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## Japan: leading from behind

**Gerald Curtis** Can Japanese politics be saved?

**Naohiro Yashiro** Fixing the labour market

**Ippei Fujiwara** The missing piece in the puzzle of the lost decades

**Aurelia George Mulgan** Has the agriculture lobby captured the state?

**Yoshihide Soeya** The dilemmas of middle-power diplomacy

**and more . . .**

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## From the editors

By the end of the 1980s, Japan had caught up in technology, productivity and living standards to the advanced economies of the West. After the end of the 1980s boom, economic growth plummeted after the bubble burst in 1991 to an average rate of around 0.7 per cent for the remainder of the 1990s, rising slightly to 0.9 per cent in the first decade of this century. Those two so-called 'lost decades' have frequently been cited as an object lesson in failed economic policies, from central banking to innovation to failure to reform financial institutions.

Growth remains low and there are a host of challenges facing Japan in the longer-term because of its hyper-ageing and shrinking population, high government debt and a revolving-door political regime. On top of all this, Japan suffered the triple disaster of a massive earthquake, tsunami and nuclear meltdown in March 2011. Reform and change seems frustratingly slow and not even the triple disaster seems yet to have stimulated the changes that many hoped for.

Yet Japan is a very prosperous society. Its people are safer and enjoy greater longevity than the people of most other countries. Its social infrastructure is the envy of the world and unemployment is low. The cities are efficient and clean. It has modernised while maintaining its uniqueness, with Japanese fashion, music and culture (even anime) a major soft-power force in Asia and beyond.

Despite what seem to be insurmountable problems, Japan appears to get things done and the idea of policy and institutional failures in the 'lost decades' is being re-evaluated. At the same time, aspects of Japanese infrastructure have become less competitive, the under-utilisation of the talent and potential of females in the workforce, a cosseted agricultural sector and uncompetitive service sector all beg reform.

Political stalemate hampers national reform and international influence. In this issue of EAFQ, those areas that are in urgent need of change are set out alongside stories about, and in the context of, what Japan has done right and where Japan continues to lead.

**Peter Drysdale and Shiro Armstrong**  
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## CONTENTS

### **3 IPPEI FUJIWARA**

The missing piece in the puzzle of the lost decades

### **5 GERALD CURTIS**

A time of drift: can Japanese politics be saved?

### **7 NAOHIRO YASHIRO**

Fixing the labour market

### **9 EDWARD J. LINCOLN**

Six ways of staying affluent

### **11 GLEN S. FUKUSHIMA**

Removing barriers to trade, investment and business

### **13 YOICHI FUNABASHI AND KAY KITAZAWA**

Lessons from Japan's nuclear accident

### **15 AURELIA GEORGE MULGAN**

Has the agriculture lobby captured the state?

### **17 TAKESHI YAMAWAKI**

Reinvigorating national newspapers

### **20 SHIRO ARMSTRONG**

From leading to following in the region

### **22 YOSHIHIDE SOEYA**

The dilemmas of middle-power diplomacy

### **24 RYO SAHASHI**

Making the most of the US pivot

### **26 SOURABH GUPTA**

Persistent inclinations of a cautious ally

### **28 AYAKO KANO AND VERA MACKIE**

The gender fault-line

### **30 KENT ANDERSON AND YOSHIHARU MATSUURA**

Balancing old and new in forging a new cultural norm

### **31 AMY KING**

Warm trade ties help to temper neighbours' political tensions

### **34 YUKINOBU KITAMURA**

The politics of demographic change

### **35 TOBIAS HARRIS**

Japanese politics: the spirit of 2012?

### **37 JENNY CORBETT**

Growth: getting back on track

### **39 XIAO SHU**

Coping with disaster shows the strength of civil society

# The missing piece in the puzzle of the lost decades

IPPEI FUJIWARA

**J**APAN'S average GDP growth rate was around 9.5 per cent between 1955 and 1970, and 3.8 per cent between 1971 and 1990. But in the past two decades, it has dropped to just 0.8 per cent a year. This big drop in the growth rate is synonymous with 'Japan's lost two decades.'

Inflation also disappeared through the lost decades, from 2.5 per cent in the 1980s and 1.2 per cent in the 1990s, to an average of -0.2 per cent in the 2000s. This prompted claims that aggregate demand has not been large enough to match aggregate supply, or, in other words, output has been below its full employment capacity. The Bank of Japan has been blamed for not having pursued an expansive enough monetary policy to boost aggregate demand and incomes.

In 1999 the Bank of Japan reduced its policy interest rate to 0.15 per cent, thus starting its so-called zero interest rate strategy. Given that nominal interest rates cannot go below zero, any deflation (or negative inflation) results in higher real interest rates. Throughout the 2000s the Japanese inflation rate was, on average, negative. Hence deflation could have had a negative impact on aggregate demand through higher real interest rates.

Just how high was Japan's real interest rate?

Because expectations about inflation are not observable, expected real interest rates cannot be set with precision. Roughly measured, long-term real interest rates—or the difference between nominal bond yields and realised inflation rates—in both Japan and in the United States actually tend to show very similar trends, in both their levels and the way in which they have changed. The free international movement of capital means that the real interest rates will tend to be similar in all countries, although, to be precise, this depends on a host of factors and conditions, including the similarity in consumption patterns and the exchange rate risk premium among many others. A rough measure of real interest rates in Japan and the United States shows that they actually became very similar after the 1985 Plaza Accord and grew even more similar in the 2000s until recently. Deflation, together

PICTURE: ANDY RAIN / EPA / AAP



Guardian of the economy: persistent deflation might arguably have been avoided if the Bank of Japan had adopted a more aggressive and expansionary monetary policy in the 1990s.

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COVER PHOTO: Japan will need to make better use of its well-educated young people if it is to maintain its economic dynamism. Picture: Getty Images.



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with a zero lower bound on the nominal interest rate, may not after all have caused Japanese real interest rates to deviate significantly from the theoretically consistent level that was operating in the global economy.

Though real interest rates are not heavily influenced by domestic factors, deflation can still have long-run detrimental effects and, through nominal appreciation of the exchange rate, adversely affect exports and aggregate spending.

Persistent deflation might arguably have been avoided if the Bank of Japan had adopted a more aggressive and expansionary monetary policy in the 1990s. But the Bank of Japan was operating under uncertainty about responses in the economy, an inevitable problem with policy making in real time. Optimal policy can look very different with the benefit of hindsight.

Japan's per capita GDP level reached almost the level of that of the United States towards the end of the 1980s. When that happened Japan's era of high growth based on the technological catching-up inevitably had to end. Thus, the puzzle of the lost decades is not what caused the fall in growth chronologically, but the difference in the growth rates across countries, and particularly between Japan and other advanced economies. Between 2000 and 2010 (in the second of the two lost decades), other advanced economies grew at an average rate of 1.4 per cent while Japan grew at around 0.9 per cent.

What are the reasons for this difference and can the growth rate be lifted now?

The rapid ageing of Japanese society is a widely known phenomenon. Total population has recently started to fall, and the working age population had already started to fall around 1995. A

most important factor in producing economic output is the input of labour and, with the working age population shrinking, unless technology allows a smaller workforce to produce more output per head, GDP is bound to grow more slowly. Yet, if the output growth rate per person in the working age population is compared with that of other industrial nations, Japan records the highest growth rate among advanced economies in the 2000s.

**N**OW that Japan is becoming a greyer society, gross national product (GNP) is the variable that should be monitored to assess the health of the Japanese economy and the welfare of its people. Unlike GDP, GNP includes financial income from the rest of the world stemming from the investment of assets abroad. Offshore assets are now providing income for the elderly in Japan and GNP is a better measure for the welfare in Japan.

These supply-side factors have had a significant impact on Japan's GDP growth rate, at least since 2000. Society's ageing results in not only a decrease in inputs into production but also reduces future increases in the scope for fiscal and social security expenditure. This is likely to further constrain aggregate demand by reducing permanent income.

Ageing will continue to have wide-ranging effects on the Japanese economy and Japanese society; the priority is to manage the policy changes that are necessary to continue to lift the productivity of a declining workforce and maintain and improve living standards. **EAFQ**

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# A time of drift: can Japanese politics be saved?

PICTURE: YOMIURI SHIMBUN / AP IMAGES / AAP

GERALD CURTIS

**P**OLITICAL leadership presupposes that there are leaders, that they know where they want to lead, and that they are able to communicate their ideas to voters and obtain their support. Political leadership in Japan falls short on all these measures.

Japan's prime ministers have changed with such rapidity since Junichiro Koizumi left office in 2005 that many Japanese voters would be hard pressed to recall all their names. Abe, Fukuda, Aso and Hatoyama were each out within a year and Naoto Kan did little better, holding on for 15 months. It is anyone's guess at this point how long Prime Minister Yoshihiko Noda, who took over last September, will last.

Even more dramatic than the annual turnover of prime ministers has been the brief tenure of other cabinet ministers since the Democratic Party of Japan (DPJ) came to power in the fall of 2009. Ministers in the Hatoyama and Kan governments served an average of 8.7 months (under Koizumi it was 18.6 months). The minister responsible for dealing with the low birth-rate has changed eight times in the past two-and-a-half years. There have been seven DPJ ministers of state for consumer affairs and food safety, and seven ministers of justice.

The DPJ came into power pledging to create a politician-led government. Had the DPJ's first prime minister, Yukio Hatoyama, been more competent and had he remained in



Ichiro Ozawa, centre, and supporters at the launch of his new party in Tokyo in July 2012.

office for a few years rather than for 11 months, the party's plan to rein in the bureaucracy and create a powerful cabinet-led government might have borne fruit. Once Hatoyama fell and the DPJ became torn by internal rivalries, public support took a nosedive.

As a consequence, the mandarins of Kasumigaseki (where Japan's bureaucratic elite works) who had been thrown on the defensive when the DPJ took power, surmised that they had time on their side. They dragged their feet on implementing policies of which they disapproved, knowing that sooner rather than later the cabinet would change. The DPJ's proclaimed intention to have DPJ ministers, deputy ministers and parliamentary secretaries make policy, relegating bureaucrats to the role of mere clerks, proved to be so naïve, so out of tune with the nation's traditions, and so incompatible with the imperatives of policy making

in modern democracies that it was impossible to execute.

Prime Minister Noda has resorted to none of Hatoyama's and Kan's vitriolic invective against the bureaucracy. He has shown none of their enthusiasm for reforms that were supposed to put politicians in charge. The result is that the bureaucracy is at least as strong as it ever was under the Liberal Democratic Party of Japan (LDP).

The rub of course is that the bureaucracy cannot lead. There is no bureaucratic mechanism for coordinating policy across ministerial lines, for setting priorities or for designing strategies to obtain public support and Diet approval for the government's program. This is the responsibility of the political leadership—leadership that has for the most part been missing in action.

Noda's determination to pass legislation to raise the consumption tax, and his ability to forge an

agreement with the Liberal Democratic and New Komeito parties to do so, have raised expectations that Japan finally again has a leader worthy of the name. His refusal to back away from his commitment to raise the tax has earned him kudos with foreigners who admire his determination to begin the process of getting Japan's fiscal deficit under control. But it has not increased support for his government among the Japanese public.

In his writings on the US presidency, Richard Neustadt defined the power of the president as 'the power to persuade', including of course the power to persuade the public. During the long years of LDP one-party dominance and factional politics, that kind of leadership skill was not especially valued. But the situation is very different now. Koizumi understood the importance of having a strategy for mobilising public support for unpopular policies. He became popular without being a populist. Noda has yet to show that he has the skill to do the same.

Japan's political leadership deficit is not the result of a divided Diet or factional infighting, though they no doubt make governance more difficult. Institutional reforms—abolishing the upper house, for example, or directly electing the prime minister, two ideas that are enjoying some currency in Japan today—would not end Japan's political deadlock or produce stronger leaders. The roots of Japan's political paralysis lie much deeper: in the inability of leaders to define national goals, in the failure of both the DPJ and the LDP to recruit enough qualified politicians, and in the absence of a realistic strategy for administrative reform.

For more than a century Japan defined its national goals in terms of

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Optimists might argue that Japan is experiencing a long phase of political creative destruction

catching up with the West. Since the late 1980s, having reached that goal, it has been flailing about trying to decide what to do for an encore.

An effective system of leadership recruitment evolved during the long years of LDP one-party rule. Candidates for the Diet came from the highest reaches of the Japanese bureaucracy or from long years of experience in local government. They joined party factions where they learned from senior members how to move legislation through the Diet, engage with the opposition parties and develop relations with the bureaucratic elite.


This recruitment and training system has all but collapsed. The main qualification for office of many Diet candidates is not their prior political or governmental experience but the happenstance of their being the offspring of Diet members. Rather than reform the bureaucracy, the DPJ has essentially thrown in the towel on bureaucratic reform.

How can Japan emerge from this political cul-de-sac? Perhaps time itself will do the trick. Optimists might argue that Japan is experiencing a long phase of political creative destruction. History may well show that the significance of the DPJ coming to power was not that it consolidated a competitive two-party system but that it provided the trigger

for a general political realignment. However, even if that were to occur, the process is almost certain to be slow and confused. At best, Japan is still several years away from having a stable reinvented political party system.

