



Structural Reform of the Japanese Economy

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Slide 1

What are “structural policies”?

Definition

- Role of the government
 - Achieving stability \Rightarrow macroeconomic policies
 - Intervening in the market when there are market failures \Rightarrow structural policies
- “Contemporary rethinking of the role of government has been reflected in two initiatives, **deregulation** and **privatization**.” (Stiglitz [2000]).
- Structural policies in narrow sense

Structural Policies in the 1970s and 80s

- President Carter began movement toward deregulation. (Deregulations in airline fares and long distance trucking prices.)
- President Reagan continued to criticize the regulatory burden imposed on business, but regulations continued to grow...
- In 1979, Mrs. Thatcher was elected, and soon started powerful drive for privatization.
- Mr. Nakasone (the P. M. of Japan in the 80s) privatized Japan National Railway (JNR), Nippon Telephone and Telegram Public Corporation (NTT), and the Government Tobacco Monopoly.


The Japanese “Big Bang” in the Late 1990s

- Globalization of capital flows and a rapid increase of JGB made many of MOF’s stringent regulations and controls meaningless.
- MOF started to relax interest rate controls and branch regulations in the late 1980s.
- P.M. Mr. Hashimoto started financial sector deregulation program in 1996. (the “Japanese Big Bang”)
 - The ban on financial holding companies was scrapped.
 - The new Bank of Japan Law
 - Deregulation of trading commissions on the value of equities transactions over ¥50 million

The Japanese “Big Bang” in the Late 1990s (continued)

- Amendment of the Foreign Exchange Law
 - Firms no longer have to pass all their foreign currency transactions through authorized banks.
 - Individuals are permitted to hold accounts abroad directly.
- The new Financial Supervisory Agency began operations. It was separated from the MOF.
- Non-life insurance premiums were deregulated.
- Banks were allowed to sell mutual funds over the counter.
- It was allowed to trade equities off exchanges.
- Brokerage commissions were fully deregulated.
- Controls on banks' securities subsidiaries were lifted.

Mr. Hashimoto's six reforms

- Mr. Hashimoto started 5 other reforms:

 - (1) administrative reform, (2) fiscal structure, (3) social security, (4) economic structure, and (5) educational.
- A) Strengthening the functions of the Cabinet
- B) Integration of ministries in the central government,
- C) Deregulation,
- D) Decentralization of administrative powers,
- E) Legislating **the law of information disclosure**,
- F) Reform of special public sector corporations
(public corporations established by special laws).

What was the successful parts of Mr. Hashimoto's Reform?

- The plan to integrate central government ministries was realized, but it was not a true streamlining.
- The most successful reform was the disclosure. Higher transparency helped reducing strong-arm resistance from producer oriented ministries against deregulation and liberalization initiatives.
- The rate of consumption tax and premium rate for the public pension were raised.
- The social security reform was a gradualist approach.
- Some of changes in commercial codes and other laws were important.

A. Major legal changes

- Procedures for corporate mergers were rationalized (Commercial codes, 1997)
- Holding companies were allowed (Anti-monopoly law, 1997)
- Financial holding companies were allowed (Financial holding company law, 1998)
- Share swaps were introduced (Commercial C., 1999)
- Private rehabilitation law was legislated (2000)
[Minji-saisei-ho]

B. Some important accounting rules were changed (2000-2002)

Consolidated accounting was reinforced; cash flow statements were introduced; consistency with tax treatment was ensured; etc.

Aborted Mr. Hashimoto's Reform and Mr. Obuchi

- Because he was forced to step down due to the serious slump in 1998, an impression that his reform effort was aborted remained.
- At least, quite a few reforms were started in the right direction.
- Was his reform one of the important cause of the economic slump in 1998? No.
- **Mr. Obuchi** tried to stimulate the economy by fiscal measures. But only short-lived recovery. ⇨
Doubt about Keynesian fiscal measures
Budget deficit and accumulated debt ↑

P.M. Mr. Koizumi's Policy (April 2001~)

- He first said “without reform, no recovery.”
- Some economists noticed that Mr. Koizumi's reform programs are supply side policies.
- Then he said “without reform, no growth.”
- He made it clear that he would not rely upon fiscal measures, and that he would concentrate on the structural policies.
“The most noticeable break with past packages is the intention to limit new borrowing by the central government to 30 trillion yen from FY 2002.”
- The Council on Economic and Fiscal Policy (new mechanism) laid down the Draft Policy Guidelines (“Large-boned policy”). (June 2001)

Narcotic Impact of the Past Policies?

