

Myopia: the Crux of the Japanese Problem

by
Dr. Yakushiji Taizo

Yakushiji Taizo: Thank you, John. Good evening, ladies and gentlemen. I am quite honored to be able to speak in front of distinguished guests on this very important program. What I'm going to talk about is on the Japanese economic problem, but I'm not an economist by training. I am a political scientist and so it's rather uncomfortable to talk about Japanese economic problems, but thanks to distinguished attackers, you know, Adam frequently appears in the Japanese newspaper, and I'm rather scared to have Adam here.

And Peter is rather harsh against the Japanese FSX problem and I used to talk about defense and technology, but now I'm going to talk about the economy. Because I am given only 30 minutes and I don't know if I can do that, I'll do my best to be able to talk within 30 minutes.

But before I drift to a different direction it's good for me to give you the conclusion I'm going to take in my talk. Koizumi, who is a Keio University graduate, says so many times he likes a slogan and he said without structural reform there is no hope for the Japanese economic recovery. And maybe this is true, but Koizumi doesn't say anything about industrial problems. He doesn't know about industry so if he listened carefully to my advice or my policy advice, which I call a rather provocative work, it's called Virtual GHQ policy, he would be very successful in reforming Japan. That's my conclusion.

Keio University Produces Optimists

And so Peter and Adam we will talk about further whether what I'm going to talk about is pessimistic about the Japanese economy or optimistic. I'm always optimistic because Keio has a distinguished reputation to produce a lot of optimists. Koizumi is an optimist.

Hashimoto is an optimist. I'm an optimist.

So we have only three prime ministers and it's hard to generalize. Do you know that we have only produced three prime ministers in our 150-year history? It's very rare. Inukai was first and Hashimoto was the second. Now we have a third, Koizumi who is a distinguished character, but the same Keio optimist. And I'm not talking about Todai (Tokyo University) graduate prime ministers or Waseda University. They are not optimists, but very dark.

But anyhow, forget this. Koizumi's structural reform has been often criticized by the Japanese themselves, but some have a warm appreciation. But some criticism says that it's nothing but a kind of regular, conventional, administrative reform. That it has nothing to do with the structure reform and so the whole kind of *gyozasei kaikaku* in Japanese were built by the previous prime ministers, like Mori and Hashimoto and Obuchi, of course. So nothing new, but he is very populist and very genius in advocating, "this is a structure reform I am proposing" and so that's the first thing I would like to say. Whether or not it is a similar, conventional reform, or structural reform.

My argument is he doesn't talk about the industry, so it's not a structure reform. He is busy talking about the financial policy to inject a lot of public funds into banks to solve the bad loans. And I'm going to briefly touch on it, because I will try to be careful not to be too much attacked by Adam.

Adam Posen: I'm going to be nice.

Yakushiji: Okay, fine.

Peter Ennis: I'll attack him. Don't worry about it.

John Ikenberry: I'm going to keep everybody peaceful.

Koizumi's Fluctuating Popularity

Yakushiji: Very good. This is a peace foundation. And, as you'll all note, Koizumi recently visited Pyongyang and he found very much useful for him and some people, like Kamei Shizuka attacks very strongly. But he gained popularity and he raised his popularity from 45 percent to 65 percent, a 20 percent increase, which is great.

And remember when he fired Tanaka Makiko from the post of the Minister of Foreign Affairs he just dropped his popularity by 30 percent because Tanaka Makiko gave 30 percent to Koizumi's popularity up to 80s, so just subtract 30 percent, he gets the 40s. But recently he gained and recovered by 20 percent by going to Pyongyang.

So the abduction case is still going on, but he just gained. But politically, his visit was very conducive to help stabilize the East Asian security situation and he did some sort of contribution to that. So based upon just his increase of popularity, he recently reshuffled his cabinet, as you know, but this was a minor, minor change. And you all know that Yanagisawa once was Minister of FSA, in English, Financial Services Agency, *kinyu-chokan* in Japanese. But he was appointed before Koizumi became prime minister. And he belongs to Kamei Shizuka's faction and he was very nice for last year. But he was finally fired and so it's kind of a quarrel among the ministers within the Koizumi cabinet over the issue of how much we have to spend, directly or indirectly, public money to help the banks suffering from the bad loans.

What I know is people are talking about how much price we have to pay to resolve the bad loans, the market value of stocks. I don't know who knows, or the kind of net book value or its value based upon the resolved money for the bank for solving the debt of

loans. So this is too technical to a political scientist like myself, but I am talking about the political implication for those. Because of the firing of Yanagisawa and, as you all know, Takenaka got their appointment and previously was planning minister and also Fiscal Service Agency Minister.

And the head of my institute, IIPS, Nakasone, was very warm, *vis-à-vis*, Koizumi. But recently he started to attack Koizumi and attacked Takenaka because it's too much for him because Takenaka doesn't have a political base and he talks about industrial cooperation and cooperation from METI, the former MITI, is important. So he knows the industrial policy should be linked to fiscal policy. But I am a little bit pessimistic. While Takenaka is a good friend of mine for many years, we need a kind of political kind of base to implement what Takenaka is thinking about.

And that's the kind of problem we are facing in Japan and so the recent survey says 70 percent of people are negative and believe Takenaka is not going to solve the bad loan problem. But this is the kind of very ordinary survey. So this is the kind of question and I'm going to not talk too much, but there is the point of the BOJ's unusual purchase of bank stocks, which received very harsh comments from polling observers. But the Bank of Japan's new move is pretty much appreciated by, of course, the Minister of the Treasury and showed us that this could be very effective if it gets ailing or failing companies to become bankrupt or fade out.

Officials Ignorant of Industry

But they don't know how to do fade out and so I'm going to argue that Takenaka and Shiokawa don't know anything about industry. They all know fiscal policy, fiscal problems, the bank problems and the macroeconomic policy, but in order to talk about structural reform for Japanese economic recovery we have to touch on how we can do the industrial revitalization and that's the argument I'm

going to convey tonight. And so MITI, and the Minister of Treasury, the former MOF, rival each other so Hiranuma, Minister of METI, is very antagonistic against Koizumi.

So how Koizumi can intervene to MOF's or METI's jurisdiction?

That's why Nakasone probably insists that we have to have the kind of very powerful faction based politician to be an economic planning minister. But I don't know. Koizumi didn't listen to the old generation, so it's good because Keio graduates are very optimistic and very individualistic. So it's okay.

Japan Faces an Industrial Problem

So what I'm going tonight to talk about is how Koizumi should know the fight we are facing is an industrial problem, and we have three types of industrial sectors in Japan. The first type and second type, which I'm going to talk about, are more or less what I call the flow industry. By flow industry I mean the industry which is dynamic and responds to a kind of changing environment. I mean the market.

And one is good, one is in trouble. So the two kinds are similar, but they have different problems. So we have three types of industry and company groups. And the last one is called the stock type of industry, construction industry and retail industry, banking industry, and all receive a kind of red tape, the licensing and permits and the stocks. It's very much stock.

And so the flow industry, the second is the flow industry, and one is the stock industry. There are three. Each has its own problems. So, in other words, there is no single industrial policy available. We have to be careful that there would be different kinds of industrial policy to implement to help revitalize those three. And the last three points, the last point is Japanese technology is still strong.

We are pessimists in Japan. I am an optimist, but most Japanese are pessimists. Japanese

industrial competitiveness is gone. We are being passed by others. We try to be a bastion again, but are passed by, but the truth is Japanese technology is very strong and look at the I-MODE cellular telephone. Japanese are not using telephone for analog communication. They are just using it for Internet mailing.