Another way to shake the political elite out of its torpor—surely the most undesirable and dangerous way—is for Japan to face some sort of international crisis: a military clash with China over disputed territory, for instance, a provocative North Korean action against Japan, or another international financial crisis that would affect the government bond market. Those who pine for dramatic political change should be careful what they wish for.

Japan has strong social bonds and a weak political system. Problems abound but living standards for the great majority are high. Unemployment is low by international standards, and national security is provided by a strong alliance relationship with the United States.

In the absence of a foreign policy crisis, and in response to a public that is unhappy with its political class but risk averse and reluctant to support bold policy change, Japanese politics is likely to continue to drift for some time to come. In the long run, a more stable and effective governance system may well emerge out of the current political malaise. But the important question is—what happens in the meantime? Those who speculate about long-run solutions, and do not focus on what needs to be done now, should take to heart John Maynard Keynes's wise admonition: 'In the long run we are all dead.' 

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# Fixing the labour market

NAOHIRO YASHIRO

**U**NTIL the end of the 1980s, the Japanese labour market appeared to work well, with an unemployment rate close to 2 per cent, 3 per cent real wage growth after inflation and small wage disparities by international standards. Japanese employment practices, including long-term employment guarantees and seniority-based wages, contributed a great deal to the efficiency and equity of the labour market.

But much has changed since the bubble burst in the early 1990s. The long-term stagnation of the economy has caused unemployment rates to increase to 5 per cent, and persistent deflation has been an obstacle to real wage growth. Traditional employment practices are changing too. The share of non-regular workers—those who have no employment guarantee and whose wages are consequently lower—increased from 16 per cent in 1985 to 34 per cent of the workforce in 2010.

So why has the Japanese labour market, which was once hailed as a model in the OECD, fallen into a trap of inefficiency and inequity? A simple answer is that both firms and labour unions have failed to adapt to new employment conditions caused by the rapidly changing age structure of the labour force and decelerating economic growth. The government has responded to this situation by tightening regulation of the labour market to discourage fixed-term employment contracts with no guarantee for renewal, in particular for temporary or dispatched workers, who are employed by one firm but actually work in another firm. The



Soon-to-graduate students at an employment rally in Tokyo: larger firms have reduced their intake of new full-time workers in favour of fixed-term employees.

contrast with Europe and Australia is instructive: reforms there have gone in the opposite direction, liberalising the labour market while protecting workers in disadvantaged positions.

Past Japanese employment practices were suitable for an expanding economy that experienced short periods of recession around a long boom. Companies invested to develop their workers' skills, and kept them on during recessions. In turn, employees accepted new labour-saving technology without fearing dismissal, and shared in their firms' profits via bonuses under firm-based labour unions. Wages based on seniority covered increasing living expenses over a worker's life and were less costly for firms, which typically had a pyramid-like age structure of employees. Harmonious employer–employee relations have been a defining feature of the Japanese labour market for many decades. The rigid

employment guarantee encouraged workers to transfer from declining to growing industries within the internal labour market of large corporate groups. Many firms established subsidiaries in growing sectors and shifted employees from the parent company in declining industries, such as mining or textiles, to the growth sectors within their operations. This movement of labour across industry without causing unemployment was the Japanese success story of the 1980s.

The merits of Japanese employment practices under more propitious circumstances became its demerits under decelerating economic growth and a rapidly ageing population. As GDP growth fell from an average of 3.7 per cent in the 1980s to 1.1 per cent in the 1990s and 2000s, the recessions have become longer and the booms shorter, so firms can less afford to hoard excess labour. In order to keep

PICTURE: EVERETT KENNEDY BROWN / EPA / AAP

the employment guarantee, large firms have reduced their intake of new regular workers in favour of increasing numbers of fixed-term workers who are easily retrenched in recessions. This has created inequality between decreasing numbers of regular workers with guaranteed jobs, and increasing non-regular workers who absorb the shock of business fluctuations.

Like the retirement pension system, the seniority-based wage schemes favoured by large firms generate conflict between younger and older generations. Older workers get the lion's share of a firm's wage fund at a time when younger workers' chances of attaining seniority-based wages in the future are getting lower. In consequence, Japanese employment practices are no longer efficient or equitable. Seniority-based wages are inefficient because excess workers in large firms are discouraged from establishing their own businesses by the high opportunity cost of leaving the firm. This traditional wage scheme also tends to generate inequality between insiders and outsiders, and between a firm's younger and older workers.


Labour unions in large firms typically share the interests of the firm and tend to protect the interests of senior regular workers, so they are largely ineffective in resolving conflicts between workers. For instance, the unions' strategy for preventing disparity between regular and non-regular workers is to coerce firms into employing more regular workers, either by prohibiting short-term employment arrangements altogether or by limiting the type of work that can be done under those conditions, or the period during which temporary workers can be employed. Earlier this year the Diet passed a law outlawing dispatched employment contracts

shorter than a month, and in August passed another law limiting fixed-term employment contracts to five years. Neither the legislator nor the unions who support the tightening of labour market regulations seem to have considered the possibility that those who currently work in fixed-term contracts may well lose their jobs without getting new regular employment.

Alternative policies for reforming the labour market include reconsidering the regulatory framework for fixed-term contracts, including dispatched workers, in order to widen their employment opportunities. Japan must follow the path of other OECD countries and establish a principle of 'same wage for the same job' in order to protect the rights of non-regular workers. Assigning a monetary compensation for non-renewal of those workers who have held fixed-term contracts for a long time will make for a more equitable labour market. Reform must aim to match the situation of non-regular and regular workers so the disparity between them is reduced. Recent reforms of the Italian labour

market suggest that allowing firms to dismiss regular workers who receive monetary compensation when employment adjustment is necessary is an effective way of reducing disparities between workers.

Creating a better work-life balance has also become a policy priority as the number of highly educated women continues to grow. They face a trade-off between child-rearing and full-time work, leading to both a low level of women's participation in the labour force and a declining fertility rate. The government has tried to help working mothers by increasing the number of nursing schools and extending maternity leave to two years, to little avail. Traditional family patterns are closely associated with Japanese employment practices, and are premised on the man working full time and the woman being a homemaker. Long working hours are a frequent occurrence for workers under an employment guarantee; intensive on-the-job training often requires employees and their families to relocate. Families with two full-time earners have completely different needs: they prefer no overtime or job relocation, even if that means less job security. But this preference is not seriously considered by Japanese labour unions or employers, who still believe the traditional work and family style is best.

Devising new employment practices will go a long way to fixing the Japanese labour market, but this will not be done until employers and labour unions can agree on what those practices will be so that it can work in the current economic and social circumstances. 

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Creating a better work-life balance has also become a policy priority as the number of highly educated women continues to grow





## Six ways of staying affluent

EDWARD J. LINCOLN

**I**F THERE is one conclusion that economists can draw with any certainty about the future of the Japanese economy, it is that the overall growth of GDP will be very slow for several decades to come. Even under the best circumstances, overall GDP growth is unlikely to exceed an annual average of about 1.5 per cent. Advanced industrial nations like Japan do not grow quickly because they are constrained by the gradual shift of the global technology frontier. In the Japanese case GDP growth is further constrained by a very low birth rate, which is responsible for negative population growth.

A more informative measure of the success and health of advanced economies is GDP per person—a crude but widely used measure

of affluence. In the 20th century successful advanced economies have typically experienced growth in GDP per person in the range of 1.5 to 2.0 per cent annually, but there are reasons to fear that Japan may not be able to achieve this growth rate.

The low birth rate is first among these. The age structure of the population has been shifting as the ratio of people over the age of 65 to the total population rises rapidly. Though this shift is happening in many countries, Japan has the highest ratio among OECD countries (23 per cent in 2010), and the ratio will continue to climb.

This shift causes an obvious fiscal problem for both the social security and the national health insurance systems. The government is already running a large fiscal deficit and has accumulated a large government debt,

Technological adventure: younger employees are a source of innovation for Japanese corporations.

raising the possibility of a Greek-like fiscal crisis at some point in the future. At the moment there is no danger of such a crisis because high levels of domestic savings continue to be more than sufficient to finance the government deficit, but this situation cannot continue indefinitely.

An ageing population could have a negative effect on productivity or output per worker, because it will likely cause economic resources to shift towards those industries that serve the elderly. Japan's productivity per worker has traditionally been higher in manufacturing than in services. If the ageing population results in less manufacturing output (less domestic demand for automobiles, for example) and more demand for services (such

as health care, travel or other leisure activities), Japan could experience a drop in output per worker. Even with a constant level of output per worker, output per person in the total population will fall because changes in the national age structure are reducing the proportion of the total population that is in the labour force.

The dearth of young adults entering the workforce could also have a negative impact on productivity. With a low birth rate for the past four decades, the absolute number of adults aged 20–24 has been falling rapidly. From 1995 to 2010 the number of people in this age cohort fell 32 per cent, and based on the number of people aged 0–4 years old in 2010, it is due to fall a further 20 per cent by 2030. If young employees are a source of innovative thinking in corporations, then Japanese corporations face a problem as managers become increasingly old, less innovative and more risk-averse.

Though these negative factors may seem to doom Japan to unimpressive levels of per capita GDP growth, there are multiple strategies to avoid long-term gloom. Here are the top six.

First, the social security system must be rescued by increasing payroll taxes, delaying the age at which individuals receive benefits, and perhaps lowering the level of future benefits. National health insurance will require higher premiums and higher co-payment levels. Though some steps have already been taken to fix the social security system, more will be needed.

Second, the economy needs further economic deregulation, especially in service industries where productivity has lagged behind manufacturing. The productivity boost from deregulation would lessen the drag caused by the shift in economic structure.

Third, building a more encouraging environment for entrepreneurs will stimulate young people to create innovative start-up firms rather than being stifled in large corporate structures. Japan continues to lag behind other advanced nations on indicators of entrepreneurial activity; encouraging innovation can help solve this problem.

Fourth, better job opportunities for women will help boost productivity. Though women have made many social and economic gains in Japan over the past several decades, corporate management remains a largely male bastion. Japanese women are well-educated, but their skills are often wasted in the labour force. Moving them into jobs that take better advantage of their skills will raise overall labour productivity.

Fifth, the Japanese economy needs to be more open to imports and more welcoming for inward direct investment, especially in agriculture and services. Joining the Trans-Pacific Partnership negotiations would be a useful start. The increased competition from imports and from foreign firms investing in Japan will help drive productivity improvements in the economy.

Finally, the economy will benefit from increased immigration. Immigrants tend to be young adults, which is positive for two reasons: on

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Politicians remain deeply divided on whether to open markets to foreign competition . . .

the one hand, they will increase the ratio of workers to total population; on the other, immigrant workers who move into management roles can stimulate corporate innovation.

Since the mid-19th century Japan has had a very practical and flexible approach to economic issues—a flexibility that helped to lift it into the ranks of the advanced industrial nations by the 1970s. Although the past record augurs well for the future, addressing these six issues would be difficult for any society.

The fiscal fix may be the easiest, as the recent move to increase the national consumption tax suggests. On other issues the political system has moved slowly at best: deregulation has occurred in some industries but resistance in others remains formidable. Past efforts to encourage entrepreneurs have yielded only very modest results and women continue to face serious obstacles in the labour market. Politicians remain deeply divided on whether to open markets to foreign competition, while immigration remains miniscule and barely registers as a topic for political debate. Solutions will require clarity of vision and political courage—two commodities in short supply in current Japanese politics. Without progress on these six issues, the growth of affluence measured by GDP per person will continue to lag behind its potential. The danger is not a collapse, but a disappointing performance that may cause Japan to slide further down from its third place in the ranking of world economies. 

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# Removing barriers to trade, investment and business

GLEN S. FUKUSHIMA

**T**HE Japanese market is more open than many foreigners claim and more closed than most Japanese believe. This has been the case since the mid-1980s and still holds true today. Foreigners typically confront governmental, structural and psychological barriers to doing business in Japan. But as Japan renews its engagement with Asia, there are many reasons to expect that the barriers that have kept Japan and its Western trading partners apart will be further reduced.

Governmental barriers include tariffs and various laws and government regulations that impede market access. Many of these have been significantly reduced or eliminated over the past 40 years, thanks in part to bilateral and multilateral trade negotiations. Japan now boasts the world's lowest average level of tariffs on industrial products. Yet it still maintains some of the highest agricultural tariffs in the world, and in services—particularly in financial services—regulations often pose a challenge to doing business for foreign and Japanese companies alike.

Structural or institutional barriers are caused by close relationships between suppliers and buyers, suppliers and subcontractors, suppliers and distributors, regulators and companies, or corporate cross-shareholding that have the effect of vastly advantaging incumbents. Newcomers and outsiders are



Worshippers at Tokyo's Kanda Myogin shrine, known as the business and commerce shrine, on the first business day of the year.

disadvantaged in most markets, but in Japan this is magnified by the tendency to value stability, continuity, predictability, precedence and long-term relationships. This tendency defies the short-term economic rationality and shareholder value that most Western companies like to believe they adhere to.

