.or.jp/en/siryo/siryo/gp9910.htm>.

40 Bank of Japan, Monthly Report of Recent Economic and Financial Developments (May 2000).

4.39 There are a number of forces at work in Japan giving rise to feelings of uncertainty and insecurity. Shifts in employment patterns and changing demographics with a falling birth rate and a rapidly ageing population have disturbed the status quo and present new challenges. These trends worry people, gnaw at their faith in the economy's ability to prosper and to provide for all. Thus many people, as well as preserving their existing savings, prefer to save any benefit from tax relief or additional earnings.⁴¹ The most immediate source of concern for the Japanese people is the high rate of unemployment.

Fear of unemployment

Unemployment rates

4.40 The unemployment rate in Japan has ranged from 3–3.5% in past years. In April 1998, however, the unemployment rate reached 4.1%, which was the worst result to that time since the figures were first calculated in 1953.⁴² More recently, due to the deepening recession, unemployment figures have continued to rise. They reached 4.3% in August and September 1998 until finally they climbed to a record high in June 1999 with the worst-ever figure of 4.9%.⁴³

4.41 The official unemployment figure may seem low but these statistics mask a more serious unemployment situation. It is generally assumed that the official rate underestimates the level of unemployment and does not indicate the extent of underemployment. Unofficial estimates put the Japanese jobless at a much higher rate since labour market practices in Japan mean that workers can be idle or virtually unemployed without appearing to be so in the official statistics.⁴⁴ A number of analysts also pointed out that Japan's official figures exclude many people who want jobs, but are not registered as job seekers.⁴⁵

4.42 On a practical level, the recession has reduced the incomes of many would-be consumers. The slowdown in production has resulted in a reduction in take home pay while falling corporate profits have kept bonuses from rising. Households have lost

41 See Christopher Pokarier, submission no. 10, p. 4 and *Committee Hansard*, 16 April 1999, p. 427.

42 Queensland Government, submission no. 18, p. 24.

43 JETRO, 'Japan's Economy Present Situation and Prospects, 1998'; Dai-ichi Kangyo Research Institute, *DKR Economic Report*, vol. 2, no. 10, 15 October 1999. Recent unemployment figures are: 4.9% for February and March 2000, and 4.8% for April 2000. See *DKR Economic Report*, vol. 3, no. 7, 15 July 2000, p. 10.

44 Luke Gower, 'What has Become of the Japanese Model?', *Agenda*, vol. 5, no. 1, 1998. See also Professor David Reid, *Committee Hansard*, 25 February 1999, p. 194; and Tadashi Nakamae, 'Japan's Impending Financial Crisis will Expedite the Necessary Shift of Resources from the Old to the New Economy', Presentation for the OECD Business and Industry Forum on Realising the Potential of the Service Economy: Facilitating Growth, Innovation and Competition, 28 September 1999.

45 Brink Lindsey and Aaron Lukas, 'Revisiting the "Revisionists": the Rise and Fall of the Japanese Economic Model', Centre for Trade Policy Studies, 31 July 1998. Yashiro Naohiro, 'Understanding Japan's Unemployment', *Japan Quarterly*, October–December 1998.

income from diminished casual and part-time employment opportunities, in particular, for female employees.⁴⁶ Mr Darryl McGarry submitted:

With full-employment, the regular provision of bonuses was a substantial and regular kick for the economy. With the economic downturn, the size of bonuses has been hit and increasingly bonuses have been done away with by corporations in response to tapered profitability while attempting to maintain the level of employment and remain in business.⁴⁷

4.43 Despite indications of a strengthening Japanese economy, the total amount of wages in 1999, even with an increase in overtime payments, was still declining because of the fall in bonus payments.⁴⁸ For a people accustomed to lifetime employment, the growing number of unemployed, together with the closure of businesses and the sale of assets, has a deeply negative influence on consumer sentiment.

Structural changes in the labour force

4.44 The employment situation in Japan is further complicated by economic, commercial and demographic pressures, which have led to structural changes in the workforce. These shifts in Japan's labour market have given rise to an unprecedented level of insecurity in the workplace.

4.45 After World War II, Japan built up an employment system whereby, once full-time employees were hired, they tended to remain with the company as a family member until they reached retirement age. Minister Taichi Sakaiya argued that this gave credence to the 'full employment myth' which held that Japan would never experience serious unemployment problems.⁴⁹ It gave the Japanese people a sense of security. During the 1990s, however, business was beginning to realise that lifetime employment, especially with practices such as wages based on seniority, was becoming 'a drag on Japanese production systems because they just cannot maintain an increasingly highly paid workforce at senior levels'.⁵⁰

46 Manuel Panagiotopoulos, submission no. 9, pp. 64–5; Christopher Pokarier, submission no. 10, pp.78–9.

47 Darryl McGarry, McGarry International Pty Ltd, supplementary submission no. 14A; also see *DKR Economic Report*, vol. 2, no. 11, 15 November 1999, p. 2.

48 Dai-Ichi Kangyo Research Institute, *Economic Report*, 15 October 1999, p. 2. JEI's Spin on the News, 8 October 1999 stated 'According to a mid-July survey of 1,164 firms by Nihon Keizai Shimbun, the average salaried Japanese worker's summer bonus was ¥720,046, a decline of nearly 5.8 percent from the year before. The drop was the largest since the leading Japanese economic daily began conducting such surveys in 1975 and was the first fall in five years...'

49 Taichi Sakaiya, 'The Present and Future of the Japanese economy', Singapore, 1 September 1999, <http://www.epa.go.jp/99/b/19990903b-daijinkouen-e.html> (1 October 1999).

50 Krishan Arun Radha, *Committee Hansard*, 24 February 1999, pp. 109–10. Mr Christopher Pokarier notes that lifetime employment is a misnomer; that the average retirement age for a core employee in a Japanese firm was between 52 and 55, and further that an employee could not access pension entitlements until 65, so a post retirement income position was important, *Committee Hansard*, 16 April 1999 p. 427. See also Professor Alan Rix, who noted that the notion of lifetime employment has gone

4.46 The corporate ‘hoarding’ of employees, where Japanese companies are likely to keep their workers on the payroll in recession even though it results in significantly lower profits, is another practice peculiar to Japan.⁵¹ But, as economic conditions have changed, such practices are being acknowledged as economically unsound and, despite a long tradition, the expectation of lifetime employment, a fundamental tenet of Japanese economic life, is being set aside. Companies, finding that they cannot survive in the market place without restructuring their workforce, are making the hard decision to retrench people. In simple terms, ‘the full employment myth has finally passed away’ leaving the Japanese people confused about shifting values and worried about future trends.⁵²

4.47 The employment situation in Japan certainly exposes the tension between strongly held traditional views and those of a new emerging corporate world where market forces and not time-honoured values such as loyalty and social responsibility dictate employment practices. Thus, at this time in Japan anxiety about job security is being heightened by a recession that has meant the shedding of jobs, the loss of overtime and reduced bonuses. The dismantling of a well-established and valued system of employment only further exacerbates people’s fears.

4.48 In such a climate of uncertainty, people will tend to be very cautious about spending. As long as they harbour misgivings about their future employment prospects, they will keep a watchful and nervous eye on their income and savings. Uncertainty ‘is paralysing individuals in their spending profile’; they will choose to stockpile rather than spend.⁵³ The current push for structural reform is simply fuelling the prevailing unease about Japan’s unemployment situation and, as a result, further dampening domestic demand.⁵⁴

and cited the retiring age as 53, *Committee Hansard*, 16 April 1999, p. 451; Hiroshi Nakano, Japan External Trade Organisation, Sydney Inc, *Committee Hansard*, 3 September 1999, pp. 787–8; Fuyuki Kitahara, Japan Chamber of Commerce and Industry, *Committee Hansard*, 3 September 1999, p. 808.

- 51 Yashiro Naohiro, ‘Understanding Japan’s Unemployment’, *Japan Quarterly*, October-December 1998.
- 52 Taichi Sakaiya, ‘The Present and Future of the Japanese Economy’, Singapore, 1 September 1999, <http://www.epa.go.jp/99/b/19990903b-daijinkouen-e.html>, (1 October 1999). The public acknowledgment of the end of this tradition is clearly spelt out in the November 1999 policy measures for Economic Rebirth which asserted that talent-based system and performance based system would be the guiding principle for employment practices. ‘Principles of the Policy Measures for Economic Rebirth’, explanatory statement by Minister Taichi Sakaiya, (provisional translation), 11 November 1999, <http://www.epa.go.jp/99/b/1999b-taisaku-el.html> (15 November 1999).
- 53 See Christopher Pokarier, *Committee Hansard*, 16 April 1999, p. 426; Dr Christopher Rawlings, QCT, *Committee Hansard*, 16 April 1999, p. 504.
- 54 See Susumu Taketomi, ‘The Current Economic Situation in Japan and its Future’, Bank of Japan, Speeches, Economic Seminar on the Japanese Economy in Bangkok, 29 June 1998, <http://www.boj.or.jp/en/press/koen023.htm> (18 January 1999). See also Christopher Pokarier, submission no. 10, pp. 3–4.

Ageing society

Demographic trends

4.49 The redefining of long-standing employment practices as well as the actual reshaping of the labour force is taking place as concerns about the ageing population are mounting. This combination only adds to people's worries.