And so we introduce, we built a very strong and powerful rocket called A2A. It is equivalent to the ICBM you have in this country, but we are not going to carry the warhead, but it's very powerful technology we still have. And also we have nuclear fusion technology which is very advanced and nano technology we are taking the lead, the U.S. government is very careful to watch what the Japanese are doing.

We took a lead in technology and also like a hybrid engine using electric motor building the gasoline convention engine, all Japanese automobiles manufactured are adopting those engines so quickly. So there are some sorts of strengths. The problem is that Japanese technology is not becoming the international standard simply because we are so outmoded in developing the business model which can be adopted by foreign countries or foreign competitors. But we are always concerned with the kind of technology as kind of indigenous. Everything by the Japanese.

Japan Cannot Capture Fruit of Technology

So today, those industries, very dynamic industries, are using outsourcing, outsourcing people, outsourcing the part supplies, but the Japanese try to make everything by ourselves. By a careless legacy and very strong confidence, it is becoming outmoded. So technology is very strong, but we cannot fully capture the fruit of technology together. So that's a serious problem.

The first type is a highly performing, highly competitive export oriented sector. Like Toyota, Honda, Canon and Sharp, those are highly performing, highly competitive. A

McKinsey study recently shows that these companies are 20 percent more productive than their American counterparts, so we are very strong. When you look at the first type of industry sector group for all industries, they are operating not only in Japan also but they are mostly operating in foreign countries - Europe, United States, ASEAN countries and China today. And I'm going to touch on the Chinese case.

And so the problem is this first type has only 10 percent of employment in Japan, but it is highly effective, highly competitive, but it's only 10 percent employment. So you see the problem. The second type sector is very important, and it is what we call a two tier performing sector or ambivalent performing sector.

And like Toshiba and the semi-conductor industry, those companies have very strong performing parts. They go out and operate in China and tell the Chinese this is Japan's very strong technology. But mostly they are operating in Japan and are too costly, too much quality and too much over capacity, because in Japan they are operating based upon very high level facilities. But it's not the top they are using in China or the United States, so it's a slight difference.

The problem is they cannot discard those facilities in Japan because the Japanese are clever, we have very good qualified engineers, and they don't like to take them out of the good facilities. But they are not competitive internationally. They are more or less competitive. They used to be very competitive 10 years ago, two decades ago, but still competitive but not highly competitive. So they are defeated by Samsung, Korea, and the American semiconductor industry. So what they are doing is to merge together to get the investment available, but nothing they can solve in my judgment.

Special Industrial Policy Necessary to Solve Problems

And this second type is so important. We have

to have a special industrial policy to solve this second type. The first type we don't care because it's so strong. The third type I call the paternalistic, red tape, low productive industry and the cases are agriculture, unofficially, having a problem of mad cow and production. Construction companies, their demand has dropped by 30 percent, but they only squeeze five percent employment so you know the problems. And they are too much dependent on the so-called *zokugin* and the government help and so the stock industry and retail industry are the same. They increased this century, in the 1990s, 60 percent of retail shops, but only sales increased 10 percent. There is over capacity, but we couldn't get Daiei bankrupt. I don't know why politically we couldn't do this. So still we have a low productive retailing industry in Japan, but the problem is they occupy 90 percent of the Japanese employment.

We have a very high competitive sector and the medium competitive sector and the very low competitive sector which has 90 percent of the employment. Unless we solve this problem, how can we solve the Japanese economic problem? That's my argument and over capacity and their productivity according to McKinsey's research is 60 percent lower than America's. But the first type is 20 percent more effective and productive than America's, so there is a spectrum of highly competitive and two-tiered competitive and very low competitive areas.

Competitiveness of China

Let me talk about the China market. The first type and the second type sector are moving to China. Chinese wages are 1/30th of Japanese, so conventional wisdom is we have to go there to lower the costs. It doesn't tell all of the picture. It is a very important factor, but it's a very small factor. Why did Japanese competitive industry go to China?

The reasons are very simple. There are three types of views about China. The first, China is a very threatening formidable country eco-

nomicallly to Japan. But all statistics, if you have a question I'll tell you detailed statistics, but China is about the same as Japan for what Japan was like in the 1960s. So we have Olympic Games in '64. They're going to have Olympics in 2008 and so are very similar. China produces, for example, as a top producer in the world they will be 54 percent, air conditioning 44 percent, and motorcycles 50 percent, desktop computers 30 percent, videotape recorders 33 percent. Those are the products where China is one of the top producers.

So it's formidable in that sense, but technologically they are very mediocre. And China is a kind of what I call commissioned producer and this is not a good word but I prefer to use. So statistics said in 1991, seven percent of Chinese exports are produced by foreign companies in China. And four years later, '95, 32 percent. And the last year, more than 50 percent.

So China is producing, but we are producing. So the Japanese second type of industry, the companies, are competing with China, but the reality is different. You've got to be careful. Japanese companies in Japan are competing with Japanese companies in China. That's true, so the problem is we have not had just industry hollowing, but we have employment problem of course. So China is not too formidable. It will be formidable in the future, but China is the kind of place for us to have a commissioned production.

And the last view of China, this is controversial, you've got to be careful, China is an American substitution. Ten years ago when I was asked to participate in a U.S.-Japan project on China, I first said China is the United States. Immediately I was dismissed, but recently METI's report says the same thing. China is much American.

China has a large territory, a large market and, more than that, they have produced interstate highways and they like to have skyscrapers like Americans. They don't care about the

details, are just like Americans, very optimistic. And Chinese are very pragmatic, individualistic, business oriented, they like to talk about money like Americans, and so are very much American. And this is very important, because of the cultural revolution they just eradicated the older generation and just a vast intellectual vacuum. So they have adopted the very young elite for the very important CEO's post or government post and recently they are having the Chinese back from foreign countries, they call the sea turtles.

You know the sea turtles come back to the same shore to have better eggs. So in China, it's not kind of based upon the low wage, but the Chinese market and people and the way they're doing are very much American, very dynamic. So I have to conclude. I've spent too much time.

Virtual GHQ Policy

So that's why I'm proposing a Virtual GHQ Policy. We have too many senior people in important posts, so we have to get them purged. So GHQ will do the purging, or what we call red purge. We need a red purge and also we got the whole disruption of the situation of the Japanese industrial products and facilities and before the war we attained a very high level of industrial capability, automobile manufacturing, but they were all destroyed by Americans and allied forces. And we started from scratch to insure the best facilities and those are conducive to the later industrial growth.

And instead of going to China where we are starting from scratch, we want to start from scratch in Japan to solve the whole employment. That's why this is what I call Virtual GHQ Policy. Very radical, nobody listens, but because we are from the same alma mater, I would like to ask Koizumi to listen to this policy. And so Virtual GHQ Policy, it's radical, but the meaning of Virtual GHQ Policy is not too radical. It touches on the problems of industry in Japan today, and so with that I'm

going to conclude my talk. Thank you very much.

Ennis: Thank you, professor, very much. First of all, thank you, John, for inviting me to be here and I have to say that my company, Toyo Keizai, mostly consists of Keio graduates, so I'm in the grand tradition even though I'm not a Keio graduate by any means. That's a long story.