The third kind of barrier to foreigners doing business in Japan is psychological. Most Japanese people over the age of 40 still view their country as a small island nation devoid of natural resources that must produce and export to survive. This partly

explains why Japan still has some of the lowest levels of manufactured imports and inward foreign direct investment among OECD countries. Many Japanese see trade and investment as a zero-sum game in which increased imports will harm Japanese producers and increased inward investment will displace Japanese companies. Japanese notions of corporate governance are different from the Anglo-American model, which gives primacy to shareholder value, board independence and board diversity. In Japan, the emphasis is on corporate stability, continuity and

predictability, and on stakeholder value (that is, the interests of employees, customers, partners and society). Companies that pursue short-term profitability, high share prices and economic rationality as defined by Western economic theory are the exception rather than the norm.

Yet in the past four decades Japan has removed or significantly reduced barriers to trade and investment. The end of the Cold War, the forces of globalisation, the maturing of the Japanese economy, the diversification of Japanese industry and generational change have all contributed to this process. Many Japanese who compare the Japan of today to the Japan of the 1950s, '60s and '70s consider these changes to be dramatic. By contrast, outside observers tend to evaluate changes less chronologically than cross-nationally. That is, they are puzzled and often frustrated that changes in Japan, although real, are so slow compared to those seen in other countries, especially in neighbouring East Asian countries.

**T**HIS gap in perception about the Japanese market has caused many Western companies to bypass Japan and seek business in other rapidly growing Asian markets. Because doing business in Japan is seen as too costly, too difficult and too time-consuming, many firms prefer to invest scarce resources in other markets that will reap returns in shorter periods of time. This gap in perception works both ways: Japanese observers point to significant reforms that have opened the market to trade and investment, and do not understand why Western companies are not more eager to enter the Japanese market or expand their operations in Japan.

To speak of 'the Japanese market' is to overgeneralise, because

there are in fact many markets in Japan. The traditional, heavily regulated energy, transportation, finance, pharmaceuticals and telecommunications markets have only recently experienced true competition. By contrast, newer industries have spawned companies that aspire to be truly global players, and value products, services, management and human resources (regardless of gender or nationality) that are globally competitive.

Another notable change in recent years is Japan's 'Asia shift'. This trend, which began in the 1990s, was temporarily arrested by the revival of the US economy and the Asian financial crisis. The Asia shift resumed in full force after the dotcom bubble burst in 2000, and again after the US-led financial crisis of 2008 and the recent European sovereign debt crisis. Japanese political, government and business leaders have concluded that their nation's economic future lies with Asia, the world's fastest-growing region, both as a market to sell to and as a platform in which to invest for research, development and manufacturing.

This shift of attention and energy to Asia has led Japan to actively pursue a range of free trade, economic partnership and economic integration agreements. Even the Trans-Pacific Partnership, which includes the United States, is seen by Japan as part of long-term efforts to promote bilateral and multilateral trade and investment in Asia, ultimately leading to the Free Trade Area of the Asia Pacific. The conclusion of these agreements would necessarily lead to reducing tariffs, regulations and other governmental barriers to the Japanese market.

As Asia's economy assumes a more important role for Japan, its own economy will likely become

more integrated with other Asian economies. To this extent, the barriers to trade, investment and doing business in Japan that have caused intense controversy between Japan and its Western trading partners since the 1960s are apt to decline in significance.

The Asia shift will make the sharp divide between Japanese and Anglo-American notions of corporate governance less relevant. Valuing continuity or stakeholder value over shareholder value are also features of Asian corporate governance, which means that the often legalistic, ideological disputes between Japan and its Western partners over issues of corporate governance (which directly affect mergers and acquisitions, joint ventures and strategic alliances) are less likely to be repeated.

**T**HE gradual opening of Japan's market from the 1980s, coupled with the growing attractiveness of the emerging markets of Asia, led many Western companies to scale back their complaints about Japan and to redirect their attention elsewhere. Japan's shift towards Asia will further reduce the trade and investment barriers that were so contentious between Japan and its Western trading partners. A question for the future is whether Japan's increasing economic integration with Asia—especially with China—will lead to a reduction of Japan's dependence on the US as a political and military ally, and what implications this will have for the US policy toward Asia. 

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# Lessons from Japan's nuclear accident



YOICHI FUNABASHI  
AND  
KAY KITAZAWA

**T**HE cataclysmic earthquake and tsunami that crippled Japan's Fukushima Daiichi nuclear power station on 11 March 2011 caused one of the most severe nuclear accidents in history.

A 400-page report from the Rebuild Japan Initiative Foundation on which we served reveals an utter unpreparedness for nuclear crises and an astounding neglect of safety standards. Regulatory capture only begins to explain what many consider a man-made disaster.

The industry's pre-disaster nuclear regulation system was arguably

the result of Japan's Galápagos syndrome—a condition that describes the phenomenon of a particular product or society evolving in isolation from the rest of the world. Japanese nuclear policies and the attitudes toward safety and security among nuclear professionals unfortunately seem to have suffered as a result of this syndrome; the main actors focused exclusively on domestic power games while paying very little attention to what was happening in the outside world.

A culture of overconfidence and arrogance among the national regulatory agencies and other relevant nuclear professionals, once praised as the best in the world, may have sabotaged Japan's strenuous efforts to

improve nuclear safety in the recent past. The Nuclear Safety Commission (NSC), the authority that double-checks the regulatory activities of the Nuclear and Industrial Safety Agency (NISA), issued a statement in 2008 that vividly illustrates how the Japanese nuclear community has isolated itself from the global regulatory regime.

The Integrated Regulatory Review Service, one of the peer-review systems of the International Atomic Energy Agency (IAEA), demanded clarification in June 2007 of the roles the NISA and the NSC played in developing safety-assessment guidelines. Nuclear safety regulation suffered greatly as sectionalism and turf wars within Japan's rigid bureaucracy left the

system unnecessarily complex and the accountability of each organisation unclear. The NSC issued a chairman's statement in response to the IAEA in 2008, dismissing the latter's recommendations and claiming the current nuclear regulatory system had been functioning effectively to ensure safety at an outstanding level, even by international standards.

Japanese electricity companies, including TEPCO, have also been unwilling to cooperate with the IAEA's other safety-review program, the Operational Safety Review Team (OSART), since its induction in the 1980s. OSART is a peer-review system in which international teams of experts conduct in-depth reviews of operational safety performance at a nuclear power plant by checking the factors affecting safety management and personnel performance.

The 1992 OSART review of the Fukushima Daiichi plants led to a number of recommendations, which TEPCO dismissed. It was revealed in 2002 that TEPCO had falsified 29 cases of safety-repair records regarding cracks found at several of its nuclear reactors, including those in Fukushima Daiichi in the late 1980s and 1990s. TEPCO declined an offer by IAEA's then chief, Mohamed ElBaradei, to help in the fact-finding process, and this seemingly insouciant attitude continued when TEPCO's then CEO subsequently announced to the media that he thought all the regulations were unrealistically strict and were not in accordance with actual operation.

Such events enhanced the culture of secrecy and technical hauteur within the Japanese nuclear community. This allowed the industry to minimise the disclosure of detailed information about its operation and to develop its own safety assurance practices, which

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The world should learn from the mistakes of Japan's ineffectual nuclear regulation system . . .

were not in accordance with global standards. This can be described as Japan's withdrawal into nuclear Galápagos syndrome.

This environment produced the twisted myth that was being propagated by interest groups—a belief in the 'absolute safety' of nuclear power. Risks of disaster were deliberately downplayed by Japan's nuclear club, which provided a procession of nuclear advocates in industry, government and academia. The nuclear safety regulatory regime has been under the joint jurisdiction of the Science and Technology Agency and the Ministry of Economy, Trade and Industry, the latter of which promotes nuclear energy use.

The Rebuild Japan Initiative Foundation revealed in its investigation that the Japanese nuclear community's safety standards were not only out of sync with the rest of the world, but also completely ineffective and faulty in the face of tremendous, uncontrollable nuclear power. Neither top NISA officials nor NSC nuclear science advisors were able to answer the questions posed by members of the crisis response team once the disaster happened, and offered no proposals to bring the accident under control. Beneath this dysfunction lies the country's bureaucratic sectionalism,

where short-cycle staff rotations prevent officials from serving terms long enough to equip them with real expertise in their respective fields. This practice of staff rotations needs to be eliminated along with Japan's poorly functioning regulatory organisations.

It is now time to overcome the Galápagos syndrome. The only way out is to develop a new philosophy, create further capacity and attract the right personnel—chosen from among government officials, academics and nuclear professionals—to properly fulfil the role of regulators. The Japanese government is considering creating a new nuclear safety agency to replace NISA and the NSC and to function as an extra-ministerial bureau of the Ministry of Environment. Whether the government can staff the new entity with real experts and whether the proposed agency can stand truly independent of the nuclear community will be crucial to turning the 2011 disaster into something from which the world can draw lessons.

The world should learn from the mistakes of Japan's ineffectual nuclear regulation system so that it can secure greater global nuclear safety. And Japan needs to learn from this regulatory failure, which sadly is not atypical of past regulatory failure in other areas of Japanese government, such as agriculture, medicine and finance. **EAFAQ**

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# Has the agriculture lobby captured the state?

AURELIA GEORGE MULGAN

**J**APAN'S agricultural policy arrangements, particularly those relating to trade, can be seen to favour the priorities of a well-organised farm lobby led by Japan's agricultural cooperative organisation (JA).

These conditions seem to offer a classic demonstration of 'political capture theory', whereby powerful sectional interest groups, particularly those of producer or provider groups, control policy in their sector to the exclusion of consumer interests and the wider public interest, constraining economic growth and hampering the efficient allocation of resources.

In Japan's case, the government has neither formally entered the Trans-Pacific Partnership (TPP) negotiations nor signed a free trade agreement with Australia, despite two successive prime ministers—Kan and Noda—expressing their desire that Japan join the TPP negotiations, and despite five years and sixteen rounds of trade negotiations between Japan and Australia. But both initiatives would require Japan to make major concessions on agriculture.

The JA-led farm lobby has penetrated Japanese government in two important ways: through direct political representation and by being incorporated into the agricultural administrative structure of the state.

Direct political representation involves former executives and employees of JA and related organisations seeking political careers in the Japanese Diet, which

provides a channel for JA to insert its policy preferences into government processes. JA's political offshoot organisations provide campaign, voting and financial support for candidates with direct links to the co-ops. JA's executive, staff and farmer members number around five million votes.

In the current Democratic Party of Japan (DPJ) administration, the minister of agriculture, forestry and fisheries, Akira Gunji, was previously secretary-general of the Ibaraki Prefecture Federation of JA labour unions, the trade union body that organises all JA employees in the prefecture. He was one of only 16 candidates in the 2010 Upper House elections to receive endorsement from JA's national political arm, the National Federation of Farmers Agricultural Policy Campaign Organisations. Not

surprisingly, JA was very pleased with his appointment as minister, particularly as he had served as vice-chairman of the 'group to think cautiously about the TPP', an intra-DPJ group opposed to TPP participation. He has maintained this 'cautious' stance as minister.

Other JA politicians in DPJ ranks are Kozo Watanabe, who used to be chairman of an agricultural cooperative in Fukushima Prefecture and who supported JA's petition opposing participation in the TPP negotiations; and former farmer and staff member of a Hokkaido agricultural cooperative Yoshio Hachiro, who served as chairman of the DPJ's Economic Partnership Project Team examining the issue of Japan's joining the TPP.

Although not great in number, these direct political representatives



Farmers turn out in strength to protest against the proposed Trans-Pacific Partnership.

PICTURE: AAP

can be great in influence, particularly if they occupy strategic positions in the policy-making process. It is a pattern of agricultural representation that has been evident for decades and has altered little since the DPJ came to power, although numbers of JA representatives have declined over the years and have been far more prominent in the ranks of the Liberal Democratic Party.

Corporatisation involves JA's performing various administrative tasks as an adjunct to the bureaucracy. Rather than being an 'independent' interest group, JA is firmly anchored in the administrative system for agriculture. The Ministry of Agriculture, Forestry and Fisheries (MAFF) has to be mindful of JA's interests in designing policies, including how agricultural reform will impact on JA's organisational and business interests, which rest substantially on keeping producer prices high and maximising the number of its farmer members and, therefore, maintaining large numbers of part-time, small-scale producers, who make up the majority of JA members.

For example, the MAFF contracted out the administration of rice production adjustment (*gentan*) to JA in the mid-2000s, including the setting of production volume targets. This JA-cum-producer-run cartel helped to keep the domestic price of rice high by restricting supply. JA benefited because the higher the producer price, the more JA earned from its marketing commissions as a fixed percentage of the sale price. The *gentan* has now been replaced with direct income subsidies to rice farmers, which are conditional on their compliance with a MAFF rice production plan.