4.50 Of major concern to the Japanese people are the demographic trends showing a declining birth rate, now at 1.38 children per female; an ageing of society; and a shrinking population. The population aged 65 and over will increase from 14.6% of the total population in 1995 to 26.9% in 2020 and 32.3% in 2050, the highest percentage in the world. Concomitantly, the productive population (ages 15 to 64) has been decreasing since peaking in 1995 and is estimated to fall 16% by 2020 and approximately 43% by 2050. The decline in birth rates combined with an ageing population is expected to have a major effect on Japan's macroeconomic environment.⁵⁵

4.51 The ageing of the population is progressing in Japan at a pace that is without parallel in the rest of the world. Such a trend suggests not only a decrease in the working population but also a rise in the public burden due to increased social security expenditures. Within two decades, the future ratio of workers to pensioners will be reduced by approximately half of the present level. Currently each elderly person in Japan is supported by slightly less than five working age persons. By the year 2015, Japan will have approximately 2.5 persons to support each elderly person and, by the year 2025, the ratio will drop to 2.2 persons. Clearly, the rate of dependency is increasing rapidly.⁵⁶ As summarised by economic journalist, Mr Luke Gower, 'Aging implies a rising dependency ratio, which will inflate expenditure on social security for the elderly and ultimately increase the tax burden'.⁵⁷

55 See General Survey, Bulletin, vol. 38, no. 9 September 1999. It stated that Japan's total fertility rate has continued to fall since 1973 when it reached 2.14 during the second baby boom. See also Arun Radha Krishan, 24 February 1999, *Committee Hansard*, p. 109; Fuyuki Kitahara, Japan Chamber of Commerce and Industry, Sydney Inc., *Committee Hansard*, 3 September 1999, p. 803; Dr Carolyn Stevens, *Committee Hansard*, 17 May 1999, p. 571. The Department of Family and Community Services gave the following predictions for the proportion of the population aged 65 and over from 7% in 1970, through about 15.4% in 1997 and 28% by 2030, Graeme Hope, Department of Family and Community Services, *Committee Hansard*, 21 June 1999, p. 745. See also Ministry of Health and Welfare, Section 1. The public Pension System: Its Significance and Mechanism, *White Paper*, http://www.mhw.go.jp/english/white_p/book1/p2_c2/c2_sect1.html (23 June 2000)

56 Commonwealth Department of Social Security, submission no. 19; p. 2. See also Jill Miller, *Committee Hansard*, 24 May 1999, p. 587; Department of Family and Community Services, *Committee Hansard*, p. 745. Yuichi Shionoya, 'Japan's Grand Reforms: From an Economic, Social and Political Perspective', Transcript of a speech delivered on 12 May 1997 at Asia Foundation and Public Policy Institute of California, http://www.infojapan.org_info/japan/socsec/shionoya.html (29 October 1999).

57 Luke Gower, 'What has Become of the Japanese Model?', *Agenda*, vol. 5, no. 1, 1998, p. 67. See also Professor Tessa Morris-Suzuki, submission no.3, pp. 3-4.

4.52 Thus, the ageing population is a major preoccupation for Japanese political and business leaders aware that it will have a significant effect on the welfare budget and government outlays as well as on the structure of the labour force and changing patterns in consumer demand.⁵⁸ The increasing welfare burden is of particular concern to the government, which is facing the responsibility for meeting the needs of an older population but with a shrinking revenue base as the labour force contracts. According to MITI:

...the consequent increase in such public burdens as taxes and social insurance premiums may weaken the international competitiveness of Japanese business corporations by pushing up wage costs and may eventually hamper the growth of the Japanese economy. Given such prospects, it is a matter of urgency that a system be established which will minimise the public burden.⁵⁹

4.53 The Japanese people are also worried about the effects of a rapidly ageing population. They have the longest average life expectancy in the world, 83 years for women and 77 years for men, and are acutely mindful of this fact. They are also aware of the trend towards population ageing with fewer children. But at the moment they do not feel confident that adequate measures are in place to ensure that they will be looked after in their retirement. Concerned about providing for an uncertain future, they prefer to save precisely at a time when increased consumption is needed to re-boot the economy.⁶⁰

4.54 According to Mr Christopher Pokarier, state-backed pensions and aged care facilities are limited and yet are still expected to become a major drain on public revenues at current contribution levels. It has been estimated that pension contributions will increase from their current level of 17.35% to 27% of monthly wages by 2015.⁶¹ The ailing financial system has also raised doubts about the soundness of private pension products. Mr Pokarier stated:

More generally, in the wake of the revealed failures of regulators to engage in adequate prudential supervision of banks and other financial institutions many Japanese citizens hold a residual fear for the security of private

58 For example see, Professor Alan Rix, *Committee Hansard*, 16 April 1999, p. 442.

59 Yashiro Naohiro, 'Need for Structural Reform of the Economy', *Journal of Japanese Trade & Industry*, no. 3 1998; General Affairs Division, Industrial Policy Bureau, Ministry of International Trade and Industry, 'An Outline of Economic Structure Reform', *Journal of Japanese Trade & Industry*, no. 3, 1998. On pensions see also Ryoichi Tsunematsu, Japan Chamber of Commerce, Sydney, Inc, *Committee Hansard*, 3 September 1999, p. 804.

60 Professor Tessa Morris-Suzuki, submission no. 3, p. 4. See Special Topic, Noriyasu Watanabe, 'Occupational Pension Systems in Japan', *Japan Labor Bulletin*, vol 37, no. 8, August 1998, <http://www.jil.go.jp/bulletin/year/1998/vol37-08/04.htm> (22 November 1999); Professor Akira Goto, *Committee Hansard*, 23 August 1999, p. 777.

61 Christopher Pokarier, submission no. 10, p. 4. See also Professor Tessa Morris-Suzuki, submission no. 3, p. 4; Charles Yuji Horioka, 'Japan's Public Pension System in the Twenty-First Century', Discussion Paper no. 482, Institute of Social and Economic Research, Osaka University, June 1999, p.21.

retirement funds. Amongst current retirees, extremely low interest rates means that people are consuming their capital and this contributing to not only their own sense of diminished wealth but of those who might inherit from them as well. Falls in land prices, which some people have used as a savings vehicle in response to the burden of inheritance taxes, have further exacerbated this sense of being less well off.⁶²

4.55 There is no doubt that people fear for their pensions. In particular, most Japanese private sector employees suspect that the corporate sector pensions that they had been expecting until just a few years ago are no longer deliverable.⁶³ They are also anxious about their jobs, and they know that the demographic trends pose problems for the future, giving rise to ‘a worried consumer sector’.⁶⁴ The government is acutely aware of the uncertainty and loss of confidence prevailing throughout the country. Minister Yosano stated:

The emphasis is thrown entirely on potential future risks to the general welfare of the people, such as health insurance and pensions, which together with the series of failures of major companies...has left the people of Japan with an extremely negative mindset.⁶⁵

4.56 While Japan’s changing demographic profile will result in a tightening labour market by the end of the decade, the uncertain prospects for many firms and industries in the short term continues to dampen consumer sentiment. The unease felt by many of Japan’s baby boomers about their financial prospects lies at the heart of the government’s repeated failed attempts to boost aggregate demand in Japan.⁶⁶

4.57 In summary, amid mounting uncertainty regarding the future of Japan’s economy, Japan’s household consumption has slumped while the savings rate has been increasing from 1990. A study by the Bank of Japan revealed the depth of concern in the community about the future of Japan’s economy. The middle-aged and elderly low-income households feel anxious about employment conditions; the young

62 Christopher Pokarier, submission no. 10, p. 4.

63 The EIU noted that there are fears that ‘many corporate pensions are now severely under-funded and unable to meet future obligations’. *The Economist Intelligence Unit’s Country Analysis, Japan*, 2000, p. 40. See also Olivia S. Mitchell, ‘Managing Pensions in the 21st Century: Design Innovations, Market Impact, and Regulatory Issues for Japan’, Pension Research Council, PRC WP 99–20, University of Pennsylvania, August 1999, p. 1.

64 Peter Hartcher, *Committee Hansard*, 15 April 1999, p. 326. See also Jill Miller, *Committee Hansard*, 24 May 1999, p. 587 and Ryoichi Tsunematsu, Japan Chamber of Commerce and Industry, Sydney Inc., *Committee Hansard*, 3 September 1999, p. 804.

65 Kaoru Yosano, ‘Japan’s Challenge Toward the 21st Century’, Speech at the Foreign Correspondents’ Club of Japan, 18 December 1998.

66 Christopher Pokarier, submission no. 10, p. 4; Professor Teresa Morris-Suzuki, *Committee Hansard*, 24 May 1999, p. 606.

households are worried about the pension systems and the elderly households are very concerned about nursing care.⁶⁷

4.58 This study concluded that people from a wide cross-section of the Japanese community are apprehensive about their future and that their fears touch specifically on their financial security and their ability to provide for themselves as they age. Clearly, the government has a major task in convincing the Japanese people that the economy will pick up, employment rates will rise, pension funds are both adequate and safe and that the nation can meet the needs of its elderly citizens.

4.59 The issue of aged care, in particular, is looming as a major problem for Japan. Official studies have suggested that the current national health insurance schemes are currently not viable at present charges against the projected growth in costs, despite the reform measures adopted that imposed additional costs on the elderly. The rising dependency ratio and the increasing welfare burden raises the question of whether or not Japan will be able to support the current level of social welfare benefits for its elderly population in the future. These issues have led to concerns about aged care facilities and health care and are a leading motivator behind the national emphasis on saving for the future.⁶⁸ The Ministry of Health and Welfare noted:

Today, the long-term care issue is the largest cause for concern of the Japanese people about their post-retirement life. In the year 2025, the continually aging population is predicted to make the number of people requiring long-term care to 2.6 times that in 1997, or 5.2 million people. Also, the period of time long-term care is required and the age of those caring for the elderly will increase. Therefore, long-term care for bedridden and senile elderly people will become a critical issue.⁶⁹

4.60 Ms Jill Miller told the Committee that the aged, who make up around 14 per cent of the population, account for 35 per cent of medical costs.⁷⁰ Mr Pokarier suggested that a more serious commitment by government to provide access to affordable aged care in the future and the immediate protection of the retirement savings of those who are now middle-aged might help boost consumer sentiment amongst those Japanese with the greatest capacity for discretionary spending. Put bluntly 'It would certainly do more than continued public sector spending on infrastructure projects of dubious worth'.⁷¹

67 Shinobu Nakagawa, Bank of Japan, Research Papers, 'Why has Japan's Household Savings Rate Remained High even during the 1990?: Empirical Analysis on Risk Bias Viewed by the Characteristics of the Household Sector', July 1999.

68 Queensland Government, submission no. 18, p. 23. See also The Japan Research Institute Ltd, Economics Department, 'Prospects for the Japanese Economy', January 1999, p. 5.

69 Ministry of Health and Welfare, 'Structural Reform of the Social Security Programs for an Aged Society with Fewer Children: 1990–Present', [1997] http://www.mhw.go.jp/english/ssp_inj_/services/6th.html (29 October 1999).