But anyway, Yakushiji did not use the word "myopia" in his talk, but when I received from John the advance notice of the thrust of the speech and I noticed the word "myopia" right at the top, it sent me on a bit of a tangent. I think myopia in English is one of those unusual words that we all know, or we think we know, but what actually does it mean? I thought I knew, but when I went to the dictionary I realized that it can mean a lot of different things.

And this morning my 13-year old was running out the door as usual and I handed him his egg sandwich, what I make for him every morning, and as he's running out I said, "Oliver, hold on a second. What does myopia mean?" He said, "Dad, come on, give me a break, I've got to get the bus." "Hold on a second, what does myopia mean?" "Well, doesn't it mean that you sort of know something, but you don't quite see the future or you don't quite see it clearly?" So I said, "well, that's not bad. When you get home tonight look it up, but that's not bad."

And then I went to, I mean I knew it in Japanese, *kinshi kingan*, but I wasn't quite sure how to use it as an adjective. Does it translate from the physical short-sightedness to a short-sighted person? Can you use that as adjective? So I checked with a few friends, *kinshigan teki*, so you can use it that way, right?

Japan's Vision Problem

The reason I'm mentioning this is that I don't, in my opinion, short-sightedness or *kinshi*

kingan, I don't think it quite captures what's happening in Japan. That may be with some people. That may be with the *Jiminto*, with the *zokugiin*, who are holding back reform. But what I feel in Japan is more of a *tenbo* problem, that is a vision.

The problem is where is Japan going? I mean everybody in Japan knows the system is broken. Everybody knows that, there's no debate about that anymore. The question is where is Japan going to go? And what I feel, still jetlagged just having come back a day or so ago, the problem is *tenbo*, vision, where is Japan going? And Japanese are stuck between a system that doesn't work anymore, that everyone knows doesn't work anymore, on the one side and on the other side, where are we going.

So they look at the U.S. and they say well, do we want to have high unemployment and companies can willy-nilly just announce 3,000 people are suddenly laid off and homeless and so on and so forth? No. Or do we want to have a European system, say Germany, where you have permanent 10 percent unemployment and it's all supported by the state structure and so on? Well, no. So I think the problem now is that Japan is stuck between a system that doesn't work and a new system that Japanese people have not yet defined for themselves. They don't want to be Americans, they don't want to be Europeans, they want to be Japanese.

Fear of Unemployment in New System

So what does it mean to be Japanese in a new system? And that's the problem. And if I can just hit the nail on the head if I may, the issue is unemployment. Everything that the professor described I think is absolutely accurate. You've got an industrial system in Japan, highly efficient Sony, Matsushita, so on and so forth, and all sorts of companies and, by the way, they are efficient precisely because they are internationally competitive. They produce in the international market.

But as the professor said, I think accurately, 90 percent, or I'm not sure exactly what the percentage is, but most of the Japanese market never faces international competition. 15-20 percent, don't quote me on that, but a huge percent of the Japanese labor force is engaged in construction projects which everyone knows are going nowhere and there's a kick-back arrangement to the LDP and so on and so forth, and then you get into the retail. I forget the numbers again, I apologize, but the food processing industry in Japan employs many, many more people than steel, auto, electronics combined. So many domestic industries in Japan face no international competition and, therefore, they exist in this void of lack of competition and, therefore, they lag.

And so the key issue is reform in Japan means unemployment, and who's going to face that? Dealing with the non-performing loan issue in Japan means unemployment, because behind every non-performing loan is a non-performing company and inside every non-performing company are people and those people have politicians who are supporting them. So Japan is in the midst of a very profound transformation, from a catch-up economy to a modern consumer-oriented economy, and that transition is extremely difficult.

Politically, very difficult. And the problem is that the LDP, the *Jiminto*, the liberal democrats, have delayed and postponed making the tough decisions, which means that the tough decisions are even more tough. The process of transition from a producer-oriented economy to a consumer-oriented economy should have begun 30 years ago.

Economic Reform Process Will Take 10 Years

The problem is Tanaka and his machine delayed it and now the delay means that the problems are even more difficult to solve. So what we're dealing with is a situation in which real reform in Japan is probably going to take, even assuming that Japan did everything right

starting today, would take five, six years. All the adjustments, moving people from bankrupt companies into new companies, having some sort of a fluid capital market in which money could move out of bankrupt companies, zombie companies, into new companies.

That's a very, very difficult process. At best, if Japan did everything right today, it would take five years at least. But Japan is not going to do everything right because no country does everything right because of politics. It's going to take at least 10 years for this process to work itself through, I think. But I think it will happen because Japan is a great nation and great nations tend to reform.

Four Scenarios of Japan's Future

Let me just end with this, quickly, with four scenarios. Some people say Japan could muddle through, just continue along doing what it's doing. In other words, one percent growth, what's wrong with that, still a rich country. All right, that's one scenario.

And the other scenario is crisis, financial cataclysm. The growth of the national debt at some point will blow up or the bank problem will blow up and you'll have a meltdown in Japan.

The third scenario is step-by-step reform—that the LDP will somehow find a way to do the things that it has to do to make the reforms.

And the fourth is that the LDP will break up and you'll have genuine reform, a multi-party system and so on and so forth.

I think the muddle-through scenario is not realistic because one percent growth in Japan is not realistic with the aging of the population. Productivity has to grow much more faster than one percent to take care of the aging of the population, so muddle through is just not realistic. Financial crisis, well, many people have predicted that, including some who've said it should have happened last September—August, September and before—

we've heard that many, many times. But Japan has too many resources available to enable it to avoid a cataclysmic financial crisis and we've never really seen a situation in which a country . . . usually when we see financial crisis it's because of a combination of external crisis, bounced payments and so on, and internal crisis.

Japan is a creditor nation. Japan, as long as the BOJ continues to fund the banks and the government continues to fund them, you're not going to have a financial cataclysm in Japan.

Step-by-step reform? Well, the problem with step-by-step reform, that scenario, is that reform means that the LDP says well, we're going to ruin our own constituents. And that's what Gorbachev faced in the Soviet Union. It's very difficult for an organization to say to its own constituents goodbye, but meanwhile please support us. It's very unusual for that to happen.

Breakup of LDP

So I think the most likely scenario is a series of political crises in which the LDP finally breaks up and there's a political realignment which allows the Japanese society to be free of what now are institutional straitjackets. The process of the LDP breaking up will free the country of these institutional straitjackets and reform will occur, but it will be very messy, very noisy and it's not going to be smooth by any means. But I think my sense is that that will happen step by step. It's going to be very messy. I'm sorry if I took too long, but that's the way that I see things happening. Thank you.

Posen: I had said earlier that I was very impressed they put out the food before the talk because I'm used to Washington, people bribe you into staying through the talk by having the food afterwards. And so now, on the other hand, that means you're not rushing to get to the food, so I can go on forever. I'm very

grateful to John and to the Sasakawa Foundation for inviting me tonight.

Professor Yakushiji and I have crossed paths in a perfectly peaceful way many times and Peter Ennis and I have crossed paths in a slightly less peaceful way many times. And so it's a great pleasure for me to be up here. I'm going to start with a visual aid which none of you will be able to see, but anyway. I have a key chain, and this is a key chain from the Toyota Commemorative Museum of Industry and Technology, which I don't know if any of you have been to.

Yakushiji: I've been several times.

Posen: It's a great, great science museum that was created by Toyota. This is to be distinguished from their automobile museum and the other things. It's in an old, one of the original Toyota plants, where the original Toyota loom plant was. And I don't even drive a car. We don't own a car, I don't have a driver's license, but I carry this key chain with me. I do have house keys obviously.