The new scheme achieves the same goal of reducing rice production


but by a different method, and so benefits JA for the same reason the *gentan* did. The problem is Japan cannot participate in the TPP unless it abolishes rice volume control, which keeps rice prices high, because if rice tariffs were abolished, cheaper rice would be imported, and the high domestic rice price could not be maintained. So the real issue with the TPP is JA's economic interests rather than farmers' incomes per se. Direct income subsidies would protect farmers against rice price falls, but JA would lose from declines in marketing commissions.

JA also accounts for more than 50 per cent of the 'agricultural land use and aggregation facilitation groups' that mediate the buying, selling and leasing of farmland to encourage consolidation of farmland and scale expansion of farm operations. According to a *Nikkei* report released on 30 March 2012, the fact that JA is mediating many of these transactions has hindered businesses and agricultural production corporations from making these land deals and taking up farming. As a result, consolidation of farmland is not making much progress.

JA's shortcomings in administering land transfers have come to light in the wake of the Noda government's *Basic Policy and Action Plan for Revitalising Agriculture*. The plan advocated agricultural structural reform centring on expanding the average size of farms to 20–30 hectares over five years in order to increase the competitiveness of agriculture and lay the foundations for agricultural trade liberalisation. However, JA favours groups of small-scale producers forming 'community farms' over full-time, professional farmers and non-JA agricultural corporations, and it is now in a position to inject this bias

into its judgments about who gets the agricultural land being transferred. Its plan for land consolidation centres squarely on community farms forming management units of 20–30 hectares that rely totally on JA's purchasing and marketing services. Either JA or JA-financed agricultural corporations will manage farmland difficult to consolidate into these management units. JA has also been demanding complete adherence to rice production adjustment from community farms for the purpose of maintaining the rice price.

For the MAFF to use an organisation that has a vested interest in small-scale owner-farming as a key broker in agricultural land consolidation looks like wilful sabotage or blind incompetence. JA was a logical choice, however, because of its long-standing, corporatised role in administering government-sponsored agricultural land programs. Its new task merely reflects continuity of administrative systems, underscoring how this aspect of state–farm interest group relations can influence the design of policy and its implementation, and, as a consequence, the entire structural adjustment process. A corporatised partnership exists between the MAFF and JA in which the MAFF colludes with agricultural producer interests at the expense of consumers.

The avenues through which the JA-led farm lobby captures agricultural policy provide important 'structural' elements of the explanation for the policy immobilism that characterises Japan's agricultural policies and which impacts on agricultural trade. 

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# Reinvigorating national newspapers

TAKESHI YAMAWAKI

**T**HE long years of economic stagnation following the collapse of Japan's bubble economy is often called the 'lost two decades', owing to the country's failure to regain high economic growth despite a series of economic stimulus policies. Instead public debt continues to rise, having soared from 61 per cent of GDP in 1990 to 211 per cent in 2011. At this rate, Japan could follow Greece's economic collapse, although there are many differences between the two economies.

Amid this economic turmoil, politicians have been debating a tax increase, with the House of Representatives passing a bill in late June to increase Japan's consumption tax. Fifty-seven members of the ruling Democratic Party of Japan (DPJ) voted against the bill while members of the two opposition parties, the Liberal Democratic Party (LDP) and the New Komeito Party, voted for it. Shortly after that, 49 congress members left the DPJ to form a new political party led by former DPJ leader Ichiro Ozawa. They were heavily critical of the DPJ for not having stuck to its 2009 party manifesto which renounced any increases in the tax rate for the following four years. Prime Minister Yoshihiko Noda and his cabinet survived a no-confidence vote from Ozawa's new party and others, but Noda was obliged to promise to hold a general election 'soon' to get support from the LDP after the tax hike legislation passed.

How is the Japanese media reporting the ongoing political debate? And how should the media move when the economic and political risks are high?

The *Asahi Shimbun's* editorials have been arguing that, although political manifestos are important, faced with an ever-changing global landscape—including the euro crisis—parties should have the freedom to modify policy to adapt to changing circumstances. And, regardless of electoral commitments, Japan has little choice: with a rapidly ageing society, consumption tax cannot stay at 5 per cent. This is but one reality the nation must accept lest future generations carry too heavy a burden. The editorials of other national newspapers, including the *Yomiuri* and *Nikkei*, are carrying similar arguments.

But these lines run against the grain of public opinion, with popular feeling against the tax increase. One recent poll found that nearly 60 per cent of Japanese were opposed to the levy,

and, on TV, many commentators claim the government should cut wasteful expenditure before increasing tax.

Quite a few voices on the internet and some news magazines have also backed Ozawa and his anti-tax-increase agenda. It is possible that support here is in part a rejection of the legitimacy of Japan's major mastheads. A regularly cited example involves the press clubs in government and political party offices, where reporters from each paper are almost exclusively given the latest announcements from officials, and are provided with a desk within the club to work or wait. This system is an ongoing source of controversy, often viewed as the privilege of big newspapers and criticised as favouring the big media outlets. One reason why Ozawa receives some public support is because he is a very vocal critic of this arrangement. Although reluctant to be interviewed by major newspapers, Ozawa sometimes accepts exclusive interviews from internet-orientated media which provide live coverage through the internet for anyone to observe.

The rise of these new media outlets speaks to a reality that Japan's traditional media strongholds must face: that newspapers are losing their influence.

At its peak, total newspaper circulation in Japan was 54 million. Now it is down to 48 million. The highest circulation the *Asahi* ever had was 8.4 million, a number that stands at 7.6 million today. In spite of longer life spans and greater household

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Editorial independence  
is also at the heart  
of a newspaper's  
legitimacy and, in turn,  
its business viability



Newspaper circulations in Japan are dropping every year and, as in other countries, the younger generation is not taking up the newspaper habit.

numbers, circulations are dropping every year. The young generation in particular are not reading newspapers, with university student readers becoming rare.

In terms of revenue, the drop in advertisements—now halved since its heyday—is sharper than that of subscription numbers. The total number of internet advertisements surpassed those of all newspapers in Japan last year. Faced with such economic hardship, many newspapers are being forced to cut costs, including those that relate to their human resource base.

Still, the *Asahi* has more than 2,000 journalists, a number that compares favourably with foreign counterparts like newspapers in the United States.

Yet clearly the current trends are not promising. To stay competitive in this changing media landscape, new, creative ideas will be needed, and with that current ways will need rethinking.

Supporting the development of any newspaper's most important asset—its journalists—is of course essential. Well-written, balanced and in-depth coverage is fundamental to retaining readership numbers and important to dealing with the challenges that lie ahead for Japan. Journalists need to be thinking about economic, social and international issues in sophisticated ways if they are to play a productive role, and this may require changes to how journalists work and learn.

Emphasis on continual learning, deepening the knowledge and

experience of journalists, is crucial. Thus business practices commonly found in Japanese companies—like the transfer of employees to different divisions or offices around the country, a practice regularly used in national newspapers as well—should be done carefully, so as not to hinder the development of journalists' skills, including their expertise on specific issues.

More informed economic reporting is also needed in Japan's media. In a luckier and simpler era, increasing government spending through things like public works projects was a sure way out of recession. Now the economic issues are far more complicated, especially with the development of globalisation. But

reading, for example, the content of anti-tax commentary pervading the media, it is evident that much reporting lacks even basic economic knowledge. It is not uncommon to find journalists who fail to even consider what will happen to Japan if taxes are not raised, or what the current problems with the social security system are. History tells us that no country has survived without suffering serious damage if public debt is allowed to increase forever. Keeping lessons like this before the public, so as to contribute to informed public debate and scrutiny of political leadership, is something to which good and responsible media should contribute.

Editorial independence is also at the heart of a newspaper's legitimacy and, in turn, its business viability. Because of this, the declining respect for,

and following of, Japan's newspapers suggest that some changes in current journalistic practices are needed. The obvious yardstick here is ensuring that newspapers be alert to, and prevent, influences that might compromise the independence of their reporting, whether such compromises are real or perceived as such by the public.

Within this context, one new idea at the *Asahi Shimbun* has been its feature Sunday supplement, *GLOBE*, which appears twice each month. Named after its goal of reconsidering Japan from global perspectives, journalists for *GLOBE* form a team and spend two to six months on investigative reporting before an article goes to press. Instead of attending press clubs, the focus is on diversity of opinion and perspective, thinking and discussing issues from different points of view and

conducting extensive interviews in and out of the country. The reporting seeks to present a realistic picture of a question, gained through extensive interviews.

Ideas like this, which place faith in traditional understandings of good journalism and in an intelligent readership, may be a part of reinvigorating the role of newspapers in Japan. While the age of the internet may be presenting new dimensions to journalism, and challenging long-held revenue models, it has not changed the reality that legitimacy and quality journalism are essential to a newspaper's success. **EAFQ**

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# From leading to following in the region

SHIRO ARMSTRONG

**I**N THE post-war period, Japan played an important and active role in creating and providing public goods and development assistance in the region, and in maintaining open and robust markets. For example, Japan effectively led the establishment of the Asian Development Bank, and, together with Australia, was instrumental in the creation of APEC.

But for the past decade or more Japan's foreign economic diplomacy has stalled, and the nation is doing little to actively contribute to shaping a stable and prosperous region at a time when regional and global institutions are under pressure, in a state of transition and flux.

Japan is a member of the G20, the preeminent steering committee for the global economy, but it has been missing in action in that forum as it hankers for the days when it was Asia's sole representative at the G7/G8—a grouping that has outlasted its relevance, given that the global economy is no longer dominated by the rich club of advanced economies.

Characteristic of its role in the G20, Japan's economic diplomacy has been drifting. Long-term economic slowdown has brought with it a stronger tendency of inward-lookingness, exacerbated by the Tohoku triple disaster of 2011. Lack of political leadership and the inability to carry through the liberalisation of agriculture has hampered Japan's participation in any meaningful

foreign economic policy beyond narrow and relatively unimportant trade agreements. Those agreements have come in the form of economic partnership agreements (EPAs) with developing countries that aim to secure Japanese investment abroad while generally avoiding opening markets so that agriculture at home can continue to be protected.

Free trade agreements (FTAs) with Australia and South Korea are being negotiated, a China–Japan–Korea FTA is under study, and an FTA with the European Union is on the horizon. Japan has shown an interest in joining the Trans-Pacific Partnership (TPP) agreement as well, but the main barrier to Japan concluding or joining all these agreements is its inability to reform key areas at home, most notably by opening up agriculture.

It is often the case—perhaps especially so in Japan—that the private sector leads the way while government policy lags behind. That is true on many domestic issues, such as in the labour market, where the inability to

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The priorities in Japan are to open its economy to foreign competition, especially in services and agriculture

reform has forced companies to hire part-time and non-regular workers, thus dividing the labour market in economically inefficient and socially unhealthy ways. Internationally, Japanese multinationals have continued to lead the offshoring of Japanese manufacturing and development of regional supply chains. And the relocation abroad of Japanese companies of all sizes has led to policies that strengthen investment protection through EPAs, not the other way around.

After multilateral liberalisation, bilateral or preferential agreements (such as FTAs or the TPP) are at most a second- or third-best option for trade liberalisation—and it is not clear whether they may have become the enemy of the first best. If the aim is (as it should be) to further open up protected and inefficient industries and make the economy more flexible, competitive and dynamic, a country's priorities should focus on unilateral liberalisation and reform, from which it stands to gain the most. The difficulties with that strategy are not arguments for a strategy of narrow bilateral deals.

The purpose of Japanese trade or foreign economic policy is to increase the welfare of Japanese people and further Japanese interests abroad. The priorities in Japan are to open its economy to foreign competition, especially in services and agriculture. Japan attracts very little foreign direct investment relative to its size, and regulatory and other barriers

inhibit the kinds of flows that occur into similar industrial economies. As Japanese firms continue to move operations to China and the rest of East Asia, the Japanese economy needs to continue to open up beyond its low tariffs on manufacturing goods so that it can benefit from deeper integration into the dynamic regional economy, especially with China.

Japanese leaders may need *gaiatsu*, or foreign pressure, to help initiate some of the difficult domestic reforms. This has been the case in the past. The TPP has been seen as just such a tool for opening up agriculture at home, bringing the weight of the TPP members—but most importantly the United States—to play as a lever. Given the political commitment to current FTAs, Japan could use them to help push long-overdue domestic reforms. That should be done not preferentially but in a way that opens up Japan to the world, not just to selected partners.

The multilateral trading system has been important for Japan's development and its peaceful integration into the global economy in the post-war period. Two examples illustrate that.

First, Australia's decision effectively to grant most-favoured-nation status to Japan in 1957—very soon after World War II—and then extend equal treatment to investment and people movement in 1976 helped to secure Japan's dependence on open global markets for raw materials and energy. These arrangements were bilateral but entirely non-discriminatory in character.

The second example is China's accession to the World Trade Organization in 2001 and the process leading up to it. China committed itself to the global trading rules, something most clearly seen in its unilateral liberalisation and 15-year-



A special case: Japan has generally avoided opening home markets to ensure that domestic agriculture can continue to be protected.

long process of showing the world its commitment to those rules, locking in reforms towards a market-based economy. Japanese companies could be confident in dealing with a China that was committing itself to the same rules and norms that governed its own international dealings. That's what allowed the bilateral Sino-Japanese trade and investment relationship to flourish, based on comparative advantage and mutual gain instead of bedevilled by divisive politics. Their unresolved history, regional rivalry and political differences did not prevent them from developing a huge economic relationship. An FTA would not have led to the same outcome.