70 Jill Miller, *Committee Hansard*, 24 May 1999, p. 587.

71 Christopher Pokarier, submission no. 10, p. 5.

4.61 Mr Pokarier also drew attention to the problem of the escalating public debt, noting that further expansion of this debt to invigorate the economy might be largely self-defeating if ‘it is widely perceived that the government’s implicit underwriting of private savings and its capacity to invest in aged care are diminished’.⁷²

Government deficit

4.62 Although pushed from centre stage for the time being by the more pressing need to revitalise the economy, the nation’s public debt lurks menacingly in the wings as another serious problem.⁷³ This issue was openly discussed by officials during 1997 when the economy held promise of a recovery and the government had the confidence to air the matter of fiscal restructuring. At this time, Prime Minister Hashimoto made clear that:

With Japanese society aging at a pace unprecedented anywhere else in the world, if we leave the fiscal structure in its present state and invite further expansion of the fiscal deficit, the economy and welfare of the Japanese people in the 21st century will be destined for failure. Under these conditions, we must take every possible step and devote all efforts toward the realization of vitalized and prosperous lives for the Japanese people.⁷⁴

In the clearest of terms, he argued that if Japan did not reform its fiscal structure, it would pass on to its children ‘an unbearable burden’.⁷⁵

4.63 This situation has not changed. Indeed, the debt has continued to grow. Since the recession deepened in 1997, the urgent and immediate task of keeping the economy afloat has assumed precedence over considerations of public debt. The government looks to fiscal stimulation to rescue the economy.

72 Christopher Pokarier, submission no. 10, p. 5.

73 Professor Gavan McCormack is one of the most vocal analysts concerned about Japan’s large public debt. In 1997 he pointed out that ‘a level of public indebtedness running at around a quarter of any country’s GDP would be regarded as serious; in Japan’s case, it is more than one quarter of global GDP’. Gavan McCormack, ‘Is Japan Facing Financial Armageddon?’, *New Asia Pacific Review*, vol. 3, no. 2 1997, p. 10 and *Committee Hansard*, 24 May 1999, p. 617–19. He provided the following statistics to the Committee: the size of the debt comes to between ¥700 and ¥800 trillion, although some figures put it much higher...the national debt as a percentage of GDP was only 5% in 1965; 21% in 1975; 84% in 1995 and 102% in 1998. Austrade put the government deficit at about 110% to 120% of GDP, *Committee Hansard*, 27 May 1999, p. 643. Dr Aurelia George Mulgan agreed with Austrade’s figures stating that the Japanese government’s financial situation has reached a level of actual bankruptcy in which the accumulated fiscal deficit amounts to about 120% of GDP, *Committee Hansard*, 28 May 1999, p. 679. See also Professor Peter Drysdale, *Committee Hansard*, 23 August 1999, p. 764. Total gross debt of general government (which includes social security) is expected to reach about 114% of GDP in 2000; Peter Jarrett, ‘Japan’s economy: is the sun rising?’, *OECD Observer*, 27 January 2000.

74 Press conference by Prime Minister Ryutaro Hashimoto on the Final Report of the Conference on Fiscal Structural Reform, 3 June 1997.

75 Policy speech by Prime Minister Ryutaro Hashimoto to the 141st Session of the National Diet, 29 September 1997.

4.64 The IMF acknowledged the difficulty for Japan in reconciling the conflicting priorities of stimulating the economy and reducing government expenditure. In October 1998, it noted:

...the current need for fiscal stimulus has to be traded against the requirements for longer-term fiscal consolidation in anticipation of the pressures that will arise from population aging, particularly given that the surpluses in the social security accounts have recently been declining.⁷⁶

4.65 A year on, the problem of the mounting public debt still awaited attention. The OECD observed that ‘earlier counter-cyclical fiscal measures had led to a rapid and worrisome deterioration in public finances, with gross and net debt reaching historically high levels’.⁷⁷ In looking ahead, Mr Atsushi Takeda from the Dai-Ichi Kangyo Research Institute argued that the extremely high level of public investments resulting from the numerous economic stimulus packages must be corrected at some time. Without mincing words, he stated, ‘Should the unbridled fiscal expansion continue, a fiscal meltdown and a heavy burden upon future generations would become unavoidable.’⁷⁸

4.66 Nonetheless, the government remains committed to economic stimulus to revitalise the economy. Minister Taichi Sakaiya made this point clear when he explained Prime Minister Obuchi’s use of the ancient Japanese proverb, ‘He who hunts two hares loses both’ to explain his government’s policy.

The Prime Minister was often criticized for only chasing the hare of economic recovery with expansion of expenditure, so letting the fiscal deficit hare run wild. But I say this criticism was unwarranted. The two hares of economic recovery or economic rebirth and fiscal reconstruction are not running in different directions, but rather moving along the same course, and the Prime Minister was correct. We must first bag the hare of economic recovery and economic rebirth that lies just before us, and only then hunt down the hare of fiscal reconstruction that waits further down the path. If we abandon our economic rebirth measures halfway and rush to increase taxes and resist government expenditures, we surely lose both hares and come home empty-handed.⁷⁹

4.67 People are conscious of the growing deficit. Those saving for retirement realise that if the government borrows a lot of money—spends it—then eventually

76 IMF *World Economic Outlook, Financial Turbulence and the World Economy*, A Survey by the staff of the International Monetary Fund, October 1998, p. 117.

77 *OECD Economic Outlook*, no. 66, preliminary version, November 1999.

78 Atsushi Takeda, ‘Japan Needs More Public Investments and Another Economic Stimulus Package’, *DKR Economic Report*, vol. 2, no. 11, 15 November 1999, p. 9.

79 Taichi Sakaiya, Minister of State, Economic Planning Agency, Government of Japan, ‘The Present and Future of the Japanese Economy’, Speech at Yale University, New Haven, Connecticut, May 2000, <http://www.epa.go.jp/2000/b/0505b-daijinkouen-e.html> (5 July 2000).

they will have to raise taxes.⁸⁰ They are aware of the trend towards population ageing and fewer children and the increasing demand this will place on the welfare budget as well as the more immediate problem of the deteriorating fiscal situation. The government understands the need to address public concern over the future of the social security system.⁸¹ The Ministry of Health and Welfare acknowledged:

Japan's finances are in a grave situation. Amidst such a state, concerns are beginning to emerge that the burden of whatever scale the future of social security takes may likely become a limiting factor in maintaining an energetic society and economy.⁸²

4.68 For the moment, the issue of public debt may be kept in the shadows, but it remains another unresolved difficulty that plays on the minds of decision-makers and, more generally, troubles the Japanese people.

4.69 But at a time when the Japanese people are looking for reassurance about their long-term security, as they search for guarantees and look to their leaders for sound and strong leadership, they are disappointed. Scandals that have involved the bureaucracy, indecisive leadership, policy inconsistency, and mounting public debt only deepen their doubts about their futures. The government faces a difficult job in winning the confidence of a highly wary people, particularly in light of its own performance.

4.70 Without doubt, the people's trust in Japan's policy-makers has been seriously tested. Japan's leaders are yet to provide a clear or coherent vision of where they hope to take the country. But officials, academics, journalists and politicians are constantly reminding the people that the world is changing. They argue that Japan and its people must adjust if the nation is to retain its place as a leading economy in the coming decades. At this critical juncture in Japan's history, its leaders are still struggling to meet the challenges of reviving a sluggish economy in a changing world. The stream of fiscal stimulus packages introduced by the government, rather than offer some respite for an anxious people, have raised further doubts about the ability of the administration to deal with the difficulties ahead. Moreover, their failure to secure the full support and trust of the people on fiscal policy has been compounded by their failure to resolve problems in other areas. The response to the bad loan problem, for example, and their mishandling of sections of the banking system has generated further misgivings about the government's ability to come to grips with the economic problems facing the country.

80 Christopher Pokarier, *Committee Hansard*, 16 April 1999, p. 428; and submission no. 10, pp. 4–5.

81 Ministry of Health and Welfare, 'Structural Reform of the Social Security Programs for an Aged Society with Fewer Children: 1990–Present', http://www.mhw.go.jp/english/ssp_inj_services/6th.html (29 October 1999).

82 Ministry of Health and Welfare, 'Structural Reform of the Social Security Programs for an Aged Society with Fewer Children: 1990–Present', http://www.mhw.go.jp/english/ssp_inj_services/6th.html (29 October 1999).

4.71 Even in the face of crisis, the administration has responded slowly. The banking industry, which has provided a most glaring example of the ‘muddling on’ approach, has only recently felt the firm hand of government intervention on its shoulder. Despite the growing seriousness of the problem, the regulatory authorities failed to acknowledge the full magnitude of the banking crisis and were reluctant to act decisively to fund major financial restructuring.⁸³ In September 1998, the Governor of the Japan Bank voiced his irritation at the failure of government to put in place full disclosure of non-performing loans that were to him a prerequisite for disposing of bad debts and a necessary step to restore confidence in the economy. He stated, ‘I find it very frustrating to see this situation unrectified fully seven years after the collapse of the bubble economy’.⁸⁴

4.72 The Ministry of Finance, the primary regulatory agency, initially adopted a ‘forbearance policy’ toward the non-performing loan problem. Clinging to the hope of a quick economic recovery and an improvement in the real estate market, it allowed banks to hold non-performing loans without special write-offs.⁸⁵

4.73 Professor Freedman endorsed this view that the Ministry was out-of-touch. He told the Committee that despite the mounting crisis in the banking system:

The Ministry of Finance treated this sector with great gentleness reminiscent of a Japanese mother with a slightly wayward son...essentially, the belief was that the economic growth would wash away these temporary financial difficulties if officials could manage to muddle through and cover things up in the interim period.⁸⁶

4.74 Less charitably in July 1998, Mr Douglas Ostrom called this approach the ‘crossed-fingers strategy’ and argued that the Ministry of Finance adhered to this policy throughout the early to mid-1990s. Moreover, he suggested that they may still have their heads in the sand.⁸⁷

4.75 With hindsight, officials now recognise, in public at least, the folly in assuming that one way or another the economy, particularly the banking system, would right itself. Mr Taichi Sakaiya explained ‘...it was as if the managers of financial institutions and the bureaucrats responsible for supervising the financial

83 See for example, Michael Hutchison and Kathleen McDill, ‘Predicting Banking Crises: Japan’s Financial Crisis in International Comparison’, *Pacific Economic Papers*, no. 289, Australia-Japan Research Centre, March 1999, p. 22.

84 Masaru Hayami, ‘Issues Regarding the Japanese Financial System and Monetary Policy’, Bank of Japan, Governor’s Speeches, 11 September 1998.

85 See Thomas Cargill, Michael Hutchison and Takatoshi Ito, ‘Japanese reregulation: What You Should Know’, Japan Information Access Project, <http://www.nmjc.org/jiap/deregulate/papers/deregcon/hutchison.html> (1 March 1999).