- The private sector began to realize the necessity to restructure their systems and to cope with the difficulty by themselves. ⇨ Restructuring
- Mr. Koizumi's policy of not using fiscal measures sent a message that the government would not bail out non-viable firms.
- Frequent fiscal measures in the past attenuated the impact of post-bubble-burst shock. This *success* had narcotic effects on ailing companies but did not provide disciplines. (Zombie corporations)
- He declared stop of narcotic medicine.
- Supply side causes (structural), or demand side cause (macro policy mistake)?

Policy objectives 2001-03

- IMPLEMENT SEVEN REFORM PROGRAMS
Privatisation, deregulation, etc. (See below.)
- RESOLVE BAD-LOAN PROBLEMS
 - Expanding Resolution Collection Corporation (RCC) and improved monitoring of progress of bad-loan disposals
 - Introduction of special inspections focused on large debtors
 - Flexibility in settling the purchase price of bank's non-performing loans by the RCC
 - Establishment of corporate reconstruction funds
- IMPROVE UNEMPLOYMENT INSURANCE AND RETRAINING.
- EXPECT BOJ TO MAKE TIMELY DECISION ON QUANTITATIVE CREDIT EASING
- LIMIT NEW ISSUE OF JGB TO 30 TRILLION YEN

Policy objectives 2001-03 (continued)

- EXPECT BOJ TO MAKE TIMELY DECISION ON QUANTITATIVE CREDIT EASING
- LIMIT NEW ISSUE OF JGB TO 30 TRILLION YEN

Policy objectives from 2004

- TURN PRIMARY BALANCE OF NATIONAL BUDGET INTO SURPLUS
- ACHIEVE ECONOMIC GROWTH LED BY PRIVATE-SECTOR DEMAND
 - Measures include promoting shift in resources to industries with higher productivity and policy reform which clarifies concerns about the future such as pensions

Key points of 7 structural reform programs (1-3)

1. PRIVATISATION AND DEREGULATION

- Privatising **postal savings, insurance and mail-delivery** services and other public corporations including universities
- Encouraging competition in non profit areas including medical treatment and nursing care

2. ENTREPRENEURSHIP

- Encouraging individual investors to participate in stock market, by reviewing tax system
- **Strengthening Fair Trade Commission**
- Encouraging competition in telecommunications sector by imposing further regulations on NTT

3. SOCIAL INSURANCE

- Introducing social security numbers
- Using market prices and fiscal incentives in determining rewards for medical care and drug prices
- Limiting growth of medical costs by setting growth-rate target

Key points of 7 structural reform programs (4-6)

4. INTELLECTUAL ASSETS

- Focussing funds on life sciences, IT, environment and nanotech.
- Introducing competition to foster world-class universities

5. QUALITY OF LIFE

- Revitalising urban areas and improving commuting
- Shortening waiting list for **nurseries** to zero
- Altering focus of taxation from families to individuals
- Abolishing gender discrimination in employment

6. MORE RESPONSIBLE LOCAL GOVERNMENT

- Promoting **mergers** of local governments
- Reviewing central government's share of contribution to local governments administrative costs
- Allocating subsidies by setting objective standards
- Adopting a **corporate tax based on sales**

Key points of 7 structural reform programs (7)

7. FISCAL REFORM

- Reviewing long-term public works projects
- Reallocating road taxes
- Lowering public works spending / GDP in the medium term.

Continued effort thereafter

- A reform schedule was released in September 2001.
- The new Council for Comprehensive Regulatory Reform started to work on more detailed proposals about reforms in the administrative system, social welfare, health, urban revitalization and education.

OECD's 2002 reports evaluated Mr. Koizumi's reform highly

- “The scale of the undertaking has made it difficult for observers to keep track of progress,…”
- “*However, contrary to public perception as reflected in the world's newspapers, the government has been very active in implementing its reform programme. From the perspective of both the progress in implementation and effectiveness, there have been successes especially in the areas of deregulation and entrepreneurship.*” (OECD, Oct. 2002)

OECD's Recommendation in 2003

- After the recommendation in 2002, little progress.