So the question is why? Well, as I explained in a paper that's available on the IIE website and was published in a book Princeton University Press published, *Technological Innovation and Economic Performance*. I think Toyota and a few other companies, many of the ones that the professor mentioned, Canon, some that he didn't mention, Sony, Hitachi, are unquestionably world class. I mean Toyota is hands-down the best manufacturing company in the world. Period. And even without friends from Toyota in the audience I have said that on many occasions.

Japan's Technological Competitiveness Is Unchanged

And the point of this essay that I wrote was actually almost totally in agreement, in some ways, with the professor, that Japanese technological competitiveness is unchanged. In fact, the original version of the paper is titled,

Unchanging Innovation and Changing Economic Performance in Japan. And it's in this sense that I'm an optimist about Japan and I have been going back to when I first started writing about Japan in 1997, that nothing fundamental had changed in Japan, that, yes, Japan had structural problems, but had you ever visited Montana? We have entire states that consist of nothing but structural problems in public works projects.

Granted, they aren't quite as comical as some of the ones people can report on in Japan, but some of them get pretty good. No structural problems got noticeably worse in Japan in the 80s. No structural problems suddenly got worse even in the 90s, except to the degree the recession itself made them so.

So construction employment – and again, I completely agree with the professor, the construction industry in Japan is a terrible waste, it's terribly inefficient, and so employment of construction went up a few percent of the workforce, but in response to the recession. I mean it was simply the LDP had to stick unemployed people somewhere, so they put some more money into the construction industry.

Japanese Government Has Betrayed the People

Where am I going with this? The reason I come across when I am able to appear in the *Nikkei* as so critical is because I believe the Japanese government and the Japanese politicians have betrayed the Japanese people. They've thrown away this enormous productive capacity that's still there by imposing this terrible banking system, this terrible macro policy, and this has completely eviscerated, cut apart, struck down the underlying productive capacity of Japan.

And so, in a sense, I've always been an optimist, even though I am one of the people Peter points out who predicts crisis in the short term. Because nothing fundamental has changed

from the Japan that was there in the 70s or the 80s and Japan could go back to being that way if only it would get rid of some of these specific banking problems and macroeconomic problems.

You see, and this is what's so interesting. I think, if you compare what I'm saying to Yakushiji, I'm sorry my pronunciation is so bad, it's another sign of how uneducated I am about Japan. But as Yakushiji and are I saying, we're pretty much in agreement actually until you get to the bottom line policy recommendation. I completely agree with him that there is this gap in the politics, that we all liked Takenaka. I think very highly of him, I know him personally, I think he's got the right agenda, but I'm very concerned he doesn't have the political force behind him to push it through.

I'm very concerned that he depends on the prime minister and the prime minister is trying to be popular and doesn't quite understand the situation. He's a Japanese Reagan. I mean he's got a sort of big picture idea, but he doesn't know about following through. One little note about Keio people, the Keio prime ministers, of course, are also the prime ministers with the best hair. I mean if you think of Hashimoto and you think of Koizumi and, of course, the professor. And I'm here and I didn't get a chance to get a haircut before today.

Ministry Rivalries Pose a Major Problem

So I agree with him there, and I agree with him that a major problem are these rivalries within the governments. You have the METI-MOF rivalry, for example, which I think is absolutely right, just as there is a MOF-BOJ rivalry and a BOJ-FSA rivalry, and a lot of these games of combat and chicken within the Japanese government I think are a major part of the problem. And so, again, I think his point about administrative reform being sort of a side show is absolutely right. And so you just go down the list.

I think this is all very true. The place where I would differ is on how you get out of this. And then I'll take up something Peter said. I have the privilege of going last, so I get to also talk about what Peter said. The difference I think of is if you had a functioning banking system and you didn't have deflation and, ideally, you had a slightly better tax code, but we don't even have to go that far, a lot of these problems would fix themselves.

GQ Approach

I don't need a GHQ approach. I need a GQ approach. I need a bunch of guys, preferably women too, but that's not realistic in Japan, in good expensive suits walking around making decisions on a decent basis about financial matters, deciding which businesses to put out of business and not. And so if that were to happen and if there were enough capital in these banks and if they were managed by people who knew what they were doing and, obviously, if there was enough political support to get you to that point, we would get rid of a lot of the problems. And it would sort of take care of itself and you wouldn't need the GHQ approach.

Which I guess is the one other point where I probably differ from Professor Yakushiji. As much as I like my friends at METI, and right now I think they provide an extremely useful role, they're sort of the team B in Japanese government, they're the ones that are thinking long term structurally and providing a lot of good counter-arguments to the people in the rest of the government, they were always overrated.

And this is not my research. This is people like my colleague, Mark Nolan, this is people like David Weinstein at Columbia or Robert Lawrence at Harvard, did a lot of work demonstrating that, Howard Packet at Penn, that industrial policy never really did what people thought it did. In a sense, Japan grew despite.

So, in other words, the Hondas, the Toyotas, remember they were not the favorites in the government. Government was busy giving a lot of money to Mitsubishi Motors and then Honda grows up from being this little generator motor bike company into being the world's great car company. Sony, remember, didn't really get any seed money from the government and Morita had to pull every string in town just to get his little bit of money to go do the first tape recorder.

Japan Grew Despite Economic Problems

You know, Japan grew despite and so to grow despite all the problems in the other 90 percent of the economy again. I mean this is what I said in '98 and I'll repeat it, structural reform is nice. It would be great to have it. It would improve growth and, as Peter points out, the people are getting older. Great to have more growth to pay for that, but that's not what's keeping Japan down because that isn't what changed. And there are plenty of countries in the world, I would say oh, I don't know, Germany, Italy, Botswana, that have huge structural problems but haven't ended up as Japan. So that's why I always come back to the macro stuff.

Let me just conclude by saying a couple things about what Peter was saying, because I think he had one very fundamental insight, which is his statement, "the issue is unemployment" and I think that's right in a sense. There is no question that if you get the reforms you will at least transitionally put a lot of people out of work. But I guess here I'm going to seem a little more like a classical economist or even a Chicago economist.

Yakushiji remembers that I was the token democrat at a meeting he was at, but I'm going to sound now like a very free market economist. You take a bunch of educated people in Japan, you put them out of work, but you have a good banking system, they'll probably find new jobs pretty quickly. There are things you can do to improve this.

Wage Insurance

A colleague of mine at the Institute for International Economics had a proposal for what's called wage insurance in the U.S., which you could also do in Japan in which you encourage people not to wait too long to find a new job. You could have a better safety net, which Keidanren has occasionally spoken of and I wish they would speak more strongly.

I mean there are things you can do, but there's no reason to think it's going to take five years or ten years. It should only take five months or ten months. And I guess that's the biggest difference I have with Peter. You know, he gives you his four scenarios and I'm in the number two scenario, the financial crisis scenario and I actually had suggested last spring that we would have a crisis more than likely by this September. We seem to be getting there and, in fact, the only reason Takenaka is in office and the only reason the Bank of Japan came out publicly to buy shares was because they thought the crisis was imminent.

Nothing Fundamentally Wrong with Japan

Otherwise, this wouldn't have happened. And there again, it's a question of I don't think there's something fundamentally wrong with Japan. I think it's a question of they simply let these problems of non-performing loans and deflation go on too long and if they had dealt with them in '98 then it wouldn't even be an issue now. And if Takenaka is lucky enough and has enough political support that a real bank reform is accompanied by a reasonable tax cut, is accompanied by the Bank of Japan stepping up and printing a lot of money, we may not have a problem a year from now.