86 Dr Craig Freedman, *Committee Hansard*, 15 April 1999, p. 342.

87 Douglas Ostrom, ‘Japan’s Banks and the Bad-Loan Problem: the Nightmare Continues’, Japan Economic Institute Report, No. 25A, 3 July 1998, p. 9.

industry were treating a festering internal infection, but relied on prayer because they were afraid to perform surgery'.⁸⁸

4.76 The neglect and mismanagement of this urgent banking problem certainly exposed a level of incompetence among some sections of the bureaucracy that only further damaged consumer confidence. The exposure of an underworld of corruption and scandal that touched a number of officials at the highest levels of the administration, however, proved far more disheartening for the people of Japan.

Scandals

4.77 For many years, authorities had turned a blind eye to the close relations between business and the bureaucracy; a relationship in which lavish rewards by corporations to government officials were a significant feature. By the late 1990s, a steady trickle of scandals involving officials at the highest levels of the bureaucracy came to public attention provoking open condemnation and finally government action.

4.78 Mr Edward Lincoln argued:

With the scandals that have emerged in the 1990s have come truly shocking revelations of indiscretion and malfeasance—shocking at least in the frequency of exposure; much of the revealed behaviour seems quite unsurprising.

...

These scandals have gone far beyond isolated incidents. They paint a picture of widespread routine corruption and incestuous relations among financial firms, their clients, government officials and politicians.⁸⁹

4.79 The uncovering in 1997 and 1998 of an 'entertainment-for-favour' practice demonstrated '...how Ministry of Finance mandarins wielded their discretionary powers to bend the rules of the marketplace and the extent to which bank and financial sector executives cultivated their bureaucratic relationships'.⁹⁰ According to Mr Michael Backman, it became apparent that:

...the nation's most prominent banks and insurance companies had systematically spent enormous sums on entertaining government bureaucrats in exchange for confidential information, tip-offs when bank

88 Taichi Sakaiya, Minister of State, Economic Planning Agency, Government of Japan, Speech at Centre for Strategic and International Studies, Washington D.C., April 1999.

89 Edward J. Lincoln, 'Japan's Economic Mess', a paper by Edward J. Lincoln, the Brookings Institution, presented to the Japan Economic Seminar, Washington, D.C., 25 April 1998, in *JEI Report, No. 18A*, 8 May 1998, pp. 6–7.

90 Ogino Hiroshi, 'Bureaucratic Prestige Imperilled by Selective Administration', *Japan Quarterly*, July-September, 1998.

inspections were about to be made, advance notice of changes to banking law, and helping conceal damaging records.⁹¹

4.80 In March 1998, there was the astonishing spectacle of prosecutors marching into the Bank of Japan to arrest a senior official suspected of trading inside information for expensive dinners and golf sessions. The Ministry of Finance suffered a similar loss of face when public investigators staged a raid on the Ministry's headquarters, seized papers and arrested two officials involved in regulating the banking sector. These officials were accused of giving the banks advance warning as to when to expect 'surprise' inspections in return for lavish entertainment and gifts. Although exposing the bureaucracy to public ridicule, these dramatic events at least signalled the government's intention to deal with this problem.⁹² In April 2000, the Prime Minister himself felt the need to state in Parliament that 'The recent series of improper acts perpetrated by civil servants is indeed truly deplorable.'⁹³ The startling disclosures of corruption and of the existence of a web of intrigue and collusion in the upper reaches of the Ministry of Finance and the nation's central bank have, without question, seriously dented their prestige.⁹⁴

4.81 Accusations of misconduct were also levelled at the business community. It suffered a serious loss of confidence in 1997 both within Japan and abroad because of the management failure in numerous corporations and the 'sokaiya' payoff scandals.⁹⁵ These scandals, involving a number of executives from two large and respected institutions, Nomura Securities and Dai-Ichi Kangyo Bank, confirmed that extortion was a problem among Japanese companies.⁹⁶

4.82 These revelations of bribery and corruption turned a harsh spotlight on the dark side of sections of the Japanese corporate and bureaucratic world. The unfolding tales of serious impropriety within the bureaucracy and business community

91 Michael Backman, *Asian Eclipse: Exposing the Dark Side of Business in Asia*, John Wiley & Sons (Asia) Pty Ltd, Singapore, 1999, p. 146.

92 Donald Macintyre, 'Ministries of Shame', *Time Asia*, vol. 151, no. 11, 23 March 1998; <http://cgi.pathfinder.com/time/asia/magazine/1998/980323/japan.html> (24 March 1999); Robert Uriu, 'Japan in 1998', *Asian Survey*, vol. 39, no. 1, January/February 1999, p. 117. There have been numerous articles written on this matter of corruption in the Japanese bureaucracy. See for example, Sandra Sugawara, 'For Japan Inc and its Regulators, the Dinner Date's Off', *Washington Post Foreign Service*, 11 April 1998; Ueda Atsushi, 'Neo-Bushido for Tomorrow's Japan', *Japan Echo*, vol. 25, no. 3, June 1998; Andrew Cornell, *Australian Financial Review*, 15 November 1999, p. 13.

93 Policy speech by Prime Minister Yoshiro Mori to the 147th Session of the Diet, 7 April 2000, <http://www.kantei.go.jp/foreign/souri/mori/2000/0407policy.html> (June 2000).

94 Ogino Hiroshi, 'Bureaucratic Prestige Imperilled by Selective Administration', *Japan Quarterly*, July-September, 1998.

95 Sam Jameson in 'Scandal hurts Big Bang reform', Asia Timesnet, 1 September 1997, defined sokaiya as a specialist—'someone who extorts money from companies in exchange for not revealing sensitive information about the firm or ask embarrassing questions at shareholders' meetings'. <http://web3.asia1.com.sg/timesnet/data/about/docs/as1403.html> (4 November 1999).

96 *ibid.*

diminished the people's trust in their leaders and has given rise to another cause for concern.⁹⁷

The push and pull for reform in Japan

Pressure to reform

4.83 In the face of all these difficulties—ailing economy, rising unemployment, rapidly ageing population, erosion of traditional values such as lifetime employment, poor leadership, corruption, mounting public debt and falling consumer confidence—Japan was being urged to reform.

4.84 The parlous state of the economy highlighted the urgent need for structural reform in Japan to facilitate its long-term economic development. Both Japanese and overseas analysts agree that the country can no longer look to its traditional industries and ways of doing business to generate growth. The United States, in particular, has been a consistent and vocal advocate for Japan to restructure its economy. It acknowledged that the government had boldly put forward a significant amount of fiscal stimulus to jumpstart the economy and also noted the government's 'very accommodative monetary policy'. But it went on to suggest:

Those are two legs to a stool of restoring prolonging economic growth. But there is a third leg missing, and without it we don't believe we can have sustained economic growth in Japan, and that is a serious restructuring of the Japanese economy, which means deregulating and reregulating and rechannelling the efforts of the Japanese economy and helping it move into the information age from the machinery age.⁹⁸

4.85 Many argued that early reform would immediately begin to restore confidence in the region and would be an enormous boost to the region's future economic prospects. They warned that if Japan's economic structure remained essentially unchanged, the economy would continue to flounder and even slip further behind.⁹⁹

Short-term dislocations versus long-term benefits

4.86 There is, however, a down side to such restructuring. It threatens to create short-term difficulties for and disruption to an economy already beset with problems. This presents Japan with a difficult trade-off—restructure with an eye to longer-range developments and future economic security but risk short-term upheavals, such as rising unemployment.

97 Yuichi Shionoya, 'Japan's Grand Reforms: From an Economic, Social and Political Perspective', Transcript of a speech delivered on 12 May 1997, at Asia Foundation and Public Policy Institute of California, http://www.infojapan.org/j_info/japan/socsec/sionoya.html.

98 Transcript: Deputy USTR Fisher, June 16 Worldnet Program on APEC, 17 June 1999.

99 DFAT, submission no. 32, p. 7.

4.87 Although concerned that reform would aggravate economic difficulties in the short term, the government, for the moment, has decided that the long-range advantages of restructuring outweigh the more immediate complications arising during the adjustment period. In outlining its policy measures for the November 1999 Economic Rebirth Package, the government emphasised that reform was an indispensable element in transforming the Japanese economy to the appropriate foundation for the knowledge-based age of the 21st century.

4.88 Having opted for change, Japanese leaders are now at pains to impress on the Japanese people the importance of restructuring. But their actions do not match the urgency of their words. As with the government's efforts to stimulate the economy through fiscal policy, it has demonstrated the same faltering and half-hearted approach to reform.

Progress slow

4.89 A recent assessment by the OECD of regulatory reform in Japan restated a common and long-held view that Japan needs to act rapidly and forcefully. It acknowledged the progress made in deregulation, but stated bluntly that Japan needs a 'sharp break with past regulatory practices'.¹⁰⁰ Despite all the talk about the pressing need to restructure, the government at first tinkered with reform; it responded with piecemeal measures and without determination. Although the Big Bang reforms in particular have given momentum to the reform initiatives, the Japanese Government is yet to formulate a well-defined template outlining the reform process. Put starkly by Mr Richard Katz in 1999, 'Japan is stuck. It can't maintain the old system, but it [is] not ready to embrace reform. It is drifting, trying to muddle through.'¹⁰¹

4.90 According to one economist, 'Deregulation has required the Japanese to rethink their extensive network of formal and informal controls imposed upon the economy. Change has been incremental, at best, with implementation lagging far behind prescription.'¹⁰² Mr Peter Hartcher also noted the lack of coherence and foresight in the reform process. He maintained that Japan is restructuring through crisis 'as market inevitabilities force themselves on reluctant policy makers and terrified politicians'. He considered that the depth of restructuring and of the transition point reached by the Japanese economy explains why Japanese consumers and employees are 'so traumatised and so reluctant to spend'.¹⁰³ He explained that this is why the recession is proving to be so deep and so intractable.

100 OECD, *Regulatory Reform in Japan*, Paris, 1999, pp. 11 and 16.

101 Richard Katz, 'Economic Anorexia: Japan's Real Demand Problem', *Challenge*, March-April 1999, p. 92. See also Philip Henry, Queensland Government, *Committee Hansard*, 16 April 1999, p. 409. Dr George Mulgan stated simply that the Japanese Government has been 'long on rhetoric and short on delivery', *Committee Hansard*, 28 May 1999, p. 673.

102 Lonny E. Carlie, 'Japanese Deregulation: What you should know', Centre for Japanese Studies, Asian Studies, University of Hawaii, Manoa, <http://www.nmjc.org/jiap/dereg/papers/deregcon/carlie.html>.