The importance of the multilateral framework for Japan underlines the country's strategic interest in having a clear strategy towards regional and bilateral agreements that do not pick and choose partner countries to do business with in ways that hurt particular economic or

political interests in the region. For this reason, it would be unwise for Japan to sign on to the TPP without signing on to the China-Japan-Korea agreement or a major East Asian agreement (such as the ASEAN-led Regional Comprehensive Economic Partnership), given the likelihood that China will not be a TPP member any time soon. China is, after all, Japan's largest trading partner, and the same can be said for almost all of Japan's other big trading partners.

Re-awakening Japanese interest in helping to create both regional and global public goods could start with a more active role by Japan in regional community building through institutions such as APEC and actively using the G20 to shape those regional interests. **EAFO**

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# The dilemmas of middle-power diplomacy

YOSHIHIDE SOEYA

**T**HE concept of a ‘middle power’ embraces three aspects of diplomacy: behaviour, status and strategy. A typical middle power, such as Australia, has struggled to synthesise these three dimensions to maximise its diplomatic power. In the case of Japan, however, both external and domestic observers have largely neglected the fact that an imbalance exists among these three factors; Japan’s diplomatic behaviour has essentially reflected ‘middle-power internationalism’, while its status has been uncertain and its strategy confused or non-existent. Any diplomacy constrained by the war-renouncing Article Nine of Japan’s post-war constitution and the country’s security treaty with the United States could not be that of a traditional great power, and on many occasions Japan has even fallen short of behaving like a full-fledged middle power in the domain of international security.

After the Cold War, many analysts argued that Japan would finally cast off the post-war constraints on its security policy that were derived from the ‘peace constitution’ and its alliance with the US. Neo-realists predicted that structural pressure created by the end of the Cold War would force Japan to go nuclear. Many other observers interpreted Japan’s wish to become a ‘normal country’ as an aspiration to play a ‘normal military role’ in the game of power politics. Others came to believe that Japanese security

policy had gradually reverted to that of a traditional great power. This understanding of what constitutes a ‘normal’ Japan became conventional wisdom in many parts of the world.

Over the past two decades none of these predictions has come to pass. The US–Japan alliance was strengthened rather than weakened, rendering suggestions about Japan’s military independence virtually meaningless in the evolving structure of strategic interdependence. The fundamental motive behind the participation of Japanese Self-Defence Forces (SDF) in United Nations peace-keeping operations and other international peace activities has been internationalism rather than nationalism, and the SDF’s activities are still guided and constrained by the norms and legal framework embedded in the peace constitution. Japan’s efforts in the domain of national defence have been upgraded but the constitutional constraints remain intact, and many of these military efforts are institutionalised in the US–Japan alliance. If judged according to actual behaviour, then Japanese security policies—including changes in recent years—are still much closer to those of a middle power and hardly reflect the sort of diplomacy conducted by strategically independent great powers, such as the US and China.

The gap between conventional wisdom about what constitutes a ‘normal’ Japan and the reality of Japanese security policy gives rise to several puzzles. First, why and how

has this conventional wisdom been so tenacious despite its obvious failure in explaining changes in Japanese security policy after the end of the Cold War? Second, how have aspects of change and elements of continuity in Japanese security policy balanced out amid significant transformations in the external security environment and domestic politics?

Where the first puzzle is concerned, the psychology of Asian and other victims of past Japanese military aggression has created a complex background. But most importantly, the rise of regressive nationalism among conservative politicians and opinion-makers in Japan has misled many observers, causing them to believe that this nationalist trend has guided many changes in Japanese security policy. As a result, the internationalist elements of Japanese policies have tended to be dismissed, interpreted as cosmetic and as containing ‘hidden’ nationalist intentions.

Unravelling the second puzzle thus becomes all the more important to understanding the substance and nature of Japan’s newly evolving security policy. Here it is important to interpret the meaning and function of regressive nationalism in transforming domestic politics and the policy making process in Japan. In short, this sentiment does have a real influence in helping to confuse domestic politics and external perceptions of Japan, but not in the way implied by the aforementioned conventional wisdom.

Particularly since the second half of the 1990s, a new set of factors has



Afghan President Hamid Karzai and Japanese Prime Minister Yoshihiko Noda at the Tokyo Conference on Afghanistan in July 2012. The fundamental motive behind Japan's participation in international peace activities has been internationalism rather than nationalism.

begun to complicate domestic politics and debates over security policy, including the perceived threat of China and North Korea. As a result, Japanese debates and politics have begun to assume a nationalistic tone and have become increasingly detached from a truly strategic debate on security and defence policies.

Many expected that the gap might finally begin to diminish after the Democratic Party of Japan formed government in the summer of 2009, but the confusion has yet to dissipate. The mix of internationalism and regressive nationalism continues to confuse Japan's domestic politics, as well as external observers of Japanese security policy. Yet the basic parameters of this policy—the peace constitution and the US–Japan alliance—still remain strong. Thus, in reality, Japanese security policy has evolved along the lines of ‘middle power internationalism’ as if an invisible hand were at work. Policy

makers have, in turn, consistently attempted to adjust the country's security policy in accordance with the shifting external environment through a series of constitutional and legal reinterpretations aimed at relaxing the constraints posed by these basic parameters.

Prime Minister Yoshihiko Noda's recent claim that Japan must revisit the question of its right to collective self-defence is a case in point. The government argues that, as a sovereign nation, Japan has the right to pursue this essential attribute of statehood, but that constitutionally the country cannot exercise it. In essence, this right is an important tool in strengthening Japan's alliance with the US, thus consolidating the foundation of Japanese post-war security policy. External observers are often confused by the fact that regressive nationalists also believe that Japan should exercise this right—in so doing it would become a much closer ally of the

US and subsequently move closer to becoming a full-fledged middle power. Recognition of this deep reality is missing in both external perceptions of Japanese security policy and domestic Japanese debates.

The intensifying territorial dispute between Japan and China poses a similar challenge. The value system of Japanese civil society might be termed ‘post-modern’, where territorial integrity is of secondary importance, and this is why the Japanese government has exercised much restraint in dealing with territorial disputes throughout the post-war years. Now regressive nationalists have openly begun to attack this traditional policy of self-restraint, again confusing both external perceptions and the Japanese decision-making process.

In both cases, the trend created by regressive nationalism is a source of confusion rather than an indication of Japan's new strategic thinking. The critical task for Japan now and in the future is to match its strategy explicitly with typical ‘middle-power internationalism’.

This is not a task that Japan alone can tackle. The virtue of middle powers is internationalism, where cooperation with like-minded states in order to strengthen a liberal and open international order is key to any aspect of strategy. Whether one likes it or not, Japan's status may also be evolving into that of a middle power, in which the creation of a culturally rich welfare society, living in an increasingly interdependent and globalised world, is a natural goal of an ageing nation.



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# Making the most of the US pivot

RYO SAHASHI

**J**APAN'S leadership has just overcome one of the most difficult challenges in a democracy: raising the nation's consumption tax for social welfare. After 49 members of the Diet broke away from the ruling Democratic Party of Japan in July 2012, a heated dispute over the timing of the next general election has ensued. In September, two major parties will choose their leader, but media attention is now going to the new party led by the mayor of Osaka, Toru Hashimoto. Alongside this struggle over national leadership, however,

Japan is also looking to refocus its Asia Pacific diplomacy.

The Obama administration has forged ahead with its pivot, or rebalancing, towards the Asia Pacific after US Secretary of State Hillary Clinton outlined the key elements of this policy in her famous 2011 *Foreign Policy* article. US Secretary of Defense Leon Panetta also outlined his plan for rebalancing in his remarks at the June 2012 Shangri-La Dialogue, when he emphasised the continued presence of the United States in the Asia Pacific and the Indian Ocean regions.

The pivot is clearly a whole-of-government initiative, and there is no

US Defense Secretary Leon Panetta addressing the Shangri-La Dialogue in Singapore in June this year, where he emphasised that the United States would continue to be a presence in the Asia Pacific region.

doubt the US alliance network and its security cooperation with non-allied states have been strikingly elevated through this policy, as well as through US participation in the region's multilateral institutions. Can Japan share this path with the United States in the Asia Pacific? Or will the current state of Japanese politics prevent it from assuming a central role as the most important US partner in the region?

Under the rebalancing initiative, the US has emphasised the importance of strategically connecting the Western Pacific and the Indian Ocean and has strengthened its combined bilateral



and multilateral approach to regional security. The US has also strengthened its bilateral relationships over the past several years, in the context of multidimensional challenges from China and articulated concern about the inadequate security mechanisms in the Indo-Pacific area. Hence, Japan has deepened its joint dynamic defence cooperation with the US, most notably in the realm of intelligence, surveillance and reconnaissance, and through further interoperability. Cyber security, space situational awareness, and defence technology are potentially further important areas for cooperation. And even though the US Marine Corps and the US Navy will reduce their presence in Northeast Asia to be rotated southwards, Japan still supports such strategic decisions by the US.

If Japan and South Korea were to give the long-awaited first step towards greater security cooperation, the US would undoubtedly regard this as an important asset for the Northeast Asian security architecture. Yet after President Lee Myung-bak's visit to the Dokdo/Takeshima islands in August 2012, it is unlikely that any steps to advance bilateral security relations will be taken before the South Korean presidential election in December. The Japanese security partnerships with India and other Asian nations would also function to underpin US commitment to the region.

But both Japan and the United States should be aware that a new balance of power is emerging, one in which the region's smaller powers are deepening their economic and social dependence on China. Multilateral institutions will be essential to sustaining a rules-based order and state autonomy across this new political landscape, although the major powers will still have a role to play in

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Supporting maritime security and the democratisation of Myanmar will be major tests for Japanese foreign policy in the near term

helping to build states' capacity for territorial defence and in encouraging international law.

As the April 2012 statement issued by the Japan-US Security Consultative Committee suggests, the Japanese government will henceforth provide development aid for its strategic goals in the Asia Pacific. Supporting maritime security and the democratisation of Myanmar will be major tests for Japanese foreign policy in the near term. The Japanese government should be instrumental in promoting this rules-based system, and the East Asia Summit in particular is one platform for pursuing this goal. In addition, 2013 will mark the 40th anniversary of ASEAN-Japan cooperation. The Japanese government could make use of this opportunity to enhance its relationship with ASEAN.

Economic liberalisation—and the Trans-Pacific Partnership (TPP)—is another important element in the US pivot to the Asia Pacific. But the Japanese government is yet to decide whether it will participate in the TPP negotiations, and it will be difficult to make this decision before the next 2012 round of negotiations, considering the political costs at

home. US engagement with the region continues to evolve as the Japanese government continues to prevaricate on important issues like the TPP.

Until a majority can be gained in both houses of Japan's parliament, the scope for political leadership is limited. The future of nuclear energy and the deployment of MV-22 Osprey aircraft to Air Station Futenma are difficult decisions that constrain the administration's initiative. While there is room for further diplomacy around political and security cooperation in the region, the Japanese leadership will inevitably encounter thornier issues such as economic liberalisation, the legal foundations of the Japanese constitution, and the increase or reallocation of defence and diplomatic budgets required in the process. Without some shock to the external environment, Japanese politics is unlikely to escape its inward-looking preoccupations, and Japan will find it difficult to capitalise on the US Asia Pacific pivot. **EAFQ**

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**Securing  
energy  
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resources**

# Persistent inclinations of a cautious ally

SOURABH GUPTA

**I**N OCTOBER 2000 a select bipartisan group of Washington's Asia hands issued a provocative policy blueprint known as the Armitage-Nye report which aimed to integrate Japan as a more equal and active security partner in the Asia Pacific and internationally. The authors laid out a vision of a radically transformed US–Japan relationship modelled on the US–UK alliance.

The response by Prime Minister Junichiro Koizumi's Task Force on Foreign Relations was equally forthright. It noted that it was impossible for the Japan–US relationship to become like that between the United States and the United Kingdom. It said that Japan, while adopting complementary policies, would proceed along its own foreign-policy axis of coordinates.

Nevertheless, with an almost Anglo-Saxon sense of mission Prime Minister Koizumi soon afterwards set in train the most sweeping set of pro-alliance-related adjustments to Japanese security policy since the mid-1980s, including unlimited geographic extension of the Self-Defence Force's right to conduct international peace cooperation activities.

The task force report and subsequent policy initiative capture in a nutshell various facets of Japanese diplomacy: a restatement of the persistently cautious inclinations of Tokyo's statecraft; the congruence in US–Japan alliance purposes

that will deepen in the foreseeable future; and the persistence of the ingrained separateness within the alliance's institutional machinery and geopolitical ends that will likely outlive it. Over the next two decades, each of these currents will continue to permeate Japan's East Asia strategy and its alliance with the US.