Excerpts of 2003 version (**Blue letters**--2002 version)

- Accelerate the disposal of non-performing loans (NPL).**
Use Industrial Revitalisation Corp. (IRC) and the Resolution and Collection Corp. (RCC) effectively to do this.
- Tighten regulatory oversight and boost transparency and disclosure.**
A stricter evaluation of deferred tax assets
- Review the role of state-owned financial institutions.**
Scale back the growing role of government financial institutions immediately .
- Accelerate deregulation.**
Establish a stronger organisation to succeed the Council for Regulatory Reform (CRR) when its mandate ends in 2004.

v. Move ahead with the creation of special structural reform zones (SZ).

Use the SZ launched in 02 as a first step to nation-wide reform.

vi. Further strengthen competition policy.

--FTC's independence should be increased by selecting its commissioners from a wider range of society

--Its resources should match its expanding role.

--Establish a career path within the FTC to attract higher quality staff.

--Sanctions for violation of the law should be increased to strengthen their deterrent effect.

vi. Take steps to encourage competition in network sectors. (Telecommunication, electricity and gas)

Introduce independent sectoral regulators to ensure pro-active *ex ante* regulation.

Establish physical interconnection and non-discriminatory access charges and conditions, as well as the vertical unbundling of activities.

To evaluate Mr. Koizumi's reform, we must wait until progress is made in three areas

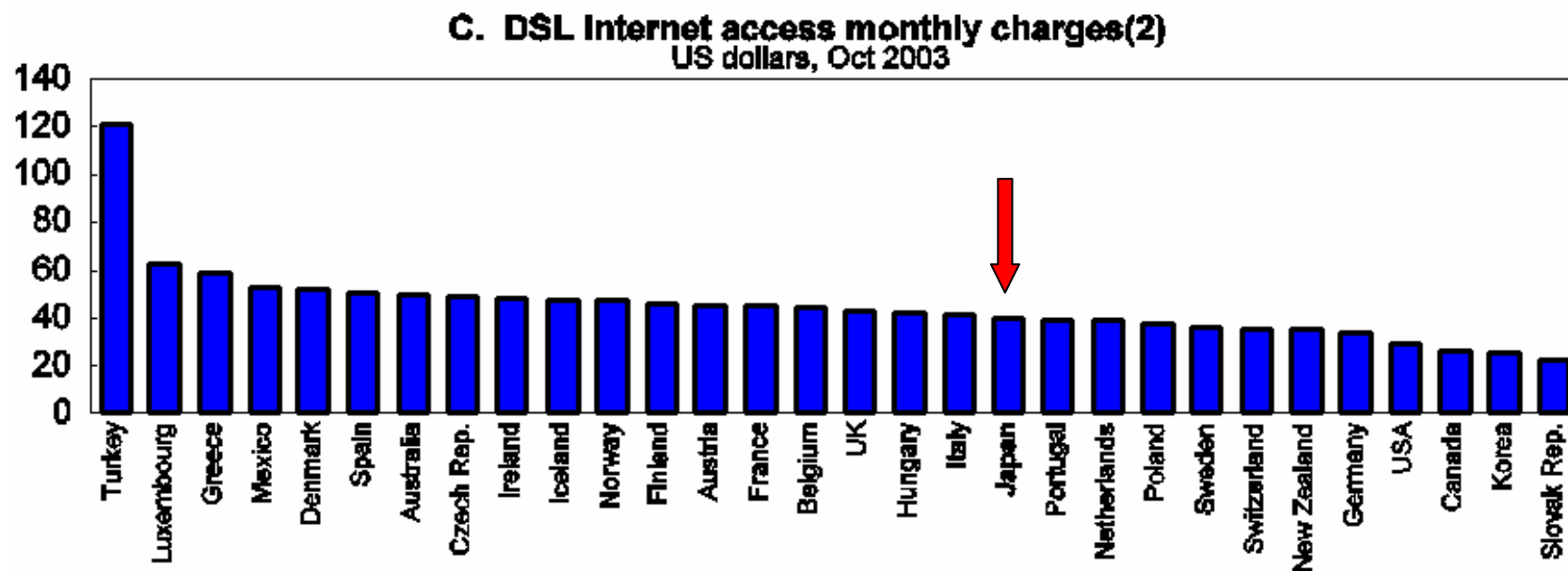
(1) reform of the Japan Post, (2) Special Zones, and (3) creation of competitive network industry.