103 Peter Hartcher, *Committee Hansard*, 15 April 1999, p. 326.

The inertia of traditional systems—reluctance to change

4.91 Although this hesitancy in implementing reform clearly contradicts the acknowledged and stated need to restructure, it is understandable within the context of Japan's economic tradition. The roots of established practice and customs run deep in Japan, especially as they are anchored in many years of achievement. Despite the recent economic difficulties, there remains in Japan a stubborn reluctance to tamper with a proven system. The changes required are drastic. They demand a reassessment, a shift in approach and attitude, and a shedding of the practices of the past. The Japanese people, who emerged from a country devastated by war to build one of the leading economies in the world, value the economic system that has carried them to success. For them, it has been a source of economic prosperity and security—it is a familiar, proven and reliable system.

4.92 As Mr Hartcher pointed out, 'Success of the system has entrenched these arrangements very deeply in the system and made it extremely resistant to change.'¹⁰⁴ Thus many Japanese hold dearly to a way of thinking that is set in a period of bygone growth.¹⁰⁵ The government itself is finding it difficult to let go of past practices and ideas. A number of witnesses pointed out that the government basically mistrusts competition and is not yet prepared to put its faith in the free market.¹⁰⁶

4.93 This strong but natural inclination to stay with valued and successful traditions is heightened during times of uncertainty. Under stress, people look to the familiar for reassurance. Thus, despite the compelling argument for reform, the Japanese people still have an enduring attachment to the past ways of doing things. People recognise the need for reform but are as yet unwilling to embrace such change. Even though fears continue to grow for the future, many in Japan still hanker after time-honoured practices to allay their anxieties.

4.94 The Economist Intelligence Unit Report for the third quarter 1999 noted the degree of tension between accepting the need for change and a willingness to undertake such change. It acknowledged that there was a broad international consensus that Japan needs to tolerate higher levels of unemployment if its economy is to become more competitive and grow more quickly. In contrast, it maintained, however, that there was no general agreement among the Japanese people that this trade-off is worth making. Thus, according to the Unit, 'the political calculus militates

104 Peter Hartcher, *Committee Hansard*, 15 April 1999, p. 326.

105 Christopher Pokarier, *Committee Hansard*, 15 April 1999, p. 425.

106 Dr Aurelia George Mulgan, *Committee Hansard*, 28 May 1999, p. 675. See also See Stuart M. Chemtob, Special Counsel for International Antitrust Division, US Department of Justice, Keynote Address 'The Frustration and Promise of Japanese Deregulation', 4 April 1997, in Japan Information Access Project; Yasuo Kanzaki, 'Deregulation in Japan: Big Bang or Big Whimper', a talk delivered at the Woodrow Wilson International Centre for Scholars, the Smithsonian Institution, Washington, 7 March 1997.

in favour of politics that sustain the status quo, even if this delays a return to sustainable economic growth'.¹⁰⁷

4.95 A major concern is that the Japanese may postpone or merely play at reform until the situation deteriorates to such an extent that conditions will force their hand. As pointed out by DFAT:

We conclude that Japan is not on the verge of economic, political or social breakdown or dislocation. Its traditional systems are, however, under stress and there is as yet within Japan no broad consensus that radical change is necessary. While the prolonged economic slump have finally brought a sense of crisis in some quarters, the Japanese unsurprisingly, remain attached to traditional socio-economic practices which have brought them many benefits, especially to rural Japan. This is causing pressures and tensions in how Japan conducts itself internationally and how its leadership manages its domestic economic and political debate.¹⁰⁸

4.96 The Chairman of Keidanren recognised the desire by many to cling to established norms and proven practices. He accepted and sympathised with this inclination but warned of the danger in harbouring such tendencies. He told a gathering of journalists:

In some ways it is easier for all of us—politicians, government administrators, the general public and industry—to continue operating according to regulations that we know. However, circumstances are changing rapidly both in Japan and abroad, so it is no longer feasible to maintain existing regulations and the existing order, nor is it possible for those who support the status quo to persuade us to maintain them.¹⁰⁹

Complacency

4.97 Not only have the long years of economic progress in Japan engendered a degree of conservatism but it has also bred complacency. Hopes for Japan's recovery are buoyed by admiration for, and conviction in, the resilience of the people. There is a very real expectation that Japan's economy will eventually lurch back on track; an outlook, however, that encourages forbearance and blunts the drive for reform.

4.98 This complacency was most evident in the administration's dealing with the bad debt problems. The evidence has shown that, to a large measure, the government in particular and the financial system generally acted on the hope that the bad debt

107 The Economist Intelligence Unit Ltd, *EIU Country Report*, 3rd quarter 1999, p. 20. See also Mr Shinji Sato, 'English Translation of Minister Sato's Speech at the Foreign Correspondents' Club of Japan, 16 June 1997, who acknowledged that reform would generate friction within Japan. <http://www.miti.jp/press-e/f300001e.html> (24 April 2000)

108 DFAT, submission no. 32, p. 6.

109 Isao Nakauchi, Text of speech by Mr Isao Nakauchi, Vice Chairman of Keidanren, at the Foreign Correspondents' Club of Japan, 19 September 1994.

problem would eventually be resolved over time and were thus prepared to let the problem drift.¹¹⁰ As Minister Sakaiya said bluntly:

The managers and bureaucrats lacked the courage to decisively dispose of the bad debts, and simply prayed that land and stock prices would soon recover.¹¹¹

4.99 The grounds for assuming that Japan will be able pull itself out of this prolonged slump are strong. The country possesses a reservoir of rich talent, experience and values that could be tapped to carry it through this troubled time. Indeed, many commentators draw on the strengths in Japanese society and look with optimism to the future. As explained by DFAT, Japan is still the world's largest creditor nation; it has an economy based firmly on the cultural discipline of a high savings rate, its people are highly educated and motivated and they have a powerful work ethic, it has a strong manufacturing sector and a remarkable export performance which should provide the basis for strong economic growth beyond the short term.¹¹²

4.100 While most analysts would agree that Japan has the potential to return its economy to robust health, most would stress that there is no room for complacency. Rather, they would point to a pressing need for a determined and driving force to galvanise all sectors of the nation into concerted action.

Lack of urgency/commitment

4.101 Undoubtedly, the ability of the government to implement proposed reforms will be a decisive factor in the recovery.¹¹³ Unfortunately, there is no sense of urgency compelling Japan to usher in reform. Many commentators are concerned by this lack of political drive in Japan at this most critical time.¹¹⁴

4.102 Lack of aggression and timid leadership have undermined attempts by those sectors of the economy eager to marshal the resources of the country into a determined effort to reinvigorate the economy. For them, precious time has been and is being wasted. Clearly concerned about lost opportunities, Mr Robert Uriu wrote, 'While the country searched desperately for some sign of strong domestic leadership, such leadership was in short supply'.¹¹⁵ The wait-and-hope approach frustrated those committed to pushing ahead with reform and confirmed in the minds of many that the administration was not fully committed to change.

110 For example see comments by Professor David Allen, *Committee Hansard*, 25 February 1999, p. 188.

111 Taichi Sakaiya, Minister of State, Economic Planning Agency, Government of Japan, 'The Present and Future of the Japanese Economy', Speech at Yale University, Connecticut, US, May 2000, <http://www.epa.go.jp/2000/b/0505b-daijinkouen-e.html> (5 July 2000)

112 DFAT, submission no. 32, pp. 5, 7.

113 Dr Yasuo Takao, *Committee Hansard*, 24 February 1999, pp. 124–5.

114 See Terrence White, Australia-Japan Foundation, *Committee Hansard*, 19 February 1999, p. 42.

115 Robert Uriu, 'Japan in 1998', *Asian Survey*, vol. 39, no. 1, January/February 1999, p. 116.

4.103 Dr Yasuo Takeo noted that Japan does ‘not have the kind of overwhelming power to usher in a transformation of Japanese society’.¹¹⁶ According to Mr Larry Crump, from Griffith University, Queensland, ‘The government of Japan, behaving in a very Japanese way, has taken the safe approach and not done very much’.¹¹⁷

4.104 A reticence to tackle difficult problems seems to be at the very heart of the administration’s failure to launch a successful reform program. The government has tinkered with reforms but stopped short when tough decisions had to be made. Akira Kawamoto accepted the argument that the reform plan lacks a firm political hand to drive it forward and give it overall shape and coherence.¹¹⁸

4.105 The Queensland Government, for example, questioned the determination of the Japanese officials to implement the financial system reform. As an indication of this lack of commitment, it noted the Japanese Government’s intervention in the stock market in 1997 to protect Japanese banks and the legislative schedule which suggests that changes are not coming into force until as late as 2001.¹¹⁹

4.106 The United States was particularly concerned with the Japanese Government’s unwillingness to move ahead, boldly and decisively, with reform. It stated:

But what we do not see yet is a commitment by the Japanese government to move away from a command-and-control mentality to a government that encourages competition.

...

What we worry about is that Japan cannot make the transformation to the information age.¹²⁰

4.107 This lukewarm commitment to reform also manifests itself in the government’s inability to put together a credible reform plan. It will respond when pushed but there is no long-term vision and no overarching architecture to guide progress in the restructuring process. Mr Arun Rhada Krishnan drew attention to the way the reforms have been pursued in small bits—‘tax concessions here, pump priming here, fighting fires as they arise and so on—they do not seem to present a long-term kind of picture’.¹²¹ Professor Karel Van Wolferen stated simply:

116 Dr Yasuo Takao, *Committee Hansard*, 24 February 1999, p. 124.

117 Larry Crump, *Committee Hansard*, 16 April 1999, p. 473.

118 Akira Kawamoto, ‘Unblocking Japanese Reform’, *OECD Observer*, 2 April 1999, <http://www.oecdobserver.org/news/fullstory.php3?aid=5> (25 October 1999).