First, unlike the British interest in manipulating the continental balance of power, the notion of aligning against the stronger power to contain its influence is at odds with the Japanese tradition. Rather the inclination of statecraft has been to pursue policies of strategic detachment or isolation. The next best option, when this has not been possible, is to forge amicable ties with whichever foreign state appeared to demonstrate the most impressive combination of military, economic and cultural power. Equally, efforts by Great Britain and US in the modern era and China throughout much of Japanese history to involve Japan in the region's strategic balance have mostly been unsuccessful because Tokyo has avoided a too-intimate strategic association with its foreign ally or mentor. Japan is not the UK of East Asia and will not assume the role of regional offshore balancer.

Second, the meteoric rise of China at a time of receding US primacy is placing Japan's choices at odds with its enduring principles.

Adaptive resilience to the reality of Chinese power is not the issue here. The stability of central authority in Beijing has been among the surest

guarantors of Japan's domestic stability and external security. Rather it is the need to hedge against the destabilisation that is rippling through the East Asian periphery as a by-product of the rise of Chinese power. A stable, ideally prosperous, periphery has been the indispensable condition of Japan's security. Historically, the Korean peninsula and the Taiwan Strait have served as the outer ramparts of Japan's defence perimeter. Time and again power vacuums or instability on the peninsula and within the straits have tempted entanglements in Korea and Taiwan, and stability has allowed Japan's strategic view to turn homewards.

The extent—or lack of—to which China consolidates its authority over this fluid East Asian periphery during the next two decades will determine the depth to which the essential bargain at the heart of the US–Japan security arrangements—that of ensuring Japan's defence in exchange for hosting the forward US presence in the Asia Pacific—is operationally deepened.

**F**INALLY, deepening the bargain will ironically aggravate the dilemma Tokyo faces in coping with the power transition underway in East Asia, given Japan's tendency to organise its external relations on a hierarchical basis and 'move with the powerful'. While the unification of Korea and the incorporation of Taiwan under the mainland's economic and political 'loose rein' hegemony will



Japan Air Self-Defence Force personnel in Kuwait. Japan's involvement in international missions is still circumscribed by constitutional requirements.

remedy this dilemma, it will also upend the fundamental bargain that underpins the US–Japan alliance.

To guard against the twin perils of alliance entrapment and abandonment during this unsettled interregnum, the low-cost, risk-minimisation strategy that characterises Tokyo's management of the US–Japan alliance will continue to prevail.

The bilateral strategic bargain between the US and Japan has never been transformed into a fully fledged alliance. There is no fully integrated sharing of risk comparable to that involved in NATO or the US–South Korean alliance, nor is there a joint command structure or attached bureaucracy that could develop a vested interest in perpetuating its institutional character.

The separate approaches in terms of strategic concepts, command, control and battle-management systems, operational planning and crisis action procedures will not be abolished. Rather a fresh division of bilateral roles and mission responsibilities will progressively chip away at the separation—a process that from

Tokyo's point of view will be geared as much to advancing the 'normal nation' defence capabilities as to enhancing interoperability within the alliance.

Japan used activities conducted under alliance auspices in Iraq and Afghanistan—such as participation in multinational peacekeeping and humanitarian operations, deploying forces overseas during times of active hostilities, and liberalising rules on supplying weapons and transporting armaments—to push the boundaries of Japanese rearmament.

Similarly, a carefully calculated set of constitutional reinterpretations can be expected to pass into legislation in coming years. The effect of these reinterpretations will be progressively to blur definitional lines between conflict and post-conflict operations, combat and non-combat zones, and military and policing activities, which still limit Japan's involvement in alliance missions within carefully prescribed thresholds. The right to exercise collective self-defence in narrowly circumscribed situations in areas surrounding Japan will also be admitted. Fundamentally, though, the

geopolitical separation that is built into the heart of the alliance, and the corresponding flexibility to hedge against entrapment or abandonment, will be preserved.

Whether the US–Japan alliance helps to stabilise the Asia Pacific periphery, whether Japan adopts a more self-reliant defence framework or whether it focuses its energies inwards, all this ultimately hinges on the gravity of Japan's demographic and economic erosion. Japan's total population is in absolute decline, nominal gross domestic output is stuck at early-1990s levels, central government tax revenues are trending at mid-1980s level, the welfare recipient list is longer than the early postwar peak, and the defence budget is in its tenth straight year of decline. With that scenario, discretion will remain the better part of valour in Japan's management of its alliance with the US. **EAFC**

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# The gender fault-line

AYAKO KANO AND VERA MACKIE

**T**HE economic, demographic and environmental shocks of recent years that have so profoundly shaped contemporary Japanese society have distinctive gendered dimensions. The economic reality has shifted, but social expectations about the roles of men and women have been slower to change. Meanwhile, the demographic crisis is placing a considerable burden on families and revealing the attendant risk of the ‘care deficit’—in the home and in the face of disaster.

The first of Japan’s two more active periods of gender policy making came after the end of World War II. In 1946 the new constitution granted equal rights to both sexes and enumerated their social, legal and political rights. The following year equal pay for equal

work and maternity leave were made mandatory. The Equal Opportunity Employment Law (EEO) of 1985 marked the beginning of the second period of gender policy making and coincided with Japan’s ratification of the United Nations Convention on the Elimination of All Forms of Discrimination Against Women (CEDAW). This was followed by the Basic Law for a Gender Equal Society and other policy developments implemented during the recession years.

The EEO has, to some extent, succeeded in outlawing direct discrimination against the new graduates who have been seeking employment in a shrinking economy. But the law does not change society’s expectations that place the major responsibility for childcare on women

and for breadwinning on men. In contemporary Japanese society women are expected to manage the double burden of work and family, often by eschewing full-time work and a career.

Nearly 70 per cent of Japanese women ‘choose’ to leave the full-time workforce on the birth of their children. This also makes it easier for companies to channel male and female workers into different employment tracks, in violation of the spirit of the EEO.

Both men and women are increasingly engaged in non-permanent employment. This is a result of deteriorating employment conditions, particularly for men in their 30s and 40s. Full-time employment eluded many in this group during the lost decade of the 1990s. Trapped in a succession of

unstable and low-wage jobs, many of these men were effectively shut out of a career, and also found it more difficult to marry because they were perceived as being incapable of supporting a family. Marginalised from both career and family, many felt deprived of a sense of belonging and social identity.

At around 1.37, Japan's total fertility rate is among the lowest in the world. Japan has the second-highest life expectancy in the world: 86 years for women and 79 years for men. It is estimated that by 2055 more than a third of the population will be over the age of 65. The productive population will thus decline, resulting in a shrinking tax base from which to provide pensions, welfare and medical care, and a smaller workforce to provide care for the elderly. The government's efforts to raise the birth rate have been ineffective. This has led some commentators to talk about a 'strike' by young people, who are marrying later, if at all, and who are having children later, or having fewer or no children.

Until the 1990s it seemed unimaginable that immigrant workers would be part of the solution for dealing with the care deficit, but the government is now moving slowly in this direction through bilateral agreements with Indonesia, the Philippines and Vietnam. Although a small number of people have passed the national examinations that allow them to stay long-term as certified nurses and carers, most of those entering Japan under these bilateral agreements will, in effect, be members of a rotating pool of short-term workers.

Non-profit organisations mediate the entry of such workers, and brokers who had hitherto helped entertainers or marriage migrants to enter

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Women have been  
conspicuously  
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decision-making at all  
levels of Japanese  
society

Japan now focus on care workers. The immigrant brides who entered the country during the 1980s are increasingly engaged in care work—some in their marital households and others in more formal settings that require special training.

While Japan as a whole suffers the effects of the economic and demographic crises, these problems are most acutely felt in Northeast Japan. The population there was older and diminishing well before the Tohoku triple disaster. On 11 March 2011 less-mobile elderly people found it harder to reach safety and were less likely to be using the social media that were the major source of information on evacuation and relief. People over the age of 65 accounted for about two-thirds of bodies recovered. Communities already suffering from the economic recession, unemployment and the care deficit were plunged into a deeper crisis.

The effects of disasters are mediated by a society's existing structures and thus reveal its fault-lines. Although disaster planning since 2005 has explicitly noted the question of gender and national Plans for Gender Equality have explicitly mentioned disaster response, only 3.6 per cent of disaster preparedness council members at prefectural level were women. A

quarter of prefectures had no female members at all.

In many of the communities affected by the tsunami and its aftermath women were in charge of caring for others, and so had to deal with the short supply of sanitary napkins and nappies (for babies as well as the elderly), infant formula and baby food. The lack of privacy in shelters affected women especially, including nursing mothers.

Women have been conspicuously absent, not only from disaster planning and energy policy making, but from decision-making at all levels of Japanese society: women make up only 13 per cent of Diet members, 16.7 per cent of lecturers and above in higher education, 2 per cent of heads of government departments, and 4 per cent of CEOs.

In 2010 the CEDAW committee urged the Japanese government to undertake affirmative action to improve women's participation in decision-making positions in government, the bureaucracy and business. The government responded with a plan aimed at increasing the share of women in leadership positions to at least 30 per cent in all fields by 2020.

The economic, demographic and environmental crises of recent years have revealed the gendered fault-lines in contemporary Japanese society, and the urgent need for more gender-inclusive decision-making. **EAFO**

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# Balancing old and new in forging a new cultural norm

KENT ANDERSON  
AND  
YOSHIHARU MATSUURA

**F**EW would any longer put France at the top of the global political order, yet any high-level international meeting must have a French representative at the table and the French approach will invariably be considered when searching for a solution to a challenging issue.

Japan is becoming the new France. While China, India and ASEAN seem to capture the public's collective attention in the Asian Century, Japan is still at the 'big table' in all serious global and regional conversations. Like France, Japan is a key reference point for any comparative study, particularly in respect of law reform.

Since at least Ezra Vogel's *Japan as Number 1* in 1979, it was envisioned that Japan would assume its place as a superpower, at least economically. In the past decade, however, economic and political stagnation, an ageing society and natural disasters—as well as the rise of China, India and ASEAN—have led to Japan's retreat at home and abroad. It is now more useful to see it as neither a superpower nor a failed superpower, but as an important member of a small group of leading nations that present a unique way of viewing the world, and whose views warrant serious consideration. Seen in this way, Japan can certainly be compared to France, a country with neither hubristic self-belief nor a paralysing lack of self-confidence. Seen in this way, Japan, like France, still

matters to the global community and is leading from behind in quieter and more innovative ways than it might have at its zenith in the 1980s.

In law reform, Japan leads from behind because its peers acknowledge its successes in modernisation and development, as well as its emergence in setting the standard. Countries looking to modernise their legal systems look to Japan as it is widely known for the successful incorporation of three influences from foreign legal systems that facilitated modernity in ways that were unique to the Japanese experience. The first influence, from China's Buddhist and Mandarin courts, created the foundations of the modern Japanese state in the 7th century. The second influence was from Europe, when the mid-18th century model and consideration of its legal structures laid the groundwork for Japan's current legal framework. The third influence was from America in the immediate post-war period, which added democratising and procedural elements to the legal system. From the 1970s to the end of the 20th century, Japan's neighbours saw the legal structures underpinning Japan's economic success as the most relevant model to follow.

Japan rightfully has taken pride in these developments and 'led from the front' through Overseas Development Assistance (ODA), sponsoring law reform in places such as Vietnam, Cambodia, Mongolia and Uzbekistan. Impressively, the leaders of this ODA-funded law reform have learned to take a soft approach, using

tools such as joint working groups and study committees to consider both Japan's approach and that of the recipient's legal tradition to social and institutional challenges.

Though the two lost decades have taken much of the shine off the Japanese legal reform model, it would be a mistake not to take its reform history seriously, especially in the light of a fourth set of influences on Japanese law reform in the decade from 1996 to 2005.

In 1996 the so-called Big Bang of financial sector reform was implemented; in 1999 the Justice System Reform Council was formed and subsequently proposed 13 major changes to the legal system, such as introducing a quasi-jury system, reconceptualising legal education and significantly increasing the number of lawyers in the country; and in 2005 the Diet introduced the new *Companies Act*. As a result, Japan's legal institutions are in a state of remarkable change—change that puts a higher priority on transparency, legal standards and global norms.

The newly reconstructed Japanese legal system is not just a poor cousin of the US model but a unique model that is a hybrid of various traditions from across the world. It also reflects the Japanese *kaizen* philosophy, which calls for ideas to be studied, tested and refined perpetually. This willingness of Japanese law reformers to honour their own traditions and strive for perfection while looking to many other systems for inspiration is a hallmark of the Japanese approach.

# Warm trade ties help to temper neighbours' political tensions

AMY KING

**T**HE Sino–Japanese relationship is paradoxical. The two countries enjoy major trade and investment ties but also suffer persistent, damaging political rifts.

The negative side of the relationship is familiar. Since the late 1980s, Chinese diplomatic rebukes and popular protests over issues relating to the legacy of World War II have become increasingly strident. During Prime Minister Koizumi's era the Chinese government protested against his visits to the Yasukuni Shrine and opposed Japan's bid for UN Security Council membership.