Special zones for structural reform

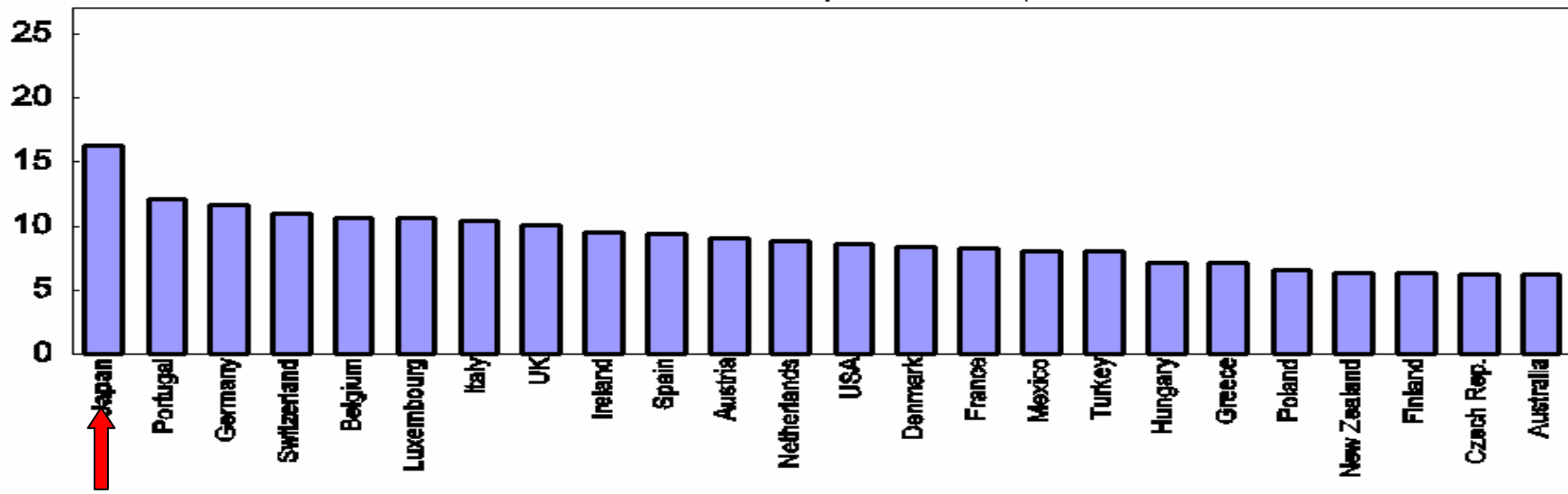
- They “marked the start of a new approach of using **local gov't initiatives** to advance nation-wide reform.”
- The SZ approach is a **testing ground** for the implementation at the national level.
- The SZs stimulate “**regulatory competition**” between municipalities to attract new business activities.
- Its success “depends on the speed and extent to which reforms in SZs are applied on a nation-wide basis.”

