

# Reawakening the Sleeping Giant: A Multi-Faceted Strategy to Economic Recovery in Japan

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## Abstract

The end of World War II ushered in a new era for Japan as a global economic powerhouse. The lost decade of the 1990's coupled with the Asian Financial Crisis of 1997-1998 and the Global Recession of 2008-2009 further complicated the already dire Japanese economic situation. To address the country's protracted economic stagnation, Prime Minister Abe has resorted to the Keynesian approach known as "Abenomics" which focuses on aggressive government spending in public works projects. The rationale behind this is that such investments will lead to creation of jobs needed to lift the economy out of stagnation. The paper starts off by recognizing that economic policies do not exist in a vacuum as there are several variables that impact on them. The essay posits that addressing the economic stagnation in Japan requires a holistic perspective as there is no one-size-fits-all solution. Hence, political, social and cultural factors all have crucial roles to play in shaping the economic policies in Japan. The paper argues that each of these variables must be accorded utmost importance as economic reforms are not stand-alone policies. This research proposes some solutions some of which are: adoption of a points-based immigration system to attract skilled workers, raising the birth rate, introduction a more inclusive policy to encourage more participation of women in the work force, increasing foreign direct investment, opening up the country's energy, breaking up monopolies and the implementation of medical insurance reforms that cater more to the needs of working women. Overall, vision not structure remains the key to recovery in Japan.

**Keywords:** Japan, Abenomics, Economic Growth, Politics, Culture

## 1. Introduction

After World War II the Japanese economy displayed high levels of growth and development and as such was applauded as one of the post-war economic miracles. The land of the rising sun was the world's second largest economy behind the United States. For an archipelago that has no natural resources, Japan's economic performance for more than four decades became enviable and well studied by analysts. The phases of the post war Japanese development are divided into three broad categories for the purposes of this analysis: Post-war Reconstruction and Catch-up, Era of Transition and the 'Bubble Economy' and the Lost Decade and Beyond.

The *World's Economic Forum's Global Competitiveness Index 2012-2013* ranked Japan 134 out of 144 countries on their flexibility in terms of hiring and firing. Also, the *World Bank's Doing Business report 2013* shows even a more startling statistics by classifying the Japanese economy 24<sup>th</sup> out of 31 high income countries.

The sorry statistics highlighted above leaves the entire world wondering whether Japan will recover from this long stagnation of its economy. The general agreement among Japanese and non-Japanese analysts is that the country is punching far below its weight. In fact, recent events in Japan depicts that the world's advanced economies are also very much susceptible to prolonged economic meltdowns. The Asian Financial Crisis of the 1997-1998 and the Global Recession of 2008-2009 are stark illustrations of the pernicious effect of international financial crises in our globalized world. As such lessons on how technological innovations in a country with a rapidly ageing population will be very useful for other advanced economies especially those in the European Union and North America. Lessons from the Japan will also be useful for East Asian economies to avoid some of the mistakes of the Japanese.

To solve this quagmire confronting the Japanese economy, the current Japanese Prime Minister Shinzo Abe ran and won elections on the promise of reviving the country's fledging economy. His economic strategy popularly referred to as 'Abenomics' is anchored on the Keynesian principle which focuses on massive investments and spending on infrastructure projects during recessions. The idea behind the Keynesian principle is that during recession government must lower taxes and increase spending. However, the results of 'Abenomics' can largely be described as so far being mixed and modest.

To this end, there is no one-size-fits-all solution to the economic slump in Japan. The analytical framework adopted in this paper seeks to explore the travails of the Japanese economy since the 'lost decade' era to present by taking a holistic perspective on the issue. The paper aims to achieve this by setting out to establish that economic policies do not exist in a vacuum as there are numerous variables that impinge on them. These factors are political, social, cultural and economic. IMF Managing Director Christine Lagarde confirmed that holistic and inclusive approach to development as recognized by the Japan's former Prime Minister Hayato Ikeda who observed in 1964 that "the vital challenge which we all face, whether domestically or internationally,

is to promote stable economic growth and reduce the disparity between the rich and the poor.” Hence, the solutions proffered in this analysis will be in line with the systems thinking approach which views problems as being interdependently related.

## 2. ‘Abenomics’

‘Abenomics’ is patterned after the Keynesian economic model which focuses on government spending during recessions. This strategy largely aims to ease money aggressively while spending on public works projects. Prime Minister Shinzo Abe’s policy is hinged on a massive \$ 1.2 trillion 10 year free-spending plan to bring about economic recovery in Japan. Overall, the goal is to spur the country’s GDP growth, which currently stands at -0.7 percent to 2 percent. This can be seen in Figure 1 below.