119 Queensland Government, submission no. 18, p. 8.

120 Transcript: Deputy USTR Fisher, June 16 Worldnet Program on APEC, 17 June 1999.

121 Arun Radha Krishnan, *Committee Hansard*, 24 February 1999, p. 108.

When you ask Japanese government officials: what actually does your policy look like?—nobody can really give you a succinct answer and tell you this is where they are heading.¹²²

4.108 As late as June 2000, doubts still lingered about the ability of Japanese leaders to formulate a comprehensive reform program that would tackle some of the most serious economic problems. Ambassador Ove Juul Jorgensen, Head of the Delegation of the European Commission in Japan, in assessing the regulatory reform process in Japan stated:

The revised Programme is, as far as we are concerned, still rather patchy. For example, competition policy plays a greater role than ever in the Programme, but the measures promised are still basically ‘nibbling around the edges’. Effective competition policy enforcement could resolve many of Japan’s regulatory reform bottlenecks in one fell swoop.¹²³

4.109 Many commentators share misgivings about the government’s ad hoc response to reform and its capacity to carry out the more difficult reforms that lay ahead.¹²⁴ Austrade could imagine ‘a scenario in which Japan undertakes some reforms but leaves the major part of its economic institutions and relationships basically intact’.¹²⁵ It suggested:

The more likely outcome will be that Japan will implement some reforms, largely in response to a major crisis brought on by internal, or more likely external, pressure leaving intact many of the existing relationships and institutions.¹²⁶

4.110 The evidence shows that the government has fallen short on two major fronts in pushing forward with a successful reform program. First, to give an absolute and unequivocal commitment to the reform process. Second, on a practical level, to put together a coherent and logical plan that marks out the steps toward a well-defined

122 Karel Van Wolferen, Professor for Comparative, Political and Economic Institutions, University of Amsterdam, Holland, Transcript of Television Programme, ‘Lateline’, 2 November 1999.

123 Presentation by Ambassador Ove Juul Jorgensen, Head of the Delegation of the European Commission in Japan, Tokyo, 6 June 2000, <http://jpn.cec.eu.int/english/press-info/4-2-48.htm> (8 June 2000).

124 Akira Kawamoto, ‘Unblocking Japanese Reform’, *OECD Observer*, 2 April 1999, <http://www.oecdobserver.org/news/fullstory.php3?aid=5> (25 October 1999). See also Professor Karel van Wolferen, transcript, ‘Lateline’, 2 November 1999; and Yoshio Ichiryu and Yuji Hosoya, MITI/RI Discussion Paper no. 98-DOF-29, ‘New Developments in Economic Policy: Complementarity between Government and the Market Place’, September 1998, p. 24.

125 Austrade, submission no. 35, p. 3.

126 Austrade, submission no. 35, p. 10. See also Douglas Ostrom, *JEI Report, no. 20*—19 May 1999, ‘Corporate Japan’s restructuring Efforts: A Progress Report’, <http://www.jei.org/Reports?JEOR/00JEIRsummaries/s0020.html> (8 June 2000); and article ‘A New Japan?’ in *Businessweek on Line*, 25 October 1999, which was also concerned that the Japanese establishment ‘will still find a way to preserve its cloistered economy’ and that reform may well be ‘just enough to prevent another real crisis’, http://businessweek.competition/1999/99_43/b3652010.htm?scriptFramed (8 June 2000).

goal. In essence, the administration must provide the motivation for change and show that it is prepared to act boldly in implementing reform as well as provide a clear sense of direction.

Structural impediments

4.111 The government is not alone in frustrating the effective introduction of structural reform. The leadership problem and the lack of heart for reform also permeates the administration. The bureaucracy carries a primary responsibility for formulating and implementing deregulatory initiatives but their contribution to the reform process has been limited.

4.112 Japan's bureaucracy has lost its authority. With their record for economic management in tatters and their reputation as upright public servants tarnished, Japanese public servants have retreated into the background. Mr Pokarier maintained that basically, 'the markets and individuals discount anything public officials say these days because they have heard it all before'.¹²⁷ They have become increasingly reluctant to take risks thus making policy formulation more difficult. One commentator observed:

With public attention focusing on their past failures, bureaucrats have great incentives to avoid further policy mistakes. In addition, turmoil in the political arena makes the bureaucrats more cautious: absent strong political leadership and direction, bureaucrats are reluctant to advocate bold actions or solutions. In short, those who have been expecting new policy directions from the bureaucracy are likely to continue to be disappointed.¹²⁸

The bureaucracy—protecting their patch

4.113 But there is a far more potent force within the bureaucracy stifling any move for reform—conflict of interest. In essence, the process of deregulation rests with the regulators themselves. Over time members of the bureaucracy have built up a system that serves their interests and they resist measures likely to weaken their influence. Messrs Lonny Carlie and Mark Tilton, were not alone in voicing their scepticism at the sincerity of the motives behind the reform measures. They wrote in 1996, 'As presently constituted, deregulation is being advanced largely at the discretion of the bureaucracy—the very party whose powers would be reduced by the process—and for that reason it is unlikely to be pushed forward with great enthusiasm or haste'.¹²⁹

4.114 Dr George Mulgan reinforced this point. She maintained that because each ministry or agency has the primary responsibility for deregulation they decide what is relevant or redundant. She stressed:

127 Christopher Pokarier, *Committee Hansard*, 16 April 1999, p. 426.

128 Robert Uriu, 'Japan in 1998', *Asian Survey*, vol. 39, no. 1, January/February 1999, p. 117. See also 'The Japan Puzzle', the *Economist*, 21 March 1998, p. 24.

129 Lonny Carlie, Mark Tilton, 'Japan's Deregulation "Action Plan" and the Deregulation', Japan Information Access Project, April/May 1996.

As a result, it is possible for ministry officials to keep major regulatory powers unto themselves by relinquishing those that are less central to their own interests and to slow the pace of change by offering up only small numbers of reforms at each step in the deregulation process...¹³⁰

4.115 With the interests of the bureaucracy intertwined in the regulatory process; officials would have to measure any deregulatory proposal against its potential to harm their interests and thus would tend to favour the status quo.¹³¹

The iron triangle

4.116 But this self-interest has another dimension. Not only are separate elements within the economic system such as government and sectors of the bureaucracy pulling against reform but there is a fusion of interests of government, business and the bureaucracy, sometimes referred to as Japan Inc., blocking change. This powerful interlocking of mutual interests has led to the entrenchment of an economic system where each element within the system cooperates with the other in preserving and further promoting their benefits.

4.117 In arguing this point, Dr George Mulgan explained that the three primary sets of beneficiaries—the authorised participants (producers and/or other business interests making administratively-sanctioned profits), bureaucrats (maintaining untrammelled regulatory powers and retirement jobs in semi-governmental regulatory institutions and private sector business) and politicians (obtaining political funding from protected industries)—form an iron triangle with a strong common interest in resisting pressure for change.

4.118 She argued:

The lack of enthusiasm for deregulation amongst many Japanese politicians derives from their interdependency relationship with the vested interests which have grown up around the rents and benefits that regulatory systems provide...sectoral interests rely on politicians to act as brokers on their behalf in order to extract, maintain or increase rents and income supports from administrators. The most powerful brokers cluster together in LDP policy tribes (*zoku*) with connections to specific sets of sectoral interests, and with the connivance of the bureaucracy, harness rents and other benefits as political goods for distribution to their supporters. In exchange they receive electoral goods such as political funding and voting support.¹³²

130 Dr Aurelia George Mulgan, submission no. 20, p. 23.

131 Dr Aurelia George Mulgan, submission no. 20, p. 22.

132 Dr Aurelia George Mulgan, submission no. 20, p. 19.

She further noted that ‘While Diet members might express support for deregulation as a general principle, if a particular item of deregulation appears to threaten an interest they represent, they will staunchly oppose it’.¹³³

4.119 As this interdependency between the distinct economic entities evolved into a stable and long-term structure, so did a support network of sub-structures that further buttress and entrench the system. Inter-company relationships, cross-shareholdings, a main bank system, labour-management relations, the legal framework and a regulatory system that includes administrative guidance work to lock-in the present system.¹³⁴

4.120 Witnesses agreed that a political-bureaucratic-vested interest triangle is at the very centre of all Japanese regulatory systems and obstructs far-reaching efforts to deregulate the Japanese economy. They argued that regulation encouraged collusion between bureaucratic regulators and protected industries by institutionalising their common interests.¹³⁵ Dr George Mulgan noted:

...integral to regulatory regimes are the numerous extra-ministerial groups (*gaikaku dantai*) and public corporations spawned by the ministries and agencies of government...In most cases, these groups established on the basis of regulations provide lucrative post-retirement posts for officials through the process of ‘descending from heaven’.¹³⁶

4.121 The intricate, strong and wide-ranging web of interdependency between the various components of the economic system make it impervious to outside pressure to change. As Michael Backman explained:

The nexus between big business, the bureaucracy, and the LDP is one that is complex and mutually reinforcing—so much so that it is scarcely possible to treat each of the three as distinct entities. And the mutually reinforcing nature of the relationships means that attempts to reform any one pillar of the structure represent a direct attack on all the sections. It simply isn’t possible to rope off one part of Japan Inc., remodel it, and then move on to the next part. The interconnectedness of the system of client-patron relationships means that it is all or nothing. So any attempt at reform, even if

133 Dr Aurelia George Mulgan, submission no. 20, pp. 19–20.

134 Akira Kawamoto, ‘Unblocking Japanese Reform’, *OECD Observer*, 2 April 1999, <http://www.oecdobserver.org/news/fullstory.php3?aid=5> (25 October 1999).

135 Dr Aurelia George Mulgan, submission no. 20, pp. 19–20. Mr Pokarier supported this view—‘Japanese firms have responded rationally to the regulatory settings within which they find themselves. Many have typically through their industry associations, also made investments in political processes aimed at securing the regulatory settings that served their own immediate interests but which have imposed costs on other, politically less well organised groups.’ See submission no. 10, p. 8; and ‘Corporate Efforts to Promote Deregulation’, text of speech given by Mr Isao Nakauchi, Vice Chairman of Keidanren, at the Foreign Correspondents’ Club of Japan, 19 September 1994, <http://www.keidanren.or.jp/english/policy/pol001.html>.

136 Dr Aurelia George Mulgan, submission no. 20, p. 20.

relatively minor, is met with resistance from the entire establishment as each part moves to safeguard its self-interest.¹³⁷

Agriculture—vested interests meld with tradition values

4.122 Within Japan's political system, farmers have stood out as a particularly powerful sector. Many agricultural organisations, particularly Nokyo, are directly represented in the Diet by politicians who hold or have held official positions in the agricultural cooperatives and who are expected to deliver benefits to their agricultural supporters.¹³⁸ This sector also shows how strongly vested interests and traditional beliefs are interlocked and mutually reinforcing in Japan's economic structure.

