

The Australian Intelligent Transport
Systems Industry

Economist.com

RESEARCH TOOLS
SURVEYS

What ails Japan?

Apr 18th 2002

From The Economist print edition

Gettyone



Twelve years in the economic doldrums: what does that say about the political system? It's almost impossible to reform, argues John Grimond

IMAGINE a country where the streets are clean, drugs cause few problems and muggings are almost unheard of. Imagine further that the trains run on time, most people are well dressed and many—at least to judge by the giggling girls shopping in the capital's swankiest area—are able to afford the most expensive trifles that money can buy. In such a prosperous country, life would be long, taxes modest and unemployment certainly lower than in Europe, probably even than in America. People would be polite, thrifty and unbelligerent. Rather, they would be munificent givers of foreign aid, vigorous investors abroad and profuse lenders. Such a country is Japan, and to many it might seem paradise. Yet open a newspaper and you will see that this is a country in crisis. How so?

The newspaper headlines are likely to suggest that the problem is the banks, which are undeniably in trouble. Japan has too many of them, they are chronically weak and they are burdened by duff loans. The government admits these loans stand at ¥37 trillion, about 7% of GDP, but some say the true figure is nearer ¥70 trillion-80 trillion, and the Tokyo branch of Goldman Sachs, an investment bank, takes an even gloomier view, putting the debts of all companies either bust or potentially bust at more like ¥170 trillion (in 2000, since when conditions have grown worse). Unfortunately, these non-performing loans cannot be treated like recalcitrant creatures in a circus act; they cannot simply be written off or replaced by performing substitutes, because Japan is going through a nasty bout of both recession and deflation, whose effect on the banks is to create new bad loans out of yesterday's good ones.

Behind the banks' troubles lie those of the companies they lend to. As a broad generalisation, it can be said that few companies outside the plain that extends from Tokyo to Osaka are internationally competitive, and some—notably in retailing and construction—are in particularly frail health. Property companies also require intensive care. Since 1991, commercial property prices have dropped by an average of 84% in Japan's six biggest cities.

Share prices, too, have been skidding. In February, the Nikkei 225, the most commonly used share-price index, dropped below the Dow Jones Industrial for the first time since 1957, though in the 1980s it had briefly stood at 14 times the Dow. By chance, the Nikkei had been almost equal with the Dow after the second world war. Though it rallied in February and March, at its February 1st level, the Nikkei had fallen by three-quarters since its zenith in 1989.

The bad news does not stop there. Unemployment stands at 5.3%, just below its recent post-war record of 5.6%—and the official figure, because it excludes those too discouraged to register, understates the true picture. Electronics giants such as Fujitsu, Hitachi and Toshiba have been laying off workers in droves. Supermarkets, such as the huge Mycal chain which went bust last September and even bigger Daiei which was bailed out in January, are shedding jobs all the time, as are building companies such as Aoki and Sato Kogyo, which collapsed in December and February respectively. The number of bankruptcies last year had been surpassed only once since the war, in 1984.

With America also in recession, Japan's trade surplus has plunged too (by 40% in 2001, in dollar terms). The economy is shrinking—the Bank of Japan forecasts a contraction of 0.9-1.2% this year—and, though many hope that America's recovery will start to help Japan at the end of this year, few are optimistic about the future.

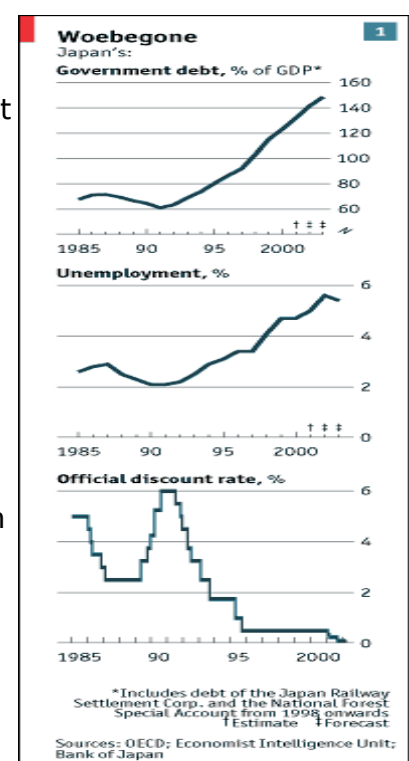
The curse of price destruction

Many companies—over 2,000 of Japan's 3,700 listed businesses—are not investing but paying down their debts. Why, it may be asked, when interest rates are virtually zero? The answer is that they must clean up their balance-sheets, thrown into disarray by the fall in asset prices. Falling prices play merry hell with normal business practices, and prices are still decreasing in Japan—consumer prices by about 1% a year, as they have done since 1999 (or 1995, if your measure is the broad GDP deflator). For consumers, deflation is a delight: money grows more valuable as it rests in the purse or pocket-book. But that encourages consumers to save, not spend. For those who have borrowed, deflation is a nightmare: the burden of the debt becomes heavier simply with the passage of time. That helps to explain companies' desire to clean up their balance-sheets—and the awful problems of their creditors, the banks.