The first of the three arrows implemented by Abe was to adopt a more expansionist monetary policy which entails buying tens of billions of dollars of Japanese bonds each month with the hope of moving from deflation to inflation. The same principle applied by the United States Federal Reserve under Ben Bernanke. The second arrow was a fiscal stimulus plan of \$ 116 billion. The third were a bunch of reforms to boost the country’s fledgling industries.

A survey conducted in June, 2013 by the Cabinet Office shows that an index of citizens’ views toward economic conditions declined for three consecutive months. In addition, the consumers’ attitude index, which includes such factors as employment statistics, income situation, people’s life circumstances and readiness to replace old durable goods, plunged in June for the first time since the beginning of the year. These numbers show that ordinary folks are becoming cautious about the country’s economic forecasts.

One major problem with the ‘Abenomics’ approach is that massive printing of cash will drive up debt in the near future as interest rates grow higher. Already, European countries such as Spain, Portugal, Italy and Greece are currently suffering from the weaknesses of such policies.

Despite its initial success, ‘Abenomics’ is still at its infancy stage and a lot is yet to be learnt as to how the program will work out. A scrutiny of Abe’s economic recovery plan shows that it fails to address five key challenges that have shaped economic policy in Japan.

- i. The Prime Minister fails to show in clear terms how they intend to break up 10 regional monopolies in the energy market in light of the recent nuclear accident. According to the Organization for Economic Cooperation and Development (OECD) (2013), addressing these problems requires the unbundling of generation and transmission and expansion of the wholesale market.
- ii. Also, changes in the medical insurance system were announced without any specific ways of extending maternity leave and allowing mothers to concentrate on child-rearing. To tackle this, high income earners in foremost Japanese companies will be required to pay higher health care insurance premiums based on their income to better finance a special health care system for people 70 and above.
- iii. The Prime Minister promised to remove stiff regulations with no specific ways of addressing the issues except for special zones to promote entrepreneurial innovation by experimenting with regulations and lifting bans on online sales of non-prescription drugs.
- iv. There were announcements of tax breaks to encourage foreign direct investment and participation of Japan in the Trans-Pacific Partnership free trade agreement. However, such strategies are long-term measure that would take time to yield dividends.
- v. The plans also calls on pensions funds to invest more in higher-return-equities and overseas assets. This is geared towards ensuring efficient use of saving but this runs the risk of increase the cost of government borrowing.

## 3. Japanese Politics

Political stability is vital if economic reforms are to take root in any society. It is therefore not possible to have a strong economic base without fixing the political system. There is a saying that ‘Japan had a first-rate economy and a third-rate political system’. There is a correlation between economics and politics as unemployment and budget shortfalls lead to increase in social unrests which in turn make societies difficult to govern for politicians. Japan has been grappling with a dearth of leadership at the highest echelon of power in the country. Over the past five years, Japan has had six prime ministers most of whom were in office for only a couple of months. The defeat of the Liberal Democratic Party which has ruled for about five decades by the Democratic Party of Japan (DPJ) has not provided the much needed succour that most Japanese people yearn for. The July 21, 2013 elections where Prime Minister Shinzo Abe’s party won a majority in the House of Councillors will provide him with the much needed political capital he needs to function.

The election of Prime Minister has shown that political will is a renewable resource. The win by Abe’s Liberal Democratic Party (LDP) gives it the majority to push through economic policies.

The Japanese parliamentary system has to be adjusted to suit modern day realities on the ground. A key political reform that will affect the economy in Japan is ending proportional representation in politics. In spite of Japan's electoral reforms of 1994 that strived to improve accountability by including provisions that ensured that political parties campaign on real policy issues, the reforms were not far-reaching enough. Presently, 180 out of 480 members of the House of Representatives are chosen from proportional representation. As a result of this trend, politicians who are power hungry join small political parties with no clear vision to clinch political power. Hence, it is important to establish a two-party political system that will promote competition on pertinent national issues, rather than single-issue politics of small political parties.

#### **4. Ageing Population and Labour Force**

The rapidly ageing population remains a huge challenge for the stagnant Japanese economy as an agile and young labour force is a key contributor to economic growth. Japan's low birth rate, high life expectancy and lack of immigration are the reasons for its fast ageing population. Japan is the only country at present where 30 percent of the population are over 60. This number is projected that more than 40 percent by 2050. (UNFPA, 2012) Japan's birth rate is 1.39 children per woman. Japan's National Institute of Population and Social Security Research projected that by 2060, the country will have lost nearly one-third of its 2010 population of 128 million, and just half of this smaller population will be between 15 and 65 years old the most productive age group in any economy.