Reform in the face of opposition

Chinks in the armour

4.123 The iron triangle stands as a major obstacle to reform in Japan. Despite its ability to resist outside influences, the pressure for change is starting to weigh heavily on this formidable power structure. The three elements to the triangle are beginning to buckle under the forces pushing for change.

4.124 First, the bureaucracy, which has strongly resisted reform in its endeavour to head off any encroachment on its power is showing signs of strain. The links between the administration and business, so long regarded as integral to the success of the economic system, are now seen as a liability and an obstacle to the development of the economy.

4.125 The growing public awareness of the failings within the administration poses a threat to its cosy world. The exposure of impropriety has eroded its credibility and given weight to public criticism.¹³⁹ Clearly, the bureaucracy has lost status. Scandals involving some bureaucrats have tarnished the aura of distinction they once enjoyed and diminished their stature as public servants who put the national interest above their own.¹⁴⁰ This power group is no longer above reproach, and has had to suffer the indignity of public probing into its affairs. With its competency in doubt and its probity under question, it seems likely that the bureaucracy will be more receptive to

137 Michael Backman, *Asian Eclipse*, John Wiley & Sons (Asia) Pty Ltd, Singapore, 1999.

138 Dr Aurelia George Mulgan, submission no. 20, p. 8.

139 Ogino Hiroshi, 'Bureaucratic Prestige Imperilled by Selective Administration', *Japan Quarterly*, July–September 1998, p. 9.

140 Robert Uriu, 'Japan in 1998', *Asian Survey*, vol. 39, no. 1, January/February 1999, p. 117. See also, Sakaiya Taichi, 'The Myth of the Competent Bureaucrat', *Japan Echo*, vol. 25, no. 4, February 1998; and Yoshihisa Murasawa, 'Corporate governance: the turmoil continues', *Euro-Japanese Journal*, vol. 5, no. 1, Summer, 1998, p. 18.

change—more likely to bow to pressure than resist it.¹⁴¹ In summary, the growing distrust of elite bureaucrats is eroding this major barrier to the reform process.¹⁴²

Practical business—surviving in the market place

4.126 Secondly, the belief that the economy must be released from old managerial practices is strengthening. The perception of Japan's economic system as outmoded and in need of reform is becoming sharper. The Japanese people are beginning to question the deeply ingrained 'production first' and anti-competition principles introduced with Japan's 'catch-up' system.¹⁴³

4.127 Tolerance for the coddled domestic sector of Japan's two-tiered economy is wearing thin. International highly productive companies are no longer prepared to carry the protected home industries that enjoy special benefits under a huge array of rules and regulations. Such practices drive up production costs and undermine the competitiveness of successful export industries. In Japan, the market place is driving reform as shown earlier in the move away from seniority-based wages and lifetime employment. Market forces are pushing their way into the system and practical business sense dictates that change must take place if business is to survive. Many Japanese firms can no longer ignore global competition and have little choice but to go along with global standards. They have to shift from the old management system to one compatible with global practices.¹⁴⁴ Keidanren argued that the economy of Japan was in such a grave situation and the dislocations coming out of the economic crisis were pressuring business, 'indeed, the economy itself—to drastically restructure and rationalise their operations'.¹⁴⁵

4.128 A situation has developed in Japan in which pure business considerations now take precedence over the old-style emphasis on close human relationships and attachment to traditions and habits that are far removed from the values of today's corporate world.¹⁴⁶ The growing urgency to make adjustments to changed circumstances has begun to replace the complacency, the lack of commitment and even the natural inclination to stay with the familiar. Mr Chester Dawson noted:

For years, board rooms in Tokyo delayed making painful choices in the hope that a strong tide of economic recovery would lift the country. But after nearly a decade in the doldrums, the prospects for a return to the boom

141 Terrence White, Australia-Japan Foundation, *Committee Hansard*, 19 February 1999, pp. 48–9; DFAT, submission no. 32, p. 26.

142 Yuichi Shionya, 'Japan's Grand Reforms: From an Economic, Social and Political Perspective', Transcript of a speech delivered on 12 May 1997, at Asia Foundation and Public Policy Institute of California, http://www.infojapan.org/j_info/japan/socsec/sionoya.html.

143 Noguchi Yukio, 'The Persistence of the 1940 Setup', *Japan Echo*, vol. 24, Special issue, 1997.

144 See Dr Keiko Morita, *Committee Hansard*, 15 April 1999, p. 310.

145 Keidanren, 'Keidanren Urges the Government to Resolutely Carry out Sweeping Regulatory Reforms', 19 October 1999, <http://www.keidanren.or.jp/english/policy/pol1107.html> (5 November 1999).

146 Jiro Ushio, Chairman's Address for the 1998 Annual Meeting, Keizai Doyukai, 22 April 1998.

years of the 1980s remain dim. Now, pressure for reform may finally be nearing critical mass after years of losses and amid increased competition resulting from deregulation.¹⁴⁷

4.129 The recession has given added incentive for businesses in Japan denied opportunities for growth because of existing regulations to lobby for reform. These enterprises can see the gains to be made from a market more open to international trade and investment. They can see the need to become better managed and are jettisoning traditional management practices. Business leaders frustrated at being beaten in international competition can no longer wear unnecessarily high costs born of domestic inefficiencies. Japan's corporate giants are demanding reform. Moreover, they are no longer waiting for government and the bureaucracy to make the difficult changes. They see the urgent need to adjust and are proceeding to do so.¹⁴⁸

4.130 Put simply, Japanese companies, facing globalization, rapid advances in information technology, and other changes in the economic environment amidst continuing domestic economic stagnation, are compelled to radically restructure their operations.¹⁴⁹ Managers are taking a long hard look at their business and some are now taking the lead. Nissan's announcement of its ambitious corporate remodelling plan in October 1999, indicated that corporate Japan was finally accepting that it had no other alternative—to survive it must restructure. The chief operating officer for Nissan admitted that the restructuring plan, which involved the establishment of a performance-based career advancement program and the closure of three assembly plants and two powertrains operations, was 'born of desperation'.¹⁵⁰

4.131 The banking sector also demonstrates how business is embracing reform in its struggle to survive in the market place. Financial reform, which facilitated a series of bank mergers in 1999, has begun to redefine banking in Japan. It has allowed the entry of foreign companies into Japan and intensified competition.¹⁵¹ A number of major

147 Chester Dawson, 'Brave New World', *Far Eastern Economic Review*, 28 October 1999, http://www.feer.com/9910_28/p76economiesb.html (18 November 1999).

148 For example see Yuichi Shionoya, 'Japan's Grand Reforms: From an Economic, Social and Political Perspective', Transcript of a speech delivered on 12 May 1997 at Asia Foundation and Public Policy Institute of California, http://www.infojapan.org_info/japan/socsec/sionoya.html (29 October 1999); Michael Hirsh and E. Keith Henry, 'The Unraveling of Japan Inc.', *Foreign Affairs*, March/April 1997, pp. 12–13.

149 Yoshio Ichiryu and Yuji Hosoya, MITI/RI Discussion Paper no. 98-DOF-29, 'New Developments in Economic Policy: Complementarity between Government and the Market Place', September 1998.

150 News Release, 'Nissan unveils Revival Plan', 18 October 1999, Tokyo, http://global.nissan.co.jp/Japan/NEWS/199991018_0e.html (18 November 1999). See articles following the decision by Nissan to shut a number of plants, *Asia Time*, 20 October, 1, 5 and 19 November 1999.

151 In September 1999, Ripplewood Holdings acquired the Long Term Credit Bank of Japan (LTCB) which had been placed under temporary nationalization in October 1998. The LTCB had retained Goldman Sachs as its financial adviser to facilitate its sale. Memorandum of Understanding on Acquisition of LTCB, 28 September 1999, <http://www.ltc.co.jp/docsdir/en/news/press0928.html> (19 November 1999). See also Professor Morris-Suzuki, *Committee Hansard*, 24 May 1999, p. 604; and Professor Peter Drysdale, *Committee Hansard*, 23 August 1999, p. 765.

banks have responded to the changing climate by restructuring. In May 1999, the Mitsui Trust & Banking Co. Ltd and the Chuo Trust & Banking Co, Ltd announced a proposed merger. The board of directors of both banks acknowledged that in the context of the ‘Big Bang’ financial reforms, Japan’s economic environment and its financial industry has been changing rapidly. They believed that their organisation must build a solid management foundation that could withstand shifts in the environment.¹⁵²

4.132 In August 1999, Dai-Ichi Kangyo Bank, Fuji Bank and the Industrial Bank of Japan announced an alliance that would form the world’s biggest bank. As part of the restructure, the new group announced its intention to downsize its work force by 6,000 within five years and to commit itself to create and develop a fair human resource management system in which individuals would be evaluated on their level of expertise and job performance. They stated that the group would invest in strategically important areas such as information technology development.¹⁵³ In October 1999, the Sumitomo Bank and Sakura Bank announced plans to merge. This quest for greater efficiency and improved competitiveness in the banking sector is forcing massive restructuring.¹⁵⁴

4.133 Moreover, the entry of foreign companies offering wider choices and better services is pushing change. In February 1998, Merrill Lynch & Co. Inc., announced its intention to establish a nationwide network of private client offices in Japan. The company began to hire and train approximately 2,000 people, most of whom worked for the former Yamaichi Securities Company. The president of Merrill Lynch Japan Securities announced that ‘we look forward to helping fulfil the objectives of the Big Bang financial reforms in Japan which include increased competition and greater choice for investors’.¹⁵⁵

4.134 The recessionary environment has also given consumers a renewed concern for value for money and they are now less inclined instinctively to prefer Japanese products before foreign products. The economic downturn has encouraged heavy discounting by retailers and introduced consumers to lower priced, good quality foreign products. This has added to the competitive pressures already at work in the domestic market.¹⁵⁶

152 The Chuo Trust & Banking Co. Ltd, Announcement of Merger, 24 May 1999, <http://www.chuotrust.co.jp/eng/may/2499a.html> (18 November 1999).

153 The Dai-Ichi Kangyo Bank, Limited (“DKB”), the Fuji Bank, Limited (“Fuji”) and the Industrial Bank of Japan, Limited (“IBJ”) to get consolidated to form a new financial services group (“the New Group”) News Release, <http://www.fujibank.co.jp/pub/news/news-e/news-e8-20.html> (18 November 1999).

154 Christopher Pokarier, submission no. 10, p. 6.

155 In May 1998, the Ministry of Finance approved a securities business licence for Merrill Lynch Japan Securities, a wholly owned subsidiary of Merrill Lynch, the company’s new private client business serving individual investors in Japan. Merrill Lynch press release, 12 February and 26 May 1998, http://www.ml.com/woml/press_release (21 January 2000).