But where, again, I think Peter is right is the issues on unemployment. How do you politically push that through? That's harder. And let me close there by just making one suggestion, and it's one, unfortunately, Americans have had to . . .

Ennis: Lay off Peter from his company.

People Must Separate Viability of Companies and Viability of Themselves

Posen: No, you could lay off some of your employees. You're at the top. You can stay there. I think the one thing I would suggest, and I'm sorry to go on so long, is people have to separate the viability of their companies and the viability of themselves. If there were people in Japan who were pushing the message just because you lose a job now doesn't mean you're going to lose a job for the rest of your life, just because you no longer work for Daiei doesn't mean there's no future for you, we could get somewhere.

Now it's hard to sell, but we also have to recognize that a lot of what people say about unemployment is sort of in line with the joke Peter just made. The real reason the banks are concerned about unemployment is because they don't want their managers to be unemployed, not because they actually care about their workers because if they're protecting their workers, they're actually putting out of work their children and their grandchildren. Anyway, great time to be here tonight.

I guess I was a little less peaceful in the end, but despite my lack of haircut I am a Keio man at heart. I'm very optimistic about Japan long term and I'm very optimistic that even if there is a crisis short term it'll come back.

Q & A

Ikenberry: Well, while we all comb our hair I wanted to open things up and we will entertain questions from the audience. Please stand up, give us your name and ask your question or make your comment and we'll take it from there. And Professor Yakushiji will weave in his responses to our two discussants as he responds to the Q&A. Please.

Questioner: This would be directed I guess primarily to Mr. Ennis because it's based on

this excellent article by Richard Katz in *The Oriental Economist* for September. And on page 8 he writes, “labor and capital productivity combined, what economists call total factor productivity, tumbled from 2 1/2 percent in 1970s to 1.4 percent in 1980s and to 0.6 percent in 1990s.”

Now this reminds of when I was studying the Soviet Union and by the late 1970s that total factor productivity had gone negative, which was a sign that the end was coming. Is there anything arresting that trend in Japan? Because as your colleague writes here that, “this is the law of diminishing returns.” Is anything arresting that?

Ennis: Well, keep in mind that I’m not, by any stretch of the imagination, an economist, but I will quickly say, yes, there are some trends. Japan is definitely importing more these days and, even though a lot of it is Japanese companies importing from Japanese facilities overseas, nevertheless you do see in certain retail sectors, for example, a lot of price competition based on imports. So that’s a good trend.

But on the whole, I think the answer is no because the only way to increase productivity in Japan is to, first of all, increase foreign direct investment and imports. That’s the key, those two elements, more foreign investment and more imports. I mean there are many other things that you can do, but those are the two keys and the tendency now is to not allow that.

So right now I think you see some positive trends where some imports are increasing, but on the whole I can’t say there’s a positive trend, no. God I wish Katz were here so he could help me out here. Probably I’m wrong what I just said, but anyway.

Ikenberry: If any of our other distinguished guests wants to comment on that or the other questions, they’re welcome.

Posen: I’ll just put out a factual note. The

decline in TFP, in total factor productivity, that Katz refers to. And that you quote is not exactly the right measure, because, as we just saw in the U.S., productivity tends to be what we call pro-cyclical. So when the business cycle is going really well it tends to look like productivity is higher than the actual trend as we’ve just discovered in the U.S., and when the business cycle is going really badly, productivity tends to look lower.

So those numbers somewhat exaggerate the decline in Japan because of the downward trend in the business cycle for the last 10 years. That’s not to say the point’s fundamentally wrong, but it’s just things are not quite as bleak as those numbers point them out to be.

Yakushiji: Well, TFP, the measure is carefully studied by the economists of Todai because the government gave money to study it. But I think the TFP, generally speaking, is the trend of Japan. You look at only the productivity within Japanese market. But it’s very hard to include the kind of TFP figures. As I said, overseas operations, and so we get the whole Todai economists to study that, and when you only talk about the domestic TFP is declining, of course, as I said before, because we are declining industrially.

Questioner: Yes, on the unemployment issue it’s interesting that when you look at labor force flexibility and unemployment in Japan, it’s actually pretty flexible. It’s much more flexible than most Japanese believe it is. There are over a million people in manufacturing, a million fewer people in manufacturing, than there were five or eight years ago and we don’t find a million people walking the streets looking for jobs. They found jobs elsewhere and the spell of unemployment in the OECD countries is among the shortest, but people don’t believe that.

The person who loses his job doesn’t realize that there’s another million people like him who have to have faced those kinds of family crises and emotional crises and have gone out

and met it and found new jobs. So I think that the politicians believe that there's a rigid economy, people believe that's a rigid economy, but people are actually much more flexible than their own beliefs are.

Yakushiji: Yes and no, because like when, for example, Canon still has their life employment system and they are very proud of having high productivity. At the same time, at the banking sectors they are getting fired and transferred to the low wage subsidiaries. And also within the company, there would be potential unemployment and they are paid, but they don't have a work assignment.

Internal unemployment, and so the labor statistics are still complicated today and so, as you said, is very flexible which doesn't mean that we don't have unemployment problem. We have employment problem and probably we are seriously having the high unemployment of the young generations, which is more important to solve.

Many Ways to Disguise Unemployment

Ennis: I totally agree with what the professor says. There are so many ways in which unemployment is disguised in Japan. One is not hiring new people, and if you look at the numbers the unemployment in young people is huge. Another way is in which the government subsidizes employment. The government pays companies to not lay off people and it's unheard of in the United States, but it occurs in Japan all the time.

If I can make this very personal, I hope you don't mind, but I just got back from Tokyo and went through rather intense budget negotiations with my company. I mean I've got a staff of five people in New York and I'm under intense pressure to cut. Not necessarily people, but I've got to cut. My company's, and I think I'll be as frank as I can, my company's revenue went from \$131 million two years ago, \$120 million last year, and we just ended September 30th, \$110 million. So we're down

\$20 million in revenue. How do we make that up? Normally, of course, an American would say just lay off people, but the company can't lay off people. It's just a principle, you just don't lay off people.

Now behind the scenes, there we are sitting at some bar and my colleagues, who are now coming into rather high level positions, and, by the way, I'm considered that too, high level management is supposed to take a 10 percent pay cut. So suddenly, Peter, that includes you. I said, oh, suddenly, I'm high level? So I'll have a 10 percent pay cut?

Yes, sir. So I said well, thank you very much, I'm now in high level management. I didn't know that, thank you very much. I'm the only foreigner in the company, by the way, out of 270 people. But behind the scenes people say, you know, we've got all these old people who aren't doing anything. Let's just buy them out. It makes more sense, but you can't say it. Everybody talks about it behind this, but you can't say it. And it's widespread.

Mr. Alexander makes a very good point, but who are these mobile people? These are people who are temporary workers, for the most part. You don't have *shain* being laid off. These are temporary workers, and the whole system is set up to allow these temporary workers to move around. Smaller companies, and if you look at the numbers, the manufacturing jobs went down by say, I don't know exactly, but a million and then construction went up by a million and so the system has a way of absorbing unemployment so that unemployment doesn't go up. It doesn't go up.

That's the problem, it's you don't have an efficient movement of people from dying companies to new companies because you don't have a dynamic capital market, everything you've written about, and this is the transition that Japan is going through. I just think it's going to take a lot of time and sure, it's very easy to say it could take six months. Well, of course it could take six months, but you're talking

about human beings and you're talking about people who have to adjust and change.