Public expenditure gulps a significant portion of government annual budgets. According to an OECD report, the over 65 age group accounts for 40-50% of healthcare spending and their per capita healthcare costs are three to five times higher than for those under 65. (Dang, 2001)

The United Nations Population Fund (UNFPA) posits that if Japan wants to counter the greying of its population and increase the birth rate, they must give more rights to women in the workplace to give them more confidence to balance child rearing and working. Another thing the government has to promote is more active participation for men in raising children. Countries such as Sweden, France, Denmark and Britain have paternity leaves for men.

One impact of this phenomenon on economic growth is that the older people get they tend to be less innovative and unwilling to take risks. This obviously results in decline in workforce and consumer spending. It also means that safety nets will be stretched to their limit as there will be greater numbers of elderly dependents in the future. A study carried out in 2010 by Goldman Sachs concludes that an increase in female labour force participation rates to the same level with men would add 8.2 million workers to Japan's economy and virtually erase the projected decline in the country's working-age population, and boost GDP growth by 15 percent.

Furthermore, policy makers and politicians have three options: increase the number of immigrants into the country, raise the birth rate and introduce a more inclusive policy for women to be more active in the work force.

Japan has to adjust its immigration policy to reflect contemporary changing economic needs of the twenty first century by attracting and integrating highly skilled individuals. Innovation which is the main engine of growth must be placed at the front burner of Prime Minister's Abe's reforms. For instance, Canada recruits highly skilled immigrants with or without a job offer using a points-based system. Japanese politicians can be instrumental in this regard by promoting Japan as an attractive economic hub and enlightening the general public on the potential benefits of immigration to the Japanese economy. In order to assist new immigrants to get jobs that suit their educational attainment, the government and non-governmental bodies should assist with effective settlement assistance. Japan can adopt the Canadian model where immigrants are offered orientation courses before they leave their home countries. Japan must create a two-pronged approach to properly administer the immigration of skilled workers. First, a point based system that concentrates on highly skilled immigrants who can take up jobs openings created by gaps in the labour force created by demographic transformation. Second, Japanese employers should have the ability to recruit newcomers on a temporary basis. Both long-term and temporary stays ought to include prospects of permanent residency as a path to citizenship.

#### **5. Culture and Structural Change**

In 2002, the World Bank held a Conference on Culture and Public Action, in which participants pointed out the need to use people's realities, including cultural ones, as starting point for every policy formulation. Hence, there is always a tendency to pay attention to the role of culture in analyzing the processes of development in economic discourse. Culture is important as policies need to be crafted to address the realities people face. Samuel Huntington in his book, *The Clash of Civilisations and the Remaking of World Order* 'In the post-Cold War world,' wrote, 'the most important distinctions among peoples are not ideological, political or economic. They are cultural. The issue is not whether culture matters but what are the different means in which culture influences stagnation in Japan? Alan Greenspan once noted in the wake of the collapse of the Russian economy in the late 1990s. "I used to think that capitalism was human nature. But it isn't at all. It's culture.'" Elaborating

on Landes's theme, Yoshihara Kunio writes, "One reason Japan developed is that it had a culture suitable for it. The Japanese attached importance to (1) material pursuits; (2) hard work; (3) saving for the future; (4) investment in education; and (5) community values."

There are myriad theories peddled to explain the monstrous economic miracles of East Asia in terms of local culture. For example, Michio Morishima a Japanese economist has linked the roots of "the Japanese ethos" to the special history of its feudal system. Also, Eiko Ikegami a Japanese historian has focused on the influence of the "Samurai code of honour." Morishima (1982), Ikegami (1995) All these scholars aver the reach of Confucian ethics in industrial development and cultural dimensions of Japanese economic success.

It is noteworthy to state that culture does not impact on development in isolation as its integration within the broader context in which culture, is seen in a dynamic and interactive way, is one important influence among many others.

Furthermore, the fundamental misconception is that structural changes are the key to Japan's economic revival. However, Garry Jacobs argues in his article entitled "Vision, Not Structure is Key to Recovery"

The difference between Japan and South Korea is not structure. It is vision and release of social energy. Korea is still playing catch-up, so its direction is clear and the energy of its people is fully released, regardless of structural obstacles. The solution for Japan lies not in structure, but in society. Money and finance are only subsets of economy. Economy is only a subset of society - of the people. Japanese society has enormous unutilized potential in the form of human energy, productive skills, technology, organizational capacity and money. These resources need a mission and a channel for productive employment.