Suddenly, the idyllic, safe and prosperous Japan looks rather less attractive. Can this really be the country that little more than ten years ago was set to conquer the world? It was certainly set to buy it. In the late 1980s, after all, Japan invested \$650 billion abroad, nearly half of it in the United States, where such icons as Columbia studios, Pebble Beach golf course and Rockefeller Centre in New York fell into Japanese hands. Americans had already become used to the idea of "Japan as Number One", as the title of Ezra Vogel's best-selling book put it in 1979. By the late 1980s, with companies such as Sony, Honda, Toyota and Toshiba sweeping all before them, Japan Inc truly seemed invincible.

That this was an illusion had become clear by the end of the decade, but what has been happening since? The short answer is that a succession of governments, led by 11 prime ministers since the start of 1989, has been trying to clear up after what turned out to have been a gigantic party in the 1980s. They have tried, or at least promised, more or less everything—stimulus after stimulus (the fiscal packages amounted to a grand total of ¥120 trillion between 1992 and 2000), constant restructuring, bail-outs and bankruptcies.

Now the choices are limited. If the government boosts demand with yet more spending, or perhaps a tax cut, the national debt, which already stands at over 130% of GDP, will rise higher than Mount Fuji. If it bails out the banks, it will squander more money, probably to no avail: less than three years have passed since ¥7.5 trillion was thrown at 15 under-capitalised banks, yet the duff-loan problem persists. Interest rates can hardly be cut further from their current 0.001%. And, though the yen fell 13% against the dollar last year, any depreciation big enough to make a significant difference to exporters would probably infuriate Japan's trading partners and competitors, causing a huge row with America and setting off other devaluations in Asia.



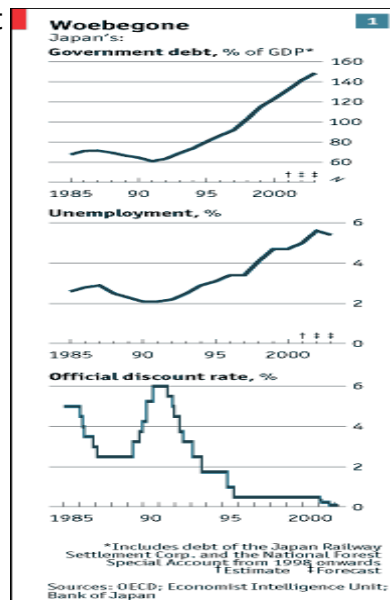
The options boil down to a much looser monetary policy, some sort of nationalisation of the banks, or crossing fingers and hoping that Japan can continue to muddle through. Any easing of monetary policy looks improbable as long as 77-year-old Masaru Hayami remains governor of the Bank of Japan. His main concern is inflation—hence his insistence that structural reform must precede any other action. Moreover, the bank did allow an increase in the monetary base last year—of 16%—without any appreciable effect on money supply. As for nationalisation, the mere talk of it puts everyone in a spin for fear of setting off a financial crisis. The collapse of a regional bank in 1997, causing depositors to lose everything, is a painful memory for politicians, as is the failure of a big broker, Yamaichi Securities, that year, and the ensuing run on an associated savings bank.

Disaster has been predicted for Japan's banks for years, and has yet to happen. That does not mean it never will, or that it is inevitable. But there is plainly a big risk, and the consequences would be

severe. Japan is the world's second-biggest economy. Its fortunes are intimately tied in not just with Asia's but with America's and the rest of the world's. Exactly how convulsive a Japanese banking crisis would be would depend on the gravity of the country's current situation, which no one is really sure about. Everyone assumes that the 30 to 50 heavily indebted big companies, mostly in property and construction, would be inevitable casualties. If Goldman Sachs is right, though, almost all industries have their share of seriously rocky companies, whose collapse would be felt much more widely, both in Japan and internationally.

In the face of such a possible catastrophe, it might be thought that some corrective action would be taken. Junichiro Koizumi, who has been prime minister for a year, came to power promising reform. But even Mr Koizumi's greatest admirers admit the task may be too great for him.

All this prompts some questions. First, since Japan has lurched from recession to recession—the current one is the fourth in ten years—and since the 1990s have been called “the lost decade” for several years now, why has concerted action not been taken before? And, second, will Mr Koizumi succeed where others have failed, or, perish the thought, is the political system that delivered Japan's economic miracle with such panache after the war now incapable of seeing the economy through to its new, mature stage? These are the questions this survey will seek to answer.



Exchange rates

Yen, April 9th 2002

\$1=	131.5	€1=	115.2
10 yuan=	158.9	100 won=	9.89