

# The sinking economy of japan



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The country which almost ruled the world in economy for decades even being one of the tiniest countries of the world setting an example of perfection in most of sectors is presently suffering from some drastic challenges which have mesmerized the people across Japan as its economy is sinking and national debt is touching sky. The revolutions of growth which started right from the 1868 in the Meiji Period rarely witnessed great slumps till 1990s. Adaptation of free market economy and North American type of free enterprise capitalism took Japan to such great heights from where it never looked to topple down, but alas the growth slowed markedly in the 1990s (i. e. during “ the Lost Decade”), substantively because of the after effects of Japanese asset price bubble and somewhat deliberative domestic policies which caused to extract speculative excesses from the stock and real estate markets. In the present decade, less stable governments although left no stone unturned to revitalize the giant economy but were thrashed down by global economic crisis of 2008. In 2010, Japan could do nothing but see its position being acquired by another economy giant China as Japan was ranked 3rd as per economic size in terms of GDP[1]based on data from the International Monetary Fund. Besides economy, there are several other sectors which are facing jittery crisis. In this essay I’m going to discuss these problems illustratively.

## **Challenges before Japan in a Nutshell:**

### **1) Economic Outlook:**

\* Japan’s Export Competiveness: Japan’s blazing economic growth of 1980’s was thrashed by the 1990s’ stock market crash followed by a recession of almost 10 years. Country’s economy revived again but the global economic

crisis of 2008 debilitated the economic growth and consequently, Japan's ability to produce and export a wide variety of goods is getting constrained resulting in lesser demand in countries across the globe in contemporary times. Since the start of the present decade the contraction in export is almost entirely due to a steep fall in external demand, the reasons may be a shift in global demand structure, arrival of global recession in Japan relatively late with greater severity, impact of yen appreciation etc. The now fragile economic recovery of Japan is running out of steam because of the slow growth in key export markets. As a result private consumption also didn't take off for the simple reason because Japan heavily depends upon exports.

It seems that Japanese economy is governed by short term policy making. Appreciation in the value of yen is debilitating Japan's competitive power in global arena. So, responsibility is heavy on the government & Bank of Japan to take effective & decisive action against currency moves.

The comparison visible below tells the story:

\* Decrease in manufacturing: Manufacturing industries make a substantial part of Japan's secondary sector with employing almost 28% workforce of Japan. But, due to current sluggishness of economic growth, Japan's rank in manufacturing is grasped by China as it topped to 3rd position and the graph below suggests that USA manufactures almost twice as China, double what Japan makes[2]:

Developed markets like that of Japan and Euro zone are struggling with stalled recoveries, as in the fourth quarter annualized GDP in 2009 was a mere 0.9% in Japan and 0.1% in Euro Zone. While much stronger rates of

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economic growth are visible among some fastest growing economies of China, Brazil & India.

Deflationary conditions are still persisting in Japan. In December, 2009 the overall Consumer Price Index (food items & energy sectors not included) stopped at 1.2% which was below that of December, 2008[3]. This happened to be the largest such decline for CPI in history of Japanese economy. The danger inherent in deflationary conditions is that consumers tend to defer purchases as they wait for prices to fall even further. Consumer prices are influenced through changes in governmental policies, so government should make efforts to control deflation. In April-June quarter, the GDP deflator which is considered as the broadest measure of public trends was -1.8% showing a mild improvement from the -2.8% in previous quarter[4] and is also suggestive of the fact that how deeply entrenched deflation Japan is experiencing. In order to achieve fiscal reforms, it is a prerequisite to get deflation at 0%. Now let's examine what happens when people start expecting inflation:

Since the Global Economic Depression of summer 2008, Japanese companies could not help seeing a steep drop in domestic & overseas demand which provoked companies to make adjustments in production to reduce their inventories. It resulted into fast downfall in production mostly in machinery, digital & automobiles industry. In 2009, real GDP contracted at an annualized figure of -11.9% in Jan-March, the second straight quarter of double-digit negative growth following a -10.2% fall in Oct-Dec[5]. Even in 2010 no great recovery could be registered in economy of Japan as between April and June this year GDP grew by 0.1%, much lower than expected[6]. The fatal impact

of the global economic recession on world economy caused recurring profits to fall sharply (which were at boom in 1990s) along with mitigation of sales in Japan & overseas.

The housing market of Japan has not witnessed any positive growth signs since the revision of the Japan's Building Code in 2007. Even in 2010 when the effects of the revision of the Building Code have extinguished, housing sales could not notice recovery signs. The reasons may be attributed to the expectation of further fall in housing prices and stagnation of labor industry to create employment environment. Due to the factors above mentioned allied with others, in August, 2010 China replaced Japan as the world's second biggest economy after overtaking Germany as the largest exporter with a nominal GDP region of \$1. 337 trillion compared to Japan's \$ 1. 228 trillion[7].