Structural changes were and still are needed in Japan but structure alone is not the sole solution. The key objective is to mobilize and unleash the potential of the population with an inspiring vision of its future.

## **6. Protectionism, Trade Policy and Regulation**

The infant industry argument comes to mind when we talk about protectionism. Under this policy regime that was pervasive in the 1960's and 1970's, government shields certain key industries from international competition as a matter of national interest and a means of safeguarding jobs. However, empirical evidence from all the countries around the world that have practiced protectionism shows that the policy has failed woefully in all ramifications. In fact, it hurts the growth of industries as countries that have embraced free trade have grown faster than those with trade barriers.

This usually comes in the form of protective barriers such as tariffs, subsidies and taxes that stifle competition in industries. This leads to situations where politically-connected big corporations use the government to drive the smaller firms out of the market. A cross-country analysis shows that firms financed by foreign investors account for 4 percent of GDP, compared to 20 percent in the United States and 50 percent in the United Kingdom.

The Economist magazine said that unless a Japanese company is actually going out of business, it cannot fire any of its workers. This situation makes companies very unwilling to hire new workers or effect pay rise of their workers. Also, the agricultural sector in Japan receives subsidies that are six times those in the United States and three times those in the European Union.

Encouraging much needed tax breaks geared towards encouraging foreign direct investment is necessary to foster foreign direct investment in Japan. We need a limited role for the government in a free market economy but not an absent government because sometimes government has to step in because people are not always rational.

## **7. Cross Country Analysis and Comparison**

Economic Freedom of the World Index published by the Heritage Foundation reveals that four Asia-Pacific economies and Switzerland earned designation as truly "free" economies in the 2013 Index. The index measures the degree to which the policies and institutions of countries are supportive of economic freedom in five broad areas: regulation, size of government, international trade, sound money, legal and property rights. Hong Kong was able to hold its position as the world's freest economy, a position it has held for 19 consecutive years. With another strong progress in economic freedom, Singapore remains a close second and has closed the gap between it and Hong Kong. Australia, New Zealand, and Switzerland maintained their previous standings of 3rd, 4th, and 5th, respectively. However, Japan ranked 24<sup>th</sup> out of a list of 144 countries. The report noted, "Japan's overall record in advancing economic freedom is patchy, and its score is lower today than it was in 1995. The financial sector, though modern and well developed, remains subject to growing political interference. Seniority-based traditional labor practices persist, constraining mobility. A monetary policy aimed at preserving low interest rates has reduced any acute concern over Japan's large debt burden, but it has also limited the political

motivation to implement urgently needed fiscal reform. Japan continues to fall behind other neighboring economies in pursuing free trade agreements.”

Korea rose from the rubble of war using the same export-led approach that Japan had before it, and which China is currently implementing. Quite unlike Japan, Korea has been successful in drastically cutting the government's role in its industries and moved beyond maintaining an undervalued currency, an obsession that skews incentives and aggravates the risk of credit bubbles. As a result of this, banks were freed to give out credit more efficiently, while private firms, deprived of state support, had to become more innovative and competitive. In Korea for example, such measures has translated into increased support for small and medium-sized business thereby engendering economic growth from the bottom to the top. Samsung Electronics Co. is a good example of a globally competitive company where a firm deprived of state support had to become more innovative and competitive.

A trade pact such as The Trans-Pacific Partnership (TPP) which is a framework that aims to liberalize trade in the Pan-Pacific region is a good example of an initiative that could ease the Japanese economic stagnation. It started as an accord that was signed in June 2005 (and took effect in May 2006) by Chile, Brunei, Chile, Singapore and New Zealand with the goal of eliminating trade barriers. So far, other countries including the United States, Australia, Malaysia, Vietnam and Peru negotiated to join, and Prime Minister Shinzo Abe announced in March that Japan would participate as well. The TPP agreement affects nontrade issues such as internet freedom, labor, patents, food security etc. First, this sort of programme will benefit Japanese consumers benefit a lot as it will increase their ability to buy imported products at cheaper rates after tariffs are eliminated. Second, the Japanese market size will expand since the bigger the market, the larger the opportunities to expand trade. With Japan's entry, the combined gross domestic product of all the negotiating parties' jumps from \$18.8 trillion to \$24.3 trillion. Finally, it must be noted that Japan, in order to fully tap into the opportunity presented by joining the TPP, needs to increase its competitiveness. The *World's Economic Forum's Global Competitiveness Index 2012-2013* cited earlier corroborates this view. The Each country's requests for exceptions to the TPP's overriding negotiating principle show their weakness in competitiveness in the fields being protected.