It just doesn't happen that way. It's going to take awhile because you're dealing with human beings in my view.

Dealing with Human Beings

Posen: I was going to say, a company of whatever, 250 people, with \$120 million revenue seems to be doing pretty well. I think the last point that Peter made is the one part I would respond to, and I would turn his own statement against him. You're dealing with human beings. You're not dealing with Japanese. You're not dealing with Americans. You're dealing with human beings and there is this tendency in the West, as well as in Japan, to reify Japan-ness and to suggest the Japanese are just incapable of making changes that other people make.

I'm not accusing Peter of saying that. But there are people who say that, and you look at the people and you see the same people who made the enormous change in the late 19th Century and made the enormous change immediately following World War II and then went through periods where they didn't change. They're human beings. And you know? People adapt.

So I don't think we can just sort of say dismiss things out of hand. People do respond to incentives, people do respond to conditions, and we should spend less time worrying about what makes them Japanese and more time worrying about them as pure human beings and then you might see it a little differently.

Ikenberry: I'd like to ask a political science question of our panelists. The point about banking reform being the key to this and the underlying economy is still quite robust. If the Sonys and so forth of the productive economies, innovative economies, have always played that role, even with a highly regulated economy at the output, the role of

government in the past, why can't innovative companies continue to thrive even with this stalled banking system and all the non-performing loans? If your argument is correct, you would think that there would be plenty of capital and risk and willingness to take risks around the edges of this stalled inner banking system?

Posen: You said it was a political science question, so I was going to talk last, but okay.

Ennis: I'll be glad to go first.

Posen: No, I mean the way I'll answer it in a very economics kind of way, which is capital markets as we're seeing in the U.S. at the moment are kind of funny things. They run on what we call imperfect information, which means you tend to get effects where one person's transaction affects other people's transactions.

Greater Environment Hurts Good Companies

So, in other words, Toyo Keizai, Toyo Keizai structurally is exactly the same company it was three years ago. Its revenues are going down, same people, same products, might even be better products, certainly not significantly different products. And yet, because of the greater environment, it's going to run into more financial difficulties through no fault of its own.

And what happens is, in a broken banking system you always get that. But in that process that gets magnified, because what happens is everybody is trying to borrow, everybody has to make payments at the same time, the banks have their own lack of capital so they're very scared to put anything at risk. So they have to call in more loans to make their payments. And then they don't want to foreclose on any loans they don't have to because then they have to write them off. And so the proportion of loans that go to their old debtors, the construction firms, relative to their total portfolio rises because they keep rolling over the loans they can put off calling in.

And so then, in the end, as an empirical fact what happens is it's the new companies who are most cut out in recessions. And this is why, and I'm sorry to give such an economic answer. And I apologize if it's too narrow, but this is why people like me have always been opposed to things like the Bank of Japan or other people saying it's good to have a recession because it wipes out the bad companies and their lending less in general.

Because the evidence is it actually goes the opposite way. If you have a recession it's the incumbents who are entrenched who keep collecting the money and they also have the political say. And it's the newcomers, the young people who are shut out of work that Peter is talking about, who are the ones who can't get new money.

Yakushiji: Well, I'm not an economist though I have a lot of friends who are. I'm not talking about not performing, the loan programs, but historically, as you know, we have a legacy of so-called industrial banks. We eradicate a whole industrial bank, but an emergent bank system has not been developed in Japan politically and so although banks become very much merchant like, still they keep up industrial bank mentality. That's not a political program, but that would disturb the kind of solution of the banking system today. That's my understanding.

Politicians Will Solve Japan's Problems

And just a small comment on what Adam said about the macroeconomic solution is more important rather than industrial policy, yes or not. All economists assume if we do this that will solve the problem. But politically, I'm in political science, it's very difficult who is going to solve the problem. Not the economists, but the politicians. And if politicians can understand the kind of hypothesis if we are going to solve the bad performing loan that creates the very healthy industrial incapability. But the question is who did this? Who will do and who will support this?

But in Japan I am becoming very pessimistic. Takenaka knows the solution. I know the solution. It's good for us to solve the bad loan program, if I look at the kind of political power configuration within the existing government, it's very difficult, very difficult. So that's why I put more emphasis on the industrial structure problem.

Japan Is Made Up of Thousands of Tiny Companies

Ennis: Very quickly, I promise it'll be very quick. Sorry. People outside of Japan tend to think that Sony, Matsushita, Toyota and so on are Japan. It's not true. As the professor said, I really want to reinforce this point, Japan is made up of thousands and thousands of tiny little companies that are kept alive through so many restrictions and so many government regulations that are designed to keep them alive because the whole post-war system was stability, not efficiency.

Stability was the goal. And in the midst of all that, you have these world-class companies emerge like Sony and so on and so forth and they drove the post-war economy. That's absolutely true. But meanwhile, what's happening now because of the high cost of production in Japan, it's so difficult for them. You find more and more that the most productive companies in Japan are producing more and more offshore and more and more Japan is left with the highly unproductive companies.

Japan's Village Economy

And so you have this dual-economy phenomenon that is well known. Many people have written about it. Japan is really like, I mean I call it *mura no keizai*, it's like a village economy. Just imagine that the whole country functions like a little village and I'm not criticizing it because people care about each other. And, of course, in every small village you have a lot corruption and so on and so forth, so you have all sorts of problems. It's a small village. The whole nation functions that way

and no one wants to say to anybody else, sorry, you're laid off. It's a very, very difficult phenomenon.

But keep in mind, I mean I understand what Adam is saying, human beings, they respond to incentives, but that has to be mediated through institutions and the problem is that Japan doesn't have in place the institutions of a modern economy that allows for a flexible labor force. For example, if you look at unemployment, the unemployment system in Japan, it's horrible. Or if you look at, for example, the outreach systems among corporations, it's very difficult for an employee to move from one company to another because the system just doesn't work that way. It's a mindset.

The whole institutional infrastructure that's required for a flexible labor market is just beginning in Japan. It's going to take a long time. Bankruptcy, for example, how do you put a company through bankruptcy? All of that, so these things have to be mediated through institutions and institutions of a modern and flexible economy in Japan don't exist or they're just beginning to exist. That's why I'd say it's going to take 10 years.

Questioner: I have one quick comment and a question. With regard to China, Professor Yakushiji said, perhaps half-jokingly, that China is the United States or China is like the United States for the Japanese or in the eyes of Japanese. And based on my experience having lived in China, that kind of statement, equating the United States with China, even jokingly, could perhaps profoundly upset the Japanese residents in China. Because they have to live and work under the conditions and circumstances, which is so different from the circumstances under which I or other Japanese live and work here, due to the vast differences in political system mainly. Thank you.

The question is primarily for Mr. Posen. Of course, Peter can answer that too.

Ennis: You are from *Asahi*, right?

Promotional Bilateral Trade Agreements

Questioner: No, I'm on my own, just as you are, Peter. Recently, representatives of METI, the Ministry for Economic Trade and Industry, were very passionately promoting the idea of a whole sort of a free trade agreement. And their rationale on the surface seems to be not so much for the sake of a free trade or trade liberalization per se, as for the sake of promoting reform, no? Then all said about the trade liberalization measures that have to precede or ensue the agreement would result in a major reform. Which could in turn result in the better macroeconomic performance to Japan.