In more recent years the main source of tension has been territorial disputes over the Senkaku/Diaoyu islands. In 2010 the Japanese coast guard arrested the captain of a Chinese fishing boat that had allegedly rammed two Japanese coast guard vessels in contested waters. The arrest prompted government protests in China. The Chinese government called off political talks with Japan and temporarily suspended a series of bilateral student exchanges. The response in Japan was chilly. A *Yomiuri Shimbun* survey published in October 2010 reported that 89 per cent of Japanese believed that the Chinese government 'went

too far' on the Senkaku/Diaoyu issue. Worse, the survey found that only 13 per cent of Japanese respondents felt any trust in China.

Routine political and territorial rifts make it easy to conclude that the Japan–China relationship is dominated by intractable animosity. But the economic connection that has long brought these two states together should not be overlooked. China is Japan's largest trade partner, and Japan is China's second-largest trade partner after the United States. More importantly, Japan is one of China's major sources of foreign capital. Over the past decade Japanese foreign direct investment in China has grown tenfold as Japanese firms have shifted their manufacturing operations to China. Both large firms and small- and medium-sized enterprises are part of this trend.

Sino–Japanese economic interdependence is set to deepen following the Chinese government's decision in May 2012 to allow direct convertibility between the yen and the renminbi. This makes the yen the first currency other than the US dollar to establish direct convertibility with the renminbi. As China's second most important economic partner, Japan was a natural first choice for Beijing, whose efforts to internationalise the

The changes are starting to yield results. For example, the financial sector looks fundamentally different, foreign investment has increased, and transparency and accountability under clear legal standards have become the norms in courtrooms and in the shadow of the law.

Despite this evidence of the earlier emergence of a new legal environment in Japan, it is difficult to ignore the magnitude of the impact of March 2011's triple disaster in encouraging a return to the more traditional Japanese values of thrift, modesty and naturalism. These tragedies reinforced the truism that no country can exist without a sophisticated interdependence of both giving to and receiving from other countries.

It might be too early to predict the net effect of the merging of the trend to law reform that embraces adaptation and modernisation, and the predilection to return to traditional values, as seen in response to the disasters of March 2011. But Japan is moving towards a 'French model' that is confident in the legal structures that underpin its post-developed economy and the traditional values that make it unique and resilient.

By recognising and valuing these trends, other countries have much to learn from the Japanese experience. Honouring traditional culture without taking away from the legal framework necessary for modern society is something Japan, like France, seems to have achieved in admirable measure.



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renminbi and reduce its reliance on the US dollar have received much publicity in recent months.

Sino–Japanese ‘hot economics, cold politics’ make this relationship a poster child for the liberal thesis that economic interdependence is a source of peace.

This may seem counterintuitive. After all, the strength of economic ties has not actively improved other aspects of the relationship. However, strong economic interdependence has helped to raise the costs of conflict. Since the end of World War II economic ties have prevented sour political relations from turning into outright conflict. Even during the most difficult years of the Cold War, when the US put pressure on Japan not to trade with ‘Red China’, Japanese and Chinese business leaders, politicians and government officials worked hard to negotiate a set of small, unofficial trade agreements. Even during the worst years of the Cold War era, the two sides relied on economics to build a relationship where politics and diplomacy could not.

Yet the ‘hot economics, cold politics’ that have worked so well in sustaining the bilateral relationship for over six decades is based on US primacy in East Asia. This East Asian regional order has allowed Japan to pursue economic engagement with China while being backed up by the security guarantees of a hegemonic US. The rise of China may change all this. Will the paradoxical quality of Sino–Japanese relations be sustained at a time of shifting power relations in East Asia, or is this a new phase in Japan–China relations?

There are some worrying signs that the basis of the Japan–China relationship is changing. Both the 2011 and 2012 *Defence of Japan: Annual White Paper* raised detailed concerns

about China’s growing military budget, lack of military transparency and the intensification of China’s military activity in the East and South China Seas. There is also strong and growing concern among the Japanese public over China’s military rise. Polling by Pew Research in 2011 found that 87 per cent of Japanese view China’s growing military strength as a ‘bad thing’ for Japan.

Linked to this, more and more Japanese are finding comfort in the US alliance. The Democratic Party of Japan (DPJ) came to power with plans to reach out to China and take a more independent stance towards the US. But support for this approach was lost when the Japanese public grew concerned that the Hatoyama government was taking a cavalier attitude towards the US–Japan alliance. In the last two or three years China’s behaviour has become increasingly provocative, and this has helped to push Japan closer to the US. A 2011 joint statement by the US and Japan explicitly referred to China’s

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There are also clear signs that despite growing concerns about China’s military rise, the Japanese public continues to support increased and open economic ties with China

lack of military transparency as an area of mutual concern, and Tokyo and Washington have strengthened their cooperation in areas such as intelligence, missile defence, space security and cyber security.

Even more worrying is the development of the Trans-Pacific Partnership (TPP), a new US-led exclusive economic grouping in the Asia Pacific. Although the TPP is still being developed, the strict standards on intellectual property rights, labour, the environment and the regulation of state-owned enterprises the US is pushing for will make it extremely difficult for China (and other transitional economies) to qualify for membership. Any perception that China is being deliberately locked out of a key regional economic grouping creates a risk that economics will be used to enhance rather than constrain political and strategic tensions between China and its neighbours. So far official statements suggest that Beijing has adopted a wait-and-see attitude towards the TPP, although in late 2011 a Chinese Foreign Ministry official stated that ‘we hope all [trade] mechanisms could remain transparent and inclusive’. China’s official Xinhua news was more blunt: ‘The TPP, which pointedly excludes China, is widely seen as a thinly disguised counterweight to free trade blocs in the region.’

Yet there are positive signs that ‘hot economics’ will continue to temper the ‘cold politics’ of the Japan–China relationship. The Japanese government is dragging its feet on the TPP, and it is unlikely that the prime minister, Yoshihiko Noda, will be successful in taking on the Japanese agricultural lobby and so enable Japan to join the new economic grouping. At the same time, Japan has strengthened its free trade negotiations with China



and South Korea, and the three countries recently concluded an agreement that will deepen trilateral investment. There are also clear signs that despite growing concerns about China's military rise, the Japanese public continues to support increased and open economic ties with China. In December 2010 an *Asahi Shimbun* survey found that 64 per cent of Japanese believed that the most important issue in the US–Japan–China relationship was not strengthening the US–Japan alliance against China, but finding ways to deepen the mutually beneficial economic ties between the three countries.

Japan and China have long used economics to sustain an otherwise difficult relationship. There are a number of reasons to expect that they will continue to do so for many years to come. **EAFQ**

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A moment of respect from a Japanese rescue worker as Chinese soldiers remove a body from the rubble of Beichuan Middle School after the Sichuan earthquake in May 2008.

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# The politics of demographic change

YUKINOBU KITAMURA

**J**APAN'S population is shrinking and ageing. This demographic transformation has set in motion a series of unprecedented policy actions and political reactions. The kerfuffle over the proposed consumption tax increase will come to frame more of Japan's political agenda, with lasting consequences for Japanese political parties.

The bill aimed to double the consumption tax rate by 2015. Tax increases will be used to pay for social security needed to care for the ageing population.

The demographic transformations of recent years have changed the distribution of voters and public expenditure requirements across voting districts. One implication of these changes is that the majority of voters will, in time, come to support consumption tax reform. If so, parties opposed to the reform will lose the election because of a mismatch between demographic transformation and these parties' geographical allocation of candidates. Yet raising the consumption tax is politically very costly in the short term.

Ichiro Ozawa, one of the founding fathers of the Democratic Party of Japan (DPJ), used consumption tax reform opportunistically to split with the DPJ. Along with 49 of his followers, last July Ozawa launched a new political party, the Kokumin no Seikatsu ga Daiichi (People's Life First).

His new party name reveals an embarrassingly straightforward populist attitude, as does its platform, which is opposed to consumption tax hikes and nuclear power plants. These are neither constructive policies nor political principles the party members believe in.

Japanese political parties have reasonably distinct core supporter groups. Trade union members and other workers in urban areas typically support the DPJ, while businesspeople in urban areas and conservative people in rural areas—including farmers, fishermen and small business owners—tend to vote for the Liberal Democratic Party (LDP). The DPJ's overwhelming success in the 2009

general election had much to do with winning seats in urban areas.

So does Ozawa's new party stand a chance electorally? Apart from Ozawa himself, who is based on the Iwate prefecture, none of his followers have strong political supporters in their constituencies. Many of them do not even have the support of their constituencies because they were elected under the proportional representation system. The People's Life First party is not likely to obtain sufficient votes in the rural areas.

Ozawa has been trying to form a coalition with regional parties, including the Shinto Daichi (New Party, Big Land) based in Hokkaido and led by Muneo Suzuki, and the Osaka Ishin no Kai (Osaka Restoration Association) led by the city mayor, Toru Hashimoto. Since Ozawa's new party has no regional base, and since, as politicians, Suzuki and Hashimoto are as cunning as Ozawa, the three would find it difficult to form a durable coalition.

In *The Economic Consequences of the Peace* (1919), John Maynard Keynes wrote that 'the great events of history are often due to secular changes in the growth of population and other fundamental economic causes, which, escaping by their gradual character the notice of contemporary observers, are attributed to the follies of statesmen or the fanaticism of atheists.'

As the ongoing demographic transformation of Japanese society activates profound structural changes, Keynes's insight is again likely to prove right. Policy responses to the ageing process have proceeded despite political conflicts and follies. The social security system in general, and the public pension scheme in particular, must be stable and sound, and should not be used as pawns in political games.

In less than a year's time, it will become all too clear that demography—and not ideas—drives current-day politics in Japan. **EAFC**

*Yukinobu Kitamura is Professor at the Institute of Economic Research, Hitotsubashi University.*



An anti-nuclear protest in Tokyo in 2011: the demonstrators may yet leave their mark on Japanese politics.

# Japanese politics: the spirit of 2012?

TOBIAS HARRIS

**J**APANESE politics have entered a volatile phase. The debate in Japan's House of Representatives over raising the consumption tax resulted in a new rift in the ruling Democratic Party of Japan (DPJ) when Ichiro Ozawa took 49 followers out of the party in July and formed the new People's Life First party. The rift follows the rise of the Osaka Restoration Association led by Osaka's mayor, Toru Hashimoto, and the consolidation of the neoliberal Your Party as challengers to Japan's two

major parties, suggesting that Japanese politics may be on the brink of a new party realignment.

Observers should not place too much significance on changes to the parties—over the past 20 years Japanese parties have formed, splintered, dissolved and merged frequently. Japan, however, may be in the midst of a wider-reaching political transformation that extends beyond the party system.

In 2012 Tokyo has seen the biggest demonstrations in Japan in more than 50 years, as tens of thousands of protesters have repeatedly converged

on the prime minister's residence to protest against Prime Minister Yoshihiko Noda's decision to restart the nuclear reactors that were shut down after the 3/11 disaster. The anti-nuclear protests come on the heels of smaller-scale protests in late 2011 and early 2012 against the Noda cabinet's intention to join the Trans-Pacific Partnership talks. These protests, together with reports of growing participation in political 'training' academies sponsored by reformist politicians, including Hashimoto, suggest that a public long dissatisfied with its political leaders is increasingly

inclined to take politics into its own hands. Whether out of disappointment at DPJ performance or dismay at the persistence of structural corruption in the Japanese state, public distrust may have reached a tipping point.

Although the Tokyo protests inspired comparisons to the Arab Spring and Hashimoto's rise to the Meiji Restoration, it is too early to tell where the tumult will lead. Typical of a mature democracy, Japan's political, electoral and administrative institutions serve as considerable barriers to political outsiders seeking entry.

First, the mixed-member electoral system for the House of Representatives is advantageous to major parties that are able to run candidates in nearly all of the 300 single-member districts. It is unclear how many candidates the expected alliance between Your Party and the Osaka Restoration Association will be able to field in the next general election, which must be held by August 2013. And campaign finance and electoral activities laws favour

incumbents, most of whom belong to the two major parties.

Moreover, the House of Councillors is a significant roadblock in the path of would-be reformists. If the opposition controls the House of Councillors, it will be able to stall or block the government's agenda, as has happened during the past five years, when the opposition controlled the House of Councillors for all but one year. While half of the House of Councillors faces re-election in 2013, the fractured party system may make it difficult for any party to win an outright majority, forcing the ruling party to reach *ad hoc* compromises with the opposition. If a populist party or coalition could form a government on the basis of a lower-house majority, a divided Diet (*nejire kokkai*) might nevertheless hamper its ability to govern.