To deal with such economic challenges, I think, Japan should first slash expenditures and then increase tax burden as minimum. It is advisable that there should be more focus on spending cuts than focusing on tax increase. The aim of fiscal reform should be equalizing the primary balance i. e. creation of such environment in which current expenditures is financed by current revenues to protect the financial position from further deterioration.

### **\* Banking Policies in Japan: challenges and prospects-**

Japan began the decade of 1990s with a heavily regulated financial system controlled by a resolute & undeterred Ministry of Finance (MoF) and ended the decade with great market reforms, a complete restructuring of the financial institutions which were regulatory in nature and providing greater

independent to 'the Bank of Japan' amid collapse of asset prices, a looming bank crisis, worsening unemployment & the lowest interest rates in industrial world. In the aftermath of the bursting of Japanese asset price bubble which choked the banking system, most of the Japanese banks unveiled "unconventional monetary policy measures" to cater to the challenges posed by monetary crisis created by aforementioned asset price bubble of 1990s. But had the Bank of Japan cut its policy rate to a great extent immediately after the bursting of the asset price bubble, deflation would have been avoided. The unpractical recommendations made to bank of Japan like "all that the bank of Japan needs to do is to set a high inflation rate target and purchase all types of assets including physical assets to achieve the target" & "the central bank should credibly promise to be irresponsible" did not help in any way. Although Japan began the decade of 1990s with a heavily regulated financial system controlled by a resolute & undeterred Ministry of Finance (MoF) and ended the decade with great market reforms, a complete restructuring of the financial institutions which were regulatory in nature and providing greater independent to 'the Bank of Japan' amid collapse of asset prices, a looming bank crisis, worsening unemployment & the lowest interest rates in industrial world. What is the problem and where does the devil lie who has pestered Japanese economy so far; let's examine[8]:

The decrease in the risk taking capacity of many economic entities which resulted in drastic reduction in effectiveness of conventional monetary policies and in such monetarily pathetic atmosphere, the overnight interest dropped down to zero, limiting the room for additional easing through conventional monetary policy formulae. In the context of Japan, the

overnight interest fell to 0.5% five years after the real estate prices peaked in 1990.

It took time to recapitalize the banking system.

Uncertainty regarding the transmission mechanism of monetary policy is bigger than that of normal times.

When the central banks try to create fruitful policy measures in the constrained atmosphere for effectiveness of traditional monetary policies, they are obviously introduced to the vicious area of fiscal policy.

Consequently, policymakers are in fear of being accountable for such policy actions in the Japanese democratic environment.

### **What should Banks do?**

Maintain the stability of financial markets and the financial system.

Inject the capital into the banking system together with the provision of liquidity in order to kill the pressure on the financial intermediation process.

Banks may take measures to take on individual credit risk such as corporate debt when there is a major risk that credit market functions shall become worse and consequently, the feebleness of financial conditions is capable of causing loss to the economy of Japan.

Communication with the market is very important in order to effectively conduct monetary policy as the effectiveness of unconventional policy is always uncertain and through communication with the market Banks are

able to show their commitment to the stability of financial market and financial system.

## **2) Piracy: a threat to be crumpled down-**

Japanese industries are facing problems in achieving value creation through the utilization of Intellectual assets due to raising graph of counterfeit, fake & pirated products. These issues have rattled the Japanese government's cage to force government to take strict and specific measures to combat as it is opening its first overseas army base in Djibouti to counter rising piracy in the region[9]. But neglecting & non-cooperative attitude of some countries is posing problems to crush the evil of piracy.

5) Japan Haunting Indebtedness: Economy of Japan got mired in the worst recession since WWII and got edged into deflation. In the 90's Japan was world's top creditor nation whilst now it ranks 1th among world's largest debtor nations[10](vide the graph below). Taro Aso's government planned 27 trillion yen (almost \$282 billion) in stimulus spending since the great recession of 2008 began to worsen the financial system of Japan[11]. But stimulus efforts from past economic problems have heaped a mountain of public debt in the region of around 189% of GDP which is highest in developed nations which consequently debilitated Japan's capacity to spend its way out of the recession. The great indebtedness of Japan is worrisome because once a government incurs significant incremental debt it results in a political impossibility to go back to the levels of indebtedness it had earlier. The debt levels become almost eternal and even if a practical government runs a surplus, there is a dim hope that ruling politicians would utilize much of that surplus to pay the debt. In order to absolve itself from raising heap of

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debt, Japanese government should make efforts to attract buyers to the nation's increasing debt. Bank of Japan should adopt measures to buy corporate debt and enhance the buying of government bonds to keep funding problems at bay which would have resulted in further derailing of economy of Japan.