And I overheard that you have some realizations about this idea of promotional bilateral trade agreements. For instance, how would you square that with the multilateral design that seems to be the more of a norm in these days? That's my question.

Posen: I thank my friend from the *Sankei Shimbun* for bothering to pay attention to what I said at some other meeting. Let me be clear, or let me attempt to be clear at least. I think you have it exactly right. I think METI is pushing the FTAs as a form of leverage, particularly against the agricultural sector, but also potentially against construction and other sectors that are real blocks to changing Japan.

I also think healthfully, there's a bit of self-interested strategy. As the professor mentioned, METI and MOF and everybody is fighting. METI's been out of power essentially. They're not in any of the major domestic debates, so if they want to make a contribution they have to think outside the box geographically. And so this is a new, creative way and, again, I support it.

I had two reservations about it. One, as you mentioned, there is this question of multilateralism. And the way that I have suggested people get out of that is that I think part of METI or Japan's efforts to promote a free trade area, bilateral or whatever, should involve efforts to

promote trade and what economists call labor services. This means not necessarily emigrants, but say Thai nurses or Filipino construction workers coming to Japan on a contractual basis doing work and then you negotiate that.

And what I have suggested both to people at METI and to people in Japanese business, although I don't think anybody's listened, is that this would be a way for Japan to actually show, not only to do this, but to show some leadership in the next trade round. Because they could stand up and say we've talked to the Philippines, we've talked to the Thais, we've talked to the Indians. The emerging markets want progress on labor services. They want to be able to send these people. Japan has a shrinking labor force. It's in our interest to send these people, to get these people. Here is a proposal for that. And so the idea is to turn some of these impetuses into a more multilateral initiative.

The second thing, which I think has been misinterpreted, is I didn't so much have reservations as I was skeptical it's not going to work. I was at a State Department conference. It was the one time I spoke publicly on this, but it's posted on the IIE website. What I suggested was I don't think it's going to work because the domestic opposition is so strong, which just goes back to things that my colleagues up here have been saying. I think METI has nothing else to offer at the moment. I think it's a constructive thing for them to offer. I think it's worth trying, but unfortunately if you ask me to do it as a forecast, I don't think it's going to work.

Use of Temporary Workers

Questioner: I'm with the Department of Commerce, and I just have a really simple question that maybe Professor Yakushiji could answer. There's this talk about the temporary workers and I just wanted to ask what's the definition in Japan of a temporary worker? Because in the U.S. it means someone who is

sort of paid by the hour, doesn't know from day-to-day whether they're going to be employed or not.

But I know that in Japan the definition of a permanent worker is very different than it is here. And I know that when I lived in Japan and I filled out a census form in 2000, I was a temporary worker even though I was on a one-year contract and had benefits and so forth. And it just led me to think maybe a temporary worker in Japan is actually something closer to what we consider just a normal worker in the United States who is able to change jobs more easily. Just a simple clarification, the definition of temporary worker. Thank you.

Yakushiji: Well, I'm not really a specialist, but I have some sort of observation of my students and my daughters and there are an increasing number of the young labor force who get a year contract. There are an increasing number of those cases so the company can fire easily, lay off, so depending upon the quality of work contracts are renewed. But the year contract, year-based contract, is increasing and the young people prefer that kind of thing because they can change, as you said.

But we don't call it a temporary worker. Temporary workers are the sort of *arbeit* working as a cashier at the supermarket to get extra money and so housewives often get the job as a cashier at a supermarket which is low wage, but very temporary. That's what we call temporary work, but the year-based contract is not temporary. But our parents said it's temporary. Why don't you get a more permanent job?

Ennis: Very quickly, if you give me your card we've written a lot on this. Again, personal experience. First of all, a temporary worker, one year, you can only renew a contract for, I don't know the details, I forget, I'm sorry, but I think only one time. So I've had this terrible experience over the last 15 years in my company where I've become very friendly with somebody and he or she says oh, Peter, I have

to say goodbye. Well, why are you saying goodbye? Well, my contract is up. I say well, let me talk to the boss. The company can't renew it because to renew it means they have to become a *shain* or full employee and that means the wage level goes up.

So it's a nasty system actually, very frankly, where the temporary workers are really discriminated against and so you fire them because you can get another person at a low wage. It's not nice. It's very difficult to break in to the level of being a *shain* or permanent employee.

Questioner: Just to follow up that, isn't that perhaps one of the ways out though for Japan is to get a lot more temporary people, people looking at going to be one-year contracts for the next 30 years? And the *shains* die off?

Ennis: Well, sure, but according to the way the law works now is that a person who is a temporary worker has to be fired. You have to change the law. But, as it works now, they have to be fired. Otherwise, they have to be employed and so the incentive is to fire them to hire someone new at a lower wage.

Crony Capitalism

Questioner: I hate to introduce a term like this, but it used to be talked about it so much that I want to ask you a question about it. A few years ago, there was a lot of talk about "crony capitalism" and, like maybe three years ago under the Clinton administration, they were trying to get Japan to get the banks to let companies close and foreclose on debt and so on, the crony system is keeping Japan from going forward and so on and so forth.

But in different strands of your talks you seem to be saying that the real crony capitalist system in Japan is kind of this construction, this culture of giving the contracts and the government permits and so on. That's the problem and that's a drag on Japan. That's a serious drag on their economy.

Would you agree with that or would you say that there is still elements of crony capitalism alive in Japan at the sort of higher levels or is it more like this sort of lower level of dragging it down?

Yakushiji: Well, it's very difficult to generalize where there is capitalism or not, but it seems to me that when you talk about low productivity in a sector like construction and others, those are products of high economic growth of Japan and because before that they are not too much dependent on the government to help. They are very competitive, small companies. But because we earn a lot of national income by exporting our goods, particularly the automobile industry made a profound impact on the increase of Japanese national wealth, and those are successes of the economy.

Growth is based upon political stability because the economists, non-business people didn't worry about the political chaos. So I think it's kind of real transaction that politicians got a kind of reward for helping stabilize the Japanese society. So the business people do not . . . I mean look at the Latin American countries. It's so disturbing and compared to the United States it's meaning is nothing. But we got the development in the post-war period and political chaos, a lot of ideological conflict in the 60s and 70s, and there was a lot of violent labor movements against established businessmen, and so we got the kind of political contributions.

In fact, you called it crony capitalism, but it's not the kind of basic Japanese system. But I try to be more rational to explain why we got the kind of system today. It was the product of the post-war Japanese growth. Japanese growth was not implemented only by the business people, but helped by the politicians.

Ikenberry: I'm going to ask a question, ask the professor to answer, then let our two other discussants think about it. Again, from a sort of political science perspective looking

at other industrial economies over the decades, centuries even, there have been those moments of great political alignment. And realignment is where you can see political parties regrouping based on very real divergent economic interests, in the 1840s over trade and a rise of a coalition of urban workers and bourgeoisie against landed interests. In the United States, it's the New Deal reconfiguration of party competition. Japan seems to be crying out for that. There seems to be an obvious role for a party that would represent the losers in this system and it's so obvious, you have to ask why it isn't there.

I know that Peter was saying that there's going to be a split of the LDP and presume that would entail sort of a coalition of young, urban and older people who are all going to benefit almost immediately from sort of cleaning out the banking system and pursuing a very different economic strategy than the servicing of the old interests that the current LDP thrives on versus some other set of interests that might be more established in the old line business. So my question is (a) do you agree that that's sort of crying out to happen and (b) do you think it will happen and (c) does it need to happen for you to see your optimistic view realized? And then just comments from the others.