156 Austrade, submission no. 35, p. 7.

4.135 Mr Michael Hirsh, Business Editor for Newsweek, and Mr E. Keith Henry from the Massachusetts Institute of Technology's Japan Program, argued that the cutthroat competition has undermined the old cartelized relationship between manufacturers, wholesalers and retailers—the 'price-it-high-at-home-and-dump-it-abroad system', at the heart of Japan Inc., no longer functions. Consumers now refuse to pay high prices at home to subsidise inefficient producers.¹⁵⁷

4.136 The need to survive in an increasing competitive world has forced change and there appears to be no going back. International business organisations involved in trade and investment, particularly those in financial and capital markets, have no choice but to have their operations conform to international standards. The practice adopted by the leading businesses and institutions in spearheading international competition will inevitably affect domestic practices.¹⁵⁸

Practical politics—surviving at the polls

4.137 Thirdly, there is the political imperative for change. Indeed, as the voice for reform grows louder and more strident, the government's response is likely to become more positive. Despite the leadership's lack of aggression and urgency in tackling economic restructuring, reform is nevertheless under way, although in some respects, especially on the economic front, it has not been as far-reaching nor as timely as some critics believe is required.

4.138 The decision to deregulate rests inevitably with the government. Although political parties may represent special interest groups, they also have to take account of matters of growing importance to the broader community and particularly to issues around which a national consensus is building. As the call for reform gathers force in Japan, political leaders see benefits in presenting themselves as credible agents of change. In a democratic country, politicians who ignore these general trends in public opinion, who do not heed the growing voice for reform over special interest groups, do so at their own risk.¹⁵⁹

4.139 As Mr Pokarier pointed out, 'Regulatory reform, as in all democracies with well-organised interest groups where the constituencies for reform are stronger than those resisting, has proceeded apace.'¹⁶⁰ It would seem that in Japan the time has arrived when the push for reform is gaining over the pull against it. Although there are the inevitable points of political resistance from industries likely to suffer because of change, the emerging support for economic reform will eat into such resistance.

157 Michael Hirsh and E. Keith Henry, 'The Unravelling of Japan Inc.', *Foreign Affairs*, vol. 76, no. 2, March/April 1997, p.13.

158 Keiko Morita, *Committee Hansard*, 15 April 1999, p. 310.

159 Dr Aurelia George Mulgan, submission no. 20, p. 24. See also Aurelia George Mulgan, 'The Politics of Deregulation and Japanese Agriculture, in T.J. Pemwel et al. Also, *The Politics of Economic Reform in Japan: Collected Papers*, Pacific Economic Papers, No. 270, August 1997.

160 Christopher Pokarier, *Committee Hansard*, 16 April 1999, p. 429.

4.140 According to Dr George Mulgan, government and party leaders can be expected to take a more reformist stance as business and the public grow increasingly strident in their demands.¹⁶¹ Indeed, the reforms introduced to rescue and to restructure the banking system stemmed from overwhelming public and business pressure.

4.141 Many commentators have noted the tendency for government to respond only when confronted with immediate problems. For example, the failure of major financial institutions in November 1997 provided a jolt that prompted the administration to take decisive action to resolve problems in the banking sector and gave the Big Bang reforms a sharp nudge. Mr Arthur Alexander observed that these financial failures introduced an element into economic policymaking in Japan that had been absent until then—utter fear. He stated:

Political, bureaucratic and popular reactions led to strategies to inject public funds into rescuing depositors and recapitalizing banks. The new policies also resulted in the closure of several insolvent institutions, albeit with great reluctance on the part of bureaucrats and mainstream politicians alike.¹⁶²

4.142 Clearly, the Japanese Government was forced to deal with the bad debt issue—prevarication was no longer an option.¹⁶³ Throughout 1999, the Financial Revitalization Commission, on finding a number of banks in financial difficulties, directed that their operations and the management of their assets be placed under financial reorganisation administrators. Although highlighting the seriousness of problems in the banking sector, the actions of the Commission nevertheless sent a loud and unmistakable statement of the government's determination to clean up the banking mess.¹⁶⁴

4.143 To summarise Japan's predicament, Mr Ken Curtis, Managing Director, Deutsche Bank Group, explained:

...Japan is now squeezed in the vice of demographics; a very quickly ageing Japan; debt, deflation, the enormously disruptive pressure that comes from the new technologies, global competition. And so the whole thing now is

161 Dr Aurelia George Mulgan, submission no. 20, p. 25.

162 Arthur J. Alexander, 'On-the-Ground Impressions of Japan's Economic Problems', *Japan Economic Institute Report*, no. 8A, 26 February 1999, p. 9. The most recent example of the Japanese Government bowing to public criticism involved the government's decision not to bail out department store giant Sogo by waiving loan claims. See *Daily Yomiuri Online*, 14 July 2000 and *AsiaNow Time*, 31 July 2000, <http://www.cnn.com/ASIANOW/time/magazine/2000/0731/japan.seiyo.html> (26 July 2000).

163 For example see Financial Reconstruction Commission, 'Basic Operating Policies for the Financial Reconstruction Commission', (Summary, Provisional translation) 20 January 1999.

164 Some examples of banks being placed under administrators are: Kokumin Bank Ltd in April; Tokyo Sowa Bank, Ltd in June; the Namihaya Bank Ltd, in August; and the Niigata Chuo Bank, Ltd in October 1999.

pushing and this country is in a massive pressure cooker, and that's what's forcing the change.¹⁶⁵

4.144 In brief, the process of deregulation is likely to gather force because of the continuing recession and because of increasing pressure both from within Japan and abroad for more radical change. Competition in the market place is driving reform. The Japanese people are beginning to feel more confident about putting their money into overseas financial institutions, and are demanding better service from their bankers and brokers.¹⁶⁶ Deregulation and increased competition have certainly undermined the highly regulated system.

4.145 Nonetheless, the tension between the different vested groups within Japan will continue to tug the government in different directions. The Economist Intelligence Unit observed in early 2000 that with the next lower house election drawing closer, the government had started to step back from economic reforms, fearful of their impact on its key supporters.¹⁶⁷

4.146 The bureaucracy, government and business as individual entities and together as the dominant power structure in Japan are finding the pressure to reform compelling. The links between them have for a long time controlled the ability of foreign firms to do business in Japan but their influence has been weakened.¹⁶⁸

4.147 Some fear, however, that rather than an overall opening of markets, regulatory reform in Japan will lead to 'selective market openings based on a combination of strategic concerns, the political clout of certain factions of business, market factors, and pressure from foreign governments'. As Mr Mark Tilton argued, 'managed deregulation will simply substitute for managed markets'.¹⁶⁹ Undoubtedly, reform in Japan will follow a course determined by a range of factors, including the influence of factional interests and economic imperatives. Nonetheless, the push for reform is gathering strength.

The momentum of change

4.148 The forces resisting change in Japan are lined up against a powerful array of counter forces that are gradually but surely gaining ground. Change which requires the application of concerted pressure because of the strength and resistance of domestic

165 Mr Ken Curtis, Managing Director, Deutsche Bank Group, transcript, 'Lateline', 2 November 1999.

166 Yasuo Kanzaki, Chairman, Nikko Research Center Ltd, 'Deregulation in Japan: Big Bang or Big Whimper?', a talk delivered at the Woodrow Wilson International Center for Scholars, Smithsonian Institution, Washington, Japan Information Access Project, 7 March 1997.

167 The Economic Intelligence Unit, *Country Report*, Japan, 1st quarter 2000. This report cited the following examples of the government's prevarication on reform—the postponement of the imposition of consolidated accounting and the backtracking in the area of deposit insurance, p. 19.

168 For example see, Austrade, submission no. 35, p. 10.

169 Mark Tilton, 'Japanese Deregulation: What you Should Know', Japan Information Access Project, <http://www.nmjc.org/jiap/deregulate/papers/deregcon/tilton.html> (15 June 1999).

vested interests in Japan is not only occurring but is gaining momentum. In many cases, the course is fixed. The banking sector reform provides an example of where reform and market imperatives have joined forces to reshape the financial landscape in Japan.

4.149 Having introduced reform, the process is difficult to reverse. Thus, although reform has been implemented piecemeal over the last ten years, it has set in train a process that is gathering force and appears irreversible. Put simply, reform will be difficult to pull back as it gathers momentum. Peter Hartcher pointed out that where the government has succeeded in clawing back resistance from vested interests and made some inroads into the regulatory web choking Japanese economic activity, there has been an upsurge in activity. The relaxation of regulations governing telecommunications and retailing saw growth in the freer environment. Even marginal relaxation of regulations has produced major changes.¹⁷⁰ Minister Taichi Sakaiya recently noted:

The major reforms in the financial system have shaken the very foundation of the vertical 'keiretsu' corporate groupings centered around large financial institutions, and this trend will only intensify from next year as the integration and mergers of the nation's principal financial institutions that have already been announced are implemented.

At the same time, the corporate 'keiretsu' affiliations linking major manufacturers and general contractors with their subcontractors are rapidly dissipating. Having been separated from their financial 'keiretsu' affiliates, manufacturers and general contractors are now facing harsh price competition, forcing them to procure parts more quickly and at lower prices.¹⁷¹

4.150 Moreover, the low economic growth rate has been an important stimulus for change. Increased competition in Japan has transformed the market place. Consumers are beginning to see the benefits to be gained from lower prices and wider choices and have become far more discriminating.

4.151 Japan has been walking on the edge of change for some time. It seems as though it now, however reluctantly, has stepped onto the road toward a more market-based and competitive society. How far it travels along this route and at what pace it chooses to proceed will have a bearing on Australia's relationship with Japan. Australia and Japan have been partners for many years and Australia will have to take close note of the changes taking place in Japan so that it can support Japan through its transition and ensure that their partnership will continue to develop and grow.

170 Peter Hartcher, *Committee Hansard*, 15 April 1999, p. 332.

171 Taichi Sakaiya, Minister of State, Economic Planning Agency, Government of Japan. 'The Present and Future of the Japanese Economy', Speech at Yale University, Connecticut, US, May 2000, <http://www.epa.go.jp/2000/b/0505b-daijinkouen-e.html> (5 July 2000).

Recommendation

The Committee recommends that the Australian Government take this opportunity to reaffirm its long-term and sincere commitment to the Australia-Japan partnership.