Despite a debt-to-GDP ratio [12] as 189.30% as shown below, the Bank of Japan never seemed to lose ability to set the key overnight interest rate, which remained below 1% for about a decade and the debt didn't drive long term rates higher either.

Low taxes: Although getting a horrible increase in government debt, taxes in Japan are relatively low among the countries of Developed world. Japan is the country with the lowest government revenue-to-GDP ratio (31%) and currently the second-highest government net debt-to-GDP ratio (78%), even then its 33% marginal tax rate on average income workers is one of the lowest in developed countries [13]. A comparison is shown below:

## **11) Governance and the Political System:**

(i) The factor that weakens the power and functioning of cabinet in Japan is the dual power structure of ruling party and cabinet. In a successful cabinet system, cabinet executes the policies of the ruling party as power within a ruling party is focused in the cabinet and the ministers who form the cabinet are the party's prime movers and rest members of the ruling party generally don't defy the policies of cabinet. But it is on earth in Japan that members of the last ruling Liberal Democratic Party (before 2009 elections) who did not become part of cabinet acquired more power than the cabinet and

subsequently, many policy decisions were framed through repeated contact, behind the scenes, negotiations & arm twisting among top politicians of ruling LDP. It also included disregard of cabinet by tribal lawmakers with close ties to “ specific political lobbies” and powerful bureaucrats. Thus, the decision making power of the cabinet in Japan was totally hampered. The LDP also had its own policy consideration section called the “ Policy Affairs Research Council” which would examine the Bills and similar policy proposals put forward by the cabinet. Further, government bills cleared by the Policy research council were then approved by the party’s General Council before submitting to Diet. This took form of a “ Prior Screening & Sanctioning”, a system alien to most of great democracies across the globe. The government Bills would also get modified or vastly changed in this prior screening process and this system reinforced the impression that any proposal approved by the ruling party would be approved by the Diet, reducing the role of the Diet as a mere rubberstamp. The LDP’s powerful policy “ tribes” (zoku[14]) had steadily emerged as a shadow government. Thus, Policy Affairs Research Council & zoku deliberated in major policy decisions, leaving Diet Committees to fight over politics rather than the substance of the legislation.

While all the major political parties have a similar structure including the present ruling Democratic Party of Japan (DPJ), Japan is forced to possess a weak cabinet, bureaucrats-led-politics, non-transparent ‘ decision making’ process in high political institutions. But the issues aforesaid are not fundamental institutional issues and there is a scope to deal with these issues to overhaul the conflicting political interests within the parties.

(ii) The ministerial coordination and cabinet leadership in Japan has taken a backseat contrary to the spirit of an actual democratic setup. Ministers have become just the figureheads who simply acquire a position on top to promote the existing policies without innovating distinct policies and give priority to bureaucratic advice which makes it difficult for government to give effect to drastic policy shifts to changing social, economic & political circumstances.

(iii) In 2010, Japan is ranked 24th for democracy, after all developed countries but Italy, Greece & Singapore. Astonishingly, it is placed behind even three developing countries: Uruguay, Costa Rica and Chile. These figures present the picture of democracy in Japan.

## **12) Straining Foreign Relations:**

Japan needs to address the challenge of China's rising regional clout, while keeping ties with this "giant" which is Japan's biggest trading partner on an even keel. Although Sino-Japanese relations have seen positive improvement in recent decades but territorial and maritime disputes still simmer coupled with growing mistrust over military hegemony like China and Japan dispute the ownership of a string of five small uninhabited islands in the East China Sea near the place known as 'Senkaku' in Japan and 'Diaoyu' in China- which are believed to hold seabed oil deposits.

There also exist tensions with USA on various issues including the issue to move the U. S. Marine air Station Futenma off the island of Okinawa as Okinawans have long complained about the noise and intrusion of the base and rape of a 12 year old local in 1995 and the charge that a US Marine

sexually abused a young Japanese girl in early 2008 renewed public outcry against the bases thus resulting into increased tensions between the residents of Okinawa and marines. Japan and USA are military allies under treaty concluded in 1951 and revised in 1960[15]. But the ruling party DPJ's past criticism of the bilateral security arrangement may further complicate alliance management issues such as the planned realignment of US forward deployed forces in Japan and the Host Nation Support (HNS) that Japan provides to help defray costs associated with the stationing of US bases across the Japanese archipelago. Besides this, political shifts & turmoil in Japan since 2006 appear to have slowed down some of the increased cooperation in the US-Japan alliance.