Yakushiji: Why don't you start?

Ennis: You want me to start? I mean I'll be glad to. Again, sorry for these personal stories, but I'm a reporter. That's what I'm supposed to do. I just got back from Tokyo a couple days ago. And the day I arrived I did what I usually do which is head off to my favorite bar in Ginza, a little hole in the wall, which is a hangout for journalists and politicians. And, as I expected, who comes walking in the door, but Kan Naoto, the Secretary general of the *Minshuto*, the democratic party, and he had just lost his campaign to be president of the party. He didn't seem all that unhappy actually, because he figured Hatoyama will somehow blow it and then Kan will take over.

I've known Kan for 20 years and over these last few years I asked him the same question and he gives me the same answer. Kan, what exactly is the difference between you and the LDP? That's very difficult to answer. So in my typical American logical way of thinking, I said well, let's look at this, 12 years of lagging economic performance, rising unemployment, corruption everywhere you can find. You can't pose an alternative? And I think what it all comes back to is what I said before, unemployment. For them to propose an alternative means that they're proposing a very different system.

And what is their system? They don't have it. They don't know. Now the *Minshuto* itself, the democrats themselves, are a hodge podge of different sorts, but I really think the central problem is there's no opposition party that is prepared to say we need to have a genuine market economy.

Ikenberry: Adam? And then we'll let the professor summarize and end the evening.

Posen: He definitely deserves the last word. What John may remember, but I think most people don't know, is actually my undergraduate and my first year in graduate school I was a comparative politics person. So let me try to dredge something useful up out of that. When you speak of these kinds of realignments or the kind of thing Peter is talking about respectively. In my understanding, they tended to also have to be accompanied by either some sort of constitutional reform often, or a military defeat. Occasionally, they would happen just sort of out of people's responses, but they would tend to be associated with major events. And so in the U.K. you had the reforms at the same time there were the reform laws about the rotten boroughs about representation. And so there was this hope, I guess, and, of course, the professor knows this infinitely better than I do.

But there was this hope a couple years ago when Kato was pushing and some other peo-

ple in the LDP were pushing for reforming the allocation of seats in Japan, that that might actually be what would change things. Because, of course, right now, again, to pick on Montana since nobody lives there anymore, right? So instead of Montana having two senators, Montana would have four or five senators if Montana was in Japan and that would tend to bias things a bit. So the question is, could you change that system?

But the other thing, which I will just suggest is I tend to believe that individual beliefs of politicians matter, which is very unfashionable. So I think especially in a system like Japan's where so much of the politics is inside baseball. That's not to make Kato Koichi out to be a saint. But let's imagine if two years ago now . . . is it two years ago . . . yes, two years ago instead of for some reason deciding to step three steps off the plank and then try to turn back, had actually successfully contested Mori, would things have been different? Probably. How different? I don't know. But I mean these kinds of things do matter I guess would be my messy take on it.

Japanese Political Problems

Yakushiji: Well, as you all know, the Japanese political system is based upon the small constituency electoral system and before that we had a medium size. So in other words, it still is very costly to run an election and so that's why most of the politicians either go to *Minshuto* or some other opposition party. It's very difficult to get elected within LDP even if they have a very good macroeconomic policy. So unless they are the son or daughter of existing politicians, a kind of political inheritance still predominant in Japan because it's so difficult to get elected.

That is the Japanese political problem. It's not the kind I want to get the change of in Japanese political system, but you have the kind of congressional system. And there are an increasing number of bills proposed by the Diet but still they lack qualities. We are backward in making a policy for the political base and so what they have to do is to still rely on the government officials, and the communication is intense.

But the complicated issue is very much described by politicians. They always tried to interpret into their own political interests and so that's why I am very pessimistic about that. There are not so many politicians, young politicians, the medium-range aged politicians, to talk about the fate of Japan and we know we have to do something to solve the bad performing loans and I agree with Adam. Look at Koizumi, he doesn't listen to the kind of complicated question. And that's why Takenaka is very good in just saying very small slogans and to make Koizumi comprehend what Takenaka is doing. And look at Shiokawa.

And so we become very much pessimistic about that and so that's why we have to all gang up with other officials to unite together to push the politicians to interpret that this is good for your political interests. Why don't you adopt funneling public funds into helping the banking system? And so I am very much for Adam's point, but we need political engineering.

Ennis: Yakushiji should be political advisor to Koizumi.

Yakushiji: My argument is very complicated and academic. Koizumi doesn't understand.

Ikenberry: Well, on that bright note, please join me in thanking our guests. (End)

About the Panelists

Main Speaker **Dr. Yakushiji Taizo** is Professor of Political Science and former Vice President for Academic and International Affairs at Keio University. He is also Research Director of the Institute for International Policy Studies and an Adjunct Professor at the United Nations University. Dr. Yakushiji was a former Visiting Professor at the University of Tokyo and an American Council for Learned Society Fellow at the Department of Political Science at U.C. Berkeley. He was selected as one of the “1988 Young Leaders of Asia” by the U.S.-Asia Institute. He received his Ph.D. in political science from MIT, a B.A. in liberal arts from the University of Tokyo, and a B.S. in electrical engineering from Keio University. Dr. Yakushiji has published *Beyond Interdependence: Meshing Earth’s Ecology and Economy*, co-author (1991), *Technohegemony* (1988), and *The U.S. and Japanese Auto Industries in Transition*, co-editor (1984).

Discussants **Mr. Peter Ennis** is Editor-in Chief of *The Oriental Economist Report* (TOE) and is U.S. Bureau Chief of the *Weekly Toyo Keizai*. He has been reporting and writing about Japan and U.S.-Japan relations for over 20 years. Mr. Ennis has been recognized for his coverage of the FSX dispute between the U.S. and Japan in 1989, and was the lead researcher on a television documentary on that subject produced by NHK. During 1995 and 1996, he broke numerous stories relating to the “Nye Initiative” and wrote several acclaimed stories on the inside workings of the Japan Defense Agency. In 1996 he was a member of a Council on Foreign Relations study group that examined the future of the U.S.-Japan defense relationship. He studied Japan and Spanish at Hunter College in New York.

Dr. Adam Posen is a Senior Fellow at the Institute for International Economics. Previously he was an international affairs fellow of the Council on Foreign Relations, the Okun Memorial Fellow in Economic Studies at the Brookings Institution, and an economist in international research at the Federal Reserve Bank of New York. He is a term member of the Council on Foreign Relations, serving on its Independent Task Force on U.S.-Japan Economic Relations. Dr. Posen received his Ph.D. in political economy and government and his A.B. from Harvard University. He is the author of *Germany in the World Economy* (forthcoming), co-author of *Japan’s Financial Crisis and its Parallels to U.S. Experience* (2000), and author of *Restoring Japan’s Economic Growth* (1998).

Moderator **Dr. G. John Ikenberry** is the Peter F. Krogh Professor of Geopolitics and Global Justice at Georgetown University. In addition, he was a Senior Associate at the Carnegie Endowment for International Peace and a Fellow at the Woodrow Wilson Center for International Scholars. He received his Ph.D. from the University of Chicago. Dr. Ikenberry is the author of numerous publications, including, *State Power and World Markets: The International Political Economy* (2002), *After Victory: Institutions, Strategic Restraint and the Rebuilding of Order after Major Wars* (2001), and *Reasons of State: Oil Politics and the Capacities of American Government* (1988).