Progresses is slow in network industry structural reform

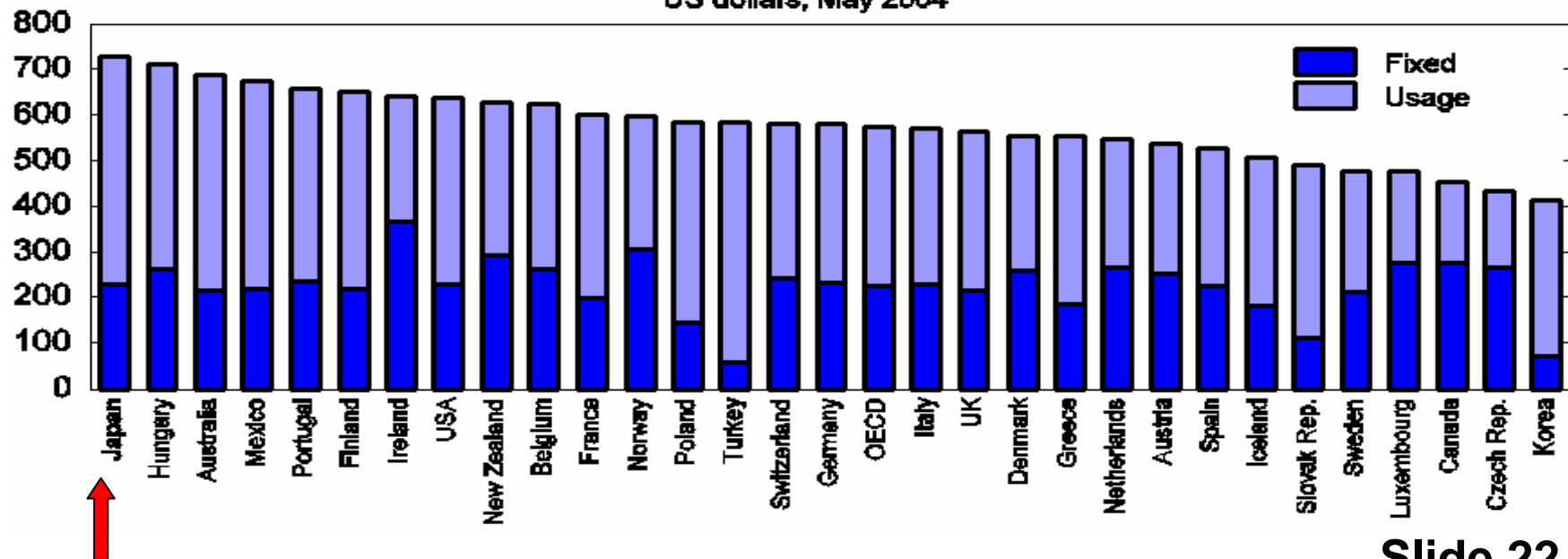
- Although the plan to intensify competition in network industries was listed in Mr. Koizumi's "Large-Boned Policy" in 2002, there was no significant reduction in price differentials of energy and telecommunication charges between Japan and other OECD countries.



A. Pre-tax electricity prices for households
 US dollars per 100kWh, 2002



B. Telephone charges for a residential basket(1)
 US dollars, May 2004



Privatization of the Japan Post

- Mr. Koizumi is enthusiastic about this reform.
- But to make it truly fruitful, two things are important.
- First, it is necessary to establish a level playing field between the Postal Savings Co. and the Postal Life Insurance Co. and private institutions, including equal treatment under the regulatory framework and the tax system. (A matter of how much Mr. K can resist to the opposition of LDP)
- Second, public financial corporations need to be scaled back. (The schedule of tackling this issue is rather remote, the goal being 2008.)

The value of Mr. Koizumi's reform depends on the development from now on.

- Compare the OECD recommendation on January 20, 2005, with the one made one year ago. You can find that the difference is rather small.
- This symbolizes the slowness of progress between late 2003 and early 2005 and the fact that the value of Koizumi reform depends on the development from now on.

OECD's Economic Survey of Japan 2005

- “The Japanese economy is in its best shape in a decade thanks to **buoyant external demand**, **the progress in restructuring the corporate sector** and **economic reforms**... These positive developments raise hopes that Japan is emerging from a decade of economic stagnation, although there are a number of risks to the current expansion.”
- Were restructuring and reforms really relevant to the present recovery?

Controversy on the causes of stagnation

“Monetarists”

- The stagnation in the 1990s was a monetary phenomenon since it is accompanied by deflation; belated and insufficient structural reform does not explain part of “the lost decade.”
- Monetary policy in particular, as the only remedy for the slump. (Theoretically fiscal policy could be used, but consider present large budget deficit.)
- “Deflation is always and everywhere monetary phenomenon.” (A paraphrase of Milton Friedman’s famous epigram)

“Structuralists”

- In the 1990s even fiscal policy, a policy tool more powerful and quicker than monetary policy, could achieve only short-lived upturns which were far from the end of the lost decade.
- Miserable performance of the Japanese economy can be attributed these structural, namely supply-side, factors. Demand-side policies can provide quick fix and short-lived recovery but never guarantees durable upswing.
- A more sophisticated version of structuralism shows that the TFP stopped improving in the 90s.