Finally, a populist government would have to contend with Japan's national bureaucracy. The bureaucracy's influence—and its hostility to reformist politicians—can be overestimated, but politicians must

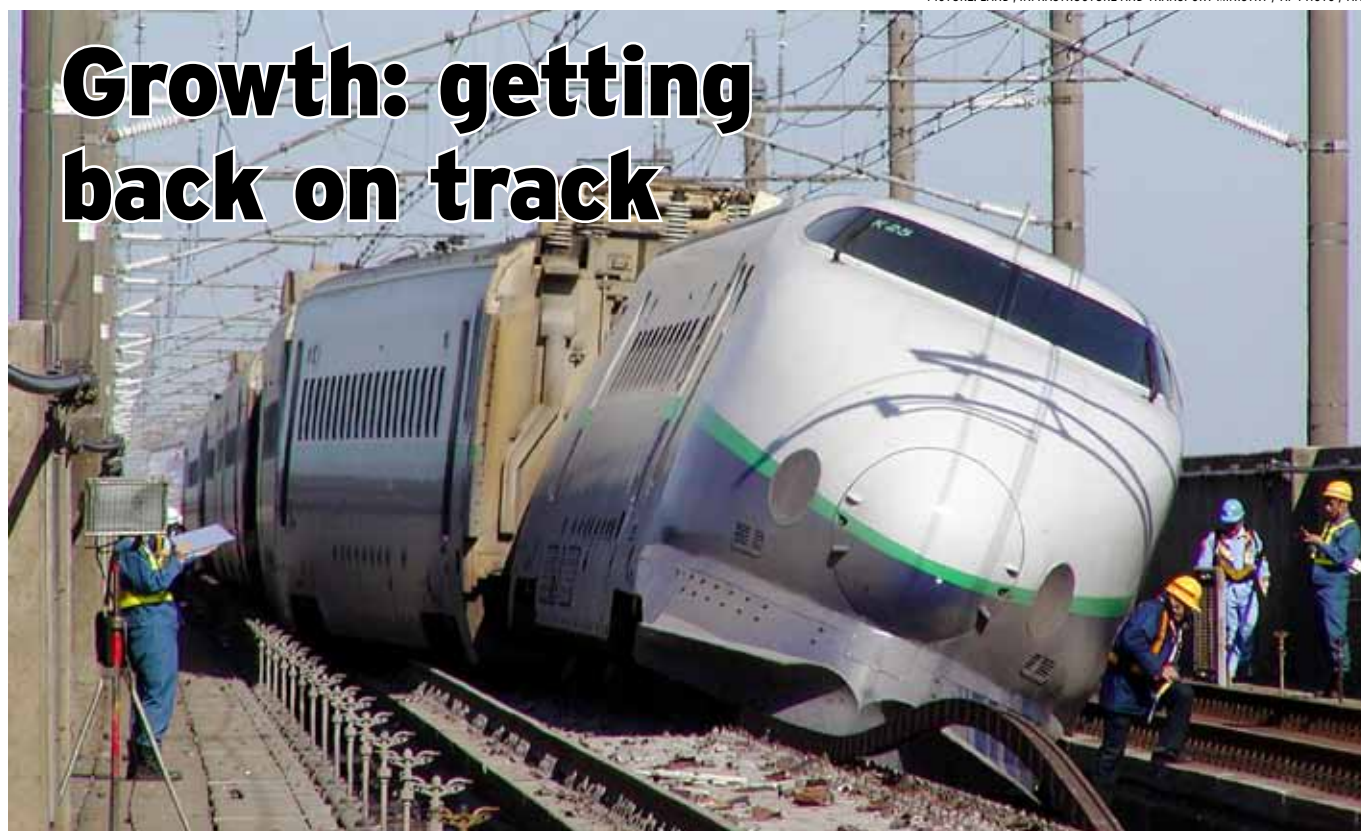
still manage even the most pliant bureaucracy. Neophyte ministers, even those with policy expertise, may not necessarily make skilled managers of the bureaucracy. This appeared to be the case with the DPJ after 2009. Without outside advice of the kind that legislative staff and think tanks might provide, political leaders have little choice but to reach some kind of understanding with the bureaucracy. Democratic legitimacy may ultimately depend on a neutral, competent national bureaucracy that is capable of administering the programs that voters want. In their zeal to reform the bureaucracy, politicians have 'hollowed out' the civil service by driving out or discouraging talented individuals and impairing the bureaucracy's ability to provide sound policy advice.

Despite mounting unrest in the Japanese political system, significant obstacles stand in the way of lasting change. Few of Japan's policy challenges have easy solutions. And despite the desire for a decisive leader, Japan, now more than ever, may need institutions in which more views are represented and compromise is easier. Prime Minister Noda has shown that reaching a compromise, while difficult, may not be impossible. But while the demonstrators in Tokyo and the urban reformists of Osaka are unlikely to see the broad changes they desire, they may yet leave their mark on Japanese politics. If frustration with the system produces an influx of new participants, Japanese democracy may become more open, and more willing to absorb new ideas from outside the centres of power within the Diet. **EAFO**

*Tobias Harris is a doctoral candidate at the Massachusetts Institute of Technology. He worked for a DPJ member of the upper house of the Diet between 2006 and 2007.*



Toru Hashimoto, leader of the Osaka Restoration Association: a reformist who recalls for some the Meiji Restoration.



# Growth: getting back on track

JENNY CORBETT

**L**ONG before the lost decade it was clear that the Japanese economy would only continue to grow after its ‘miracle’ years if it increased its productivity. Once ‘catch up’ with the leading economy was complete, domestic technological innovation and continuing structural change became the two main sources of increased productivity.

While there is still debate about the deep causes of the 1990s slowdown, the immediate causes are clear (policy change in 1990), as are the consequences (wealth declines, growth in bad debts and unemployment, falling corporate capital investment, low growth rates and price deflation). Combined with external shocks and a steadily appreciating yen, it is not surprising that recovery was difficult. A subtler disagreement, however,

surrounds the causes of the slower productivity growth. Measurement is part of the problem, because data cannot pinpoint the sources of productivity growth and decline. A demand-driven contraction in output will create a fall in measured productivity until employment contracts. But the data cannot explain whether productivity falls because of poor management or as a result of failure to introduce new technologies. This ambiguity lies at the heart of different interpretations of the outlook for Japan.

Japan’s productivity growth has been slightly above the OECD average since the mid-1990s and does not underperform most of Europe (it only fell behind that of the US economy after the latter’s surge in the early 2000s). Japanese labour productivity grew strongly enough between 1990 and 2006 to compensate for declines

in labour supply, leaving average annual GDP per capita growth not far behind that of the United States or Australia. In years to come Japan must address two crucial issues that will otherwise compromise output growth: the dramatic variation in productivity performance across sectors, and declining labour supply.

Japan’s demographic problem is well known but the impact on fiscal deficits, health care and social security spending is not the only dilemma. As the workforce ages and retires there is less labour input to produce output. Each possible strategy to overcome the labour shortage has a degree of political difficulty: raising the retirement age, increasing women’s participation in the labour force, increasing immigration and increasing trade, but they are all possible, so the ageing workforce should not automatically spell an end to growth.

Some observers blame declining labour inputs and reduced working hours from the mid-1990s onwards for the lost decades, but it is hard to see this as the major explanation for slow growth since 1991. Even if the potential of the economy was lowered by a reduced labour supply, that cannot explain the GDP outcome when unemployment was increasing. This gives credence to the argument that the economy was operating below its capacity, whatever one judges that capacity to be. But it does not alter the arithmetic for the future: to compensate for reduced labour supply there must be increased productivity from the remaining workforce.

The services sector is where Japan can make the most substantial productivity gains. Though measuring productivity in services is difficult, it seems that Japan has low levels of productivity relative to the US in most service areas except finance. Growth of productivity in market services is around the OECD average, but in 'other services' productivity growth is slow. This means that Japan has the opportunity to catch up to international productivity levels in those 'other' service sectors. The apparent low productivity may be partly a measurement issue. Because quality of service is hard to capture, the data does not reflect high or improving quality at the same price, which should be accounted for in productivity measurements. Another source of the productivity gap with the US in many service sectors is low levels of investment, particularly in IT and computers. And barriers to entry are high in Japan's services, which reduces incentives to invest and thus limits new competition from domestic start-ups and from foreign entrants. The benefits from catching up to international levels


of services productivity would be significant because research suggests that GDP growth appears to be much more responsive to improvements in services productivity than to additional gains in manufacturing or agricultural productivity.

Japan has a mixed record in policy responses to slow economic performance. The economy has not reached its potential for prolonged periods during the last 20 years. Though there is debate about how big the gap is, it is probable that a persistent gap—however modest—contributes to lower potential. The best policy response would be to work on two fronts: manage demand to minimise the GDP gap because the costs of deviation are large, and raise potential by focusing on productivity improvements.

**H**OW that should be done is broadly clear and, though details will matter, some things will probably not matter very much. For instance, improving corporate governance structures won't make much difference in the absence of other changes. In Japan there are examples of old-style behaviour (Olympus) and of very new models (Rakuten). Other firms, like Sony, have not prospered despite being one of the first to adopt the Western system of external board members with committees. OECD experience suggests that shareholder activism is not a solution to all ills. In fact, Japan's most successful growth period was under its old corporate governance system, which suggests that changes in governance structures are probably not the only key to improving productivity.

For Japan the next leap in growth can only come from a shift in economic structure just as transformative as the one that took

place between 1950 and 1970. This time it will be a shift to a service economy with a small, high-tech manufacturing sector. Most of conventional manufacturing will be moved offshore. There may be a 'niche' agricultural sector producing expensive goods adapted to local and specialist tastes, but it should be a part-time occupation and should not have its current hold over politics and trade policy. Trade in both goods and services will play a bigger part than it has so far. There are considerable challenges to setting up a service-based economy. The first is to change the regulatory framework so firms can easily enter and exit the market. Japan's own processes for bank resolution—which were perfected during and in the aftermath of the banking crisis in 1997—could be a model here.

The transition to this new structure will be difficult. There are both distractions and genuine problems along the way. Excessive focus on fiscal restructuring is one distraction; excessive gloom about the ageing population is another. By contrast, changing deep preferences for making things (*monozukuri*) over providing efficient services as the basis for the economy, and convincing embattled workers, students and managers that their services future will require good language skills and familiarity with the outside world, is a genuine problem that needs to be tackled now. Japan's future growth potential is tied to its people's commitment to internationalisation. 

*Jenny Corbett is Professor of Economics and Executive Director of the Australia–Japan Research Centre at the Crawford School of Public Policy, Australian National University.*

# Coping with disaster shows the strength of civil society

XIAO SHU

**A** NATURAL disaster is not the worst of our fears: much worse is a society in disarray.

The 2011 Tohoku earthquake and tsunami reminded us all of the tragedy of the unpredictable and the fragility of human existence.

Japan's earthquake not only teaches us what is meant by the era of risk, but it also teaches us that the best preparation for a big risk is a big and effective response.

Japan's strong society played a significant role in the response to the 1995 Kobe earthquake. The performance of the government at that time drew criticism, but government incompetence did not lead to devastating consequences, as it alone did not carry all the responsibility. Japanese society is a self-governing society; a self-governing society is a polycentric one, one with a dense web of load-bearing walls. If one or several of these collapses, the impact is not disastrous, and will not lead to national collapse. The rapid intervention of civil forces after the Kobe earthquake minimised the loss of life in the face of government failure. Even the Yamaguchi underworld group headquartered in Kobe came forward, providing food and daily necessities to victims.

Japan, having learned from the Kobe earthquake, responded more sure-footedly to the Sendai earthquake. The government did not fail this time and its response was

orderly and measured, at least until the nuclear crisis. This was a classic case of a courageous government refusing to be defeated by criticism, learning and growing from criticism, and in doing so, recovering its dignity.

But compared to the strength of the government, it was the strength of the nation and society that was most impressive. Japan's media, represented by Nippon Hōsō Kyōkai (NHK), neither panicked nor was sensationalist, and spared no efforts to provide a plain and accurate information service. Some people lament that the role of NHK in the disaster relief was greater than that of the government.

Japan's schools and communities, its civil society, without exception played their own role in helping with the disaster relief. Neither receiving nor needing executive orders, they seemed to have a natural cohesion, willingly throwing themselves into

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... the Japanese natural disaster of 2011 was great, but the resilience of the social framework was still greater

the relief effort in an instinctively orderly fashion. Free public phones, free shelter materials, free food supply, the orderly and smooth flow of public transport: all of this was mostly unsolicited and occurred in a low-key fashion.

The force of the Japanese natural disaster of 2011 was great, but the resilience of the social framework was still greater. Japan's robust social structures and core formed a safety net warding off further risks, warming people's hearts and blessing countless lives. How else could a major 9.0 earthquake and a raging tsunami not cause hundreds of thousands of casualties?

A society that lacks the ability to discipline itself and that can only rely on executive orders to mobilise and organise, is a society that is as stable as a plate of loose sand.

The strength of the civil society that grew from China's 2008 Sichuan earthquake is still there; what's to stop China from building upon it?

China's own foundations are not so weak, as the relief efforts after the Sichuan earthquake proved. This strength of civil society should not be short-lived, and China should follow Japan's lead with its responsible and constructive attitude towards building a better society. 

*Xiao Shu is Chief Editor of the China Reform magazine. This article was adapted from one originally published in Chinese on ifeng.com. David Kelly provided translation.*



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