Thus, in the new post 2008-2009 global financial crisis world, achieving growth in Japan will critically lie in its ability to tap the potential of regional economic integration as the country is surrounded by several economic heavy weights. Global economic dominance is shifting towards the East which pundits have referred to as the 'Asian Century'. A 2011 study funded by the Asian Development Bank projected that between 2010 and 2050 that the regions GDP will increase exponentially from 28 to more than 52 percent, with China accounting for 20 percent and India for 16 percent. (Kharas et al, 2011)

## 8. Conclusion and Recommendations

The basic premise of this research paper still remains that there is no one-size-fits-all solution to the problems militating against the Japanese economy. Economics cannot be isolated from political and social factors as both worlds are inseparable in shaping public policy. Addressing the economic stagnation in Japan requires a multi-faceted approach that is not purely an economic solution.

Japan's development model in the last half-century has concentrated on government meddling and planning of the economy. Empirical evidence from Japan suggests that government policies based on preserving national interests and not free markets are a sure recipe for collapse.

Hence, Japanese policy makers must adopt a policy that is sustainable, holistic, national, multi dimensional, people centred, non-western but contextualized and tailored to the needs and realities in the country.

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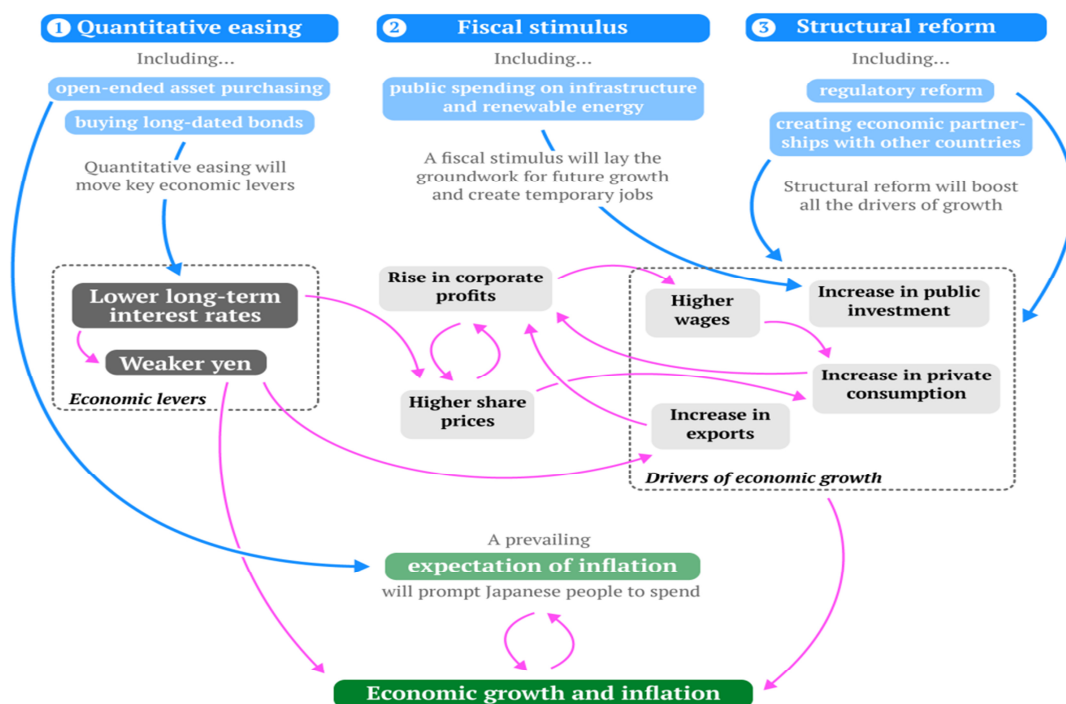
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### Abenomics

Prime minister Shinzo Abe's approach to breaking out of the deflationary spiral involves three major policy pushes—the so-called "three arrows." Their effects are multi-faceted, but each is designed to ultimately spur economic growth.



Ritchie King | Quartz | qz.com

Chart inspired by the "Abenomics Handbook" by Nomura

Figure 1

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