Structural reforms are necessary

- Although it is difficult to prove that the structural problem is the cause of the serious stagnation in the 1990s, structural reforms do have long-run positive and important impact through increased competition.
- Pure monetarists play down the impact of bad-loan problems on the monetary transmission mechanism and maintain that the proactive stance of BOJ can increase the money supply through the change of expectation.

Mr. Koizumi's reform should be welcomed

- Mr. Koizumi's attempt should be welcomed if he pursue his line thoroughly enough.
- His policy to improve the health of the banking sector through
 - (1) stricter asset assessment and provisioning and
 - (2) accelerated disposal of non-performing loanshad negative impact on the increase of loans in the short-run.
- But nobody denies that these are necessary in the long-run. Similarly, other structural reforms may not have positive short-run impact.

Long-run benefit of structural reforms

- Other structural reforms may not have short-run impact. In some cases, structural reforms might have negative short-run impact.
- But in the long-run, structural policies (reforms) have significant benefit on our economy.
- In the 1990s, Japanese policy makers adopted short-run policies and postponed the effort of reforms that have long-run benefit.
- Up to now, enough short-run measures were taken. Now is the time to stop quick-fix and push forward to structural reform.

Are there other structural problems?

1. TFP growth slow down,
2. population growth slow down,
3. an increase of aged population,
4. globalization,
5. revolutionary development of ICT,
6. deadlocked Japanese model for catch-up,
7. China factor,
8. outdated financial system centered on banking,
9. rapid increase of bad loans and delay in their disposal,
10. swollen up public work projects,
11. an increase of budget deficit,
12. slowness of administrative and regulatory reform,
13. unique Japanese employment system,
14. timidity of investment to venture enterprises

Selecting four items as structural problems

- (1) Maladjustment of systems in the corporate sector to changing circumstances,
- (2) slow down in the growth of factors of production including technological progress,
- (3) insufficient regulatory and public sector reforms,
- (4) bad loan problem.

- These are all supply side factors.
- Mr. Koizumi correctly addressed to (3) and (4).
- Present recovery can be partly explained by the change related to (1), gradual adaptation of intra- and inter-firm systems to globalization including “China factor” and technological advancement”

Was adaptation in corporate sector enough?

- Japanese firms recently changed its practices: they changed life-time employment and seniority wage system, reduced mutual share-holdings, and changed their relationships with “main banks.”
- But there are many viable practices. They have remained.
- Mentality of craftsmen, engineers, and sales-persons have not changed.
- It is not necessary to worry about behavior, practices, and even systems in the corporate sector.
- Not a policy issue. Corporations themselves take care of these if they are exposed to competition. To survive, they need to adjust to the outside changes and adopt the best practices.

The Japanese model vs. Western model? From “Seeking for a perfect model”

The Economist, August 11, 1999 (US edition)

- “In recent years, once popular models from places as far apart as Sweden, Germany, Japan and East Asia have all, in turn, been pronounced dead. Meanwhile, the American economy has gone from strength to strength. The obvious conclusion is that all countries, rich and poor, should adopt **the American model of flexible labour and product markets, and shareholder capitalism**. But has America's performance really been superior?”

“The successful part of Japan's economy in the 1970s and 1980s—meaning the export sector—actually **looked more like the American free-market model** than the supposed **Japanese blueprint of government intervention**. Indeed, in some respects, Japan's government has meddled less than others: **the country's total tax burden is actually slightly lower** as a percentage of GDP **than America's**, and it is much less than Germany's.”

- Ever since the reform of Joseph Dodge in 1949, the Japanese economy had been more market based than most of European economies. (Stiglitz, *Economics of the Public Sector* 2nd ed., p.184)

Conclusion

- Don't worry about competitive sectors. Concentrate on the reforms that enhance competition in other (sheltered and/or regulated) sectors.
- Do not confuse the problems of non-manufacturing sectors in Japan with those of manufacturing industry.
- Contrary to the image concerning industrial policy, this sector has been very competitive and still is.
- The rest of the Japanese economy has gone through some reforms since Mr. Nakasone's attempt, but still in several sectors, competition is not working.