### **13) Dullness in Employment Sector:**

Japan's labor market witnessed a recessionary financial system in recent decade with a difficult employment environment. In such a turbulent time, the conservative concepts of employment in Japan are in question and unconventional ideas & concepts are emerging throughout the companies of Japan. Ideas such as lifetime employment and seniority based payment are being revised and being replaced with new innovative as well as creative ideas in the process of revitalizing the financial system. Various techniques are entering into Japanese labor system in form of 'work-sharing, overseas jobs, and part time employment' to provide opportunity to people who are unemployed or not considering employment to enter the workforce and contribute to economic development.

**Solution:**

(i) According to a report of the Japan Institute for Labor Policy and Training (JIL)[16]released on work sharing in Japan, it is generally believed that when a country is in recession, the number of part-time and non-regular workers tends to decrease in order to lower costs and maintain the number of regular workers. But, in context of Japan this lacks reality as number of part-time workers has increased while the number of full time regular workers has decreased. In Japan, work-sharing has been utilized to combat the rising number of part-time workers and has been a highly controversial topic among the employer class. JIL's report outlines three types of working sharing:

**Employment Maintenance****Job Creation****Diversified working Patterns**

Employment maintenance work-sharing mainly targets midlevel employees, allowing them to reduce their work hours and share these hours among themselves, thus, this facilitates employees to stay employed with their wages adjusted for the hours they work.

Job creation work-sharing intends to cut down hours of work at the national & company levels aiming at increasing the overall number of jobs.

Diversified work-sharing allows employees to pin-point their hours of work in order to allow persons previously unemployed to enter the labor sector.

The working patterns mentioned above are useful in many ways. For example, Sanyo Electric Co., Ltd. announced in Jan, 2003 that they going to introduce work sharing program in one of their factories and over 200 hundred employees were involved in the program which required workers to take three more days of vacation per month and reduce their basic pay y 12%. As per company's estimate, it could save almost 100 million yen and was successful in retaining its employees[17]. So, more emphasis should be laid down to implement these patterns to save the sinking Japanese employment sector.

(ii) Working abroad either for foreign or Japanese companies may prove an excellent cure to rapidly diminishing job market & tighter job vacancies in Japan. Besides, the opportunities stored in the West, there is also great scope in growing economic markets of Asia like China, India, Thailand etc.

(iii) Non-regular jobs: The global recession and tattered economy of Japan has forced many companies to severely restrict the number of new graduate recruits so that they can retain their mid-level and senior employees. Thus, surging demand for employment can be checked through establishing job placement offices for part-time offices and distributing incentives in form of subsidies. In 2009, the number young workers with non-regular jobs surged to 1. 78 million[18]. So, there is a need to frame new policies to assist the young part-timers in gaining full time & regular employment.

### **Demographic Challenges:**

Japan's demographic problems seem to end nowhere as the combination of low birth rate, strict immigration practices, and a rapidly aging population

are haunting the think tanks of Japan. Japanese women are avoiding marriage & child-bearing to meet the difficulties of career and family. The country's birthrate has fallen to 1.25 which is below the necessary rate i. e. 2.1 to sustain a population size[19]. The country's current population is roundabout 128 million which may fall to about 100 million till 2050[20]. So, Japan is on the verge of full-fledged population decline. As per estimates of government of Japan, the nation's total fertility rate will continue to fall and that even in 2055, it may only recover to the 2005 levels at the most. In developed countries, it is found that there is a mild tendency for birthrates to rise when female employment is bigger. But, Japan is low in the ranking of both the fertility rate and the female employment rate. Hence it is suggestive of the fact that if more women were to join labor force, birthrates would grow high. However such deduction lacks practicality due to a host of reasons.

Another factor responsible for low birth rates is that in Japan the percentage of children born before marriage is also low in comparison to countries like UK, France & Sweden where birthrates have recovered.

As per my opinion, to improve birth rates, Japan government should hike the allowance for children, increase the allowance for childbirth, provide medical-care subsidies, enhance & augment child care centers and give education assistance to support the married ones as it is quite expensive in Japan to nurture the children.

Japan is also suffering from the tag of being the oldest country in the world with a high elderly share of 20% and it will further rise up to 30% in till 2025

and 40% till 2050[21]. Another vital fact is that Japan's workable population is shrinking which may result in a sharp economic decline. However, 29% of men aged 65 and over remain in labor force which is quite commendable than 20% of USA, 5% of Germany & 2% of Japan. To meet the challenges of aging population, the government must ensure that support systems for elderly are not only sustainable but also adequate; government should strengthen the private employer pension system by requiring that all benefit promises including severance pay must be fully funded.