insight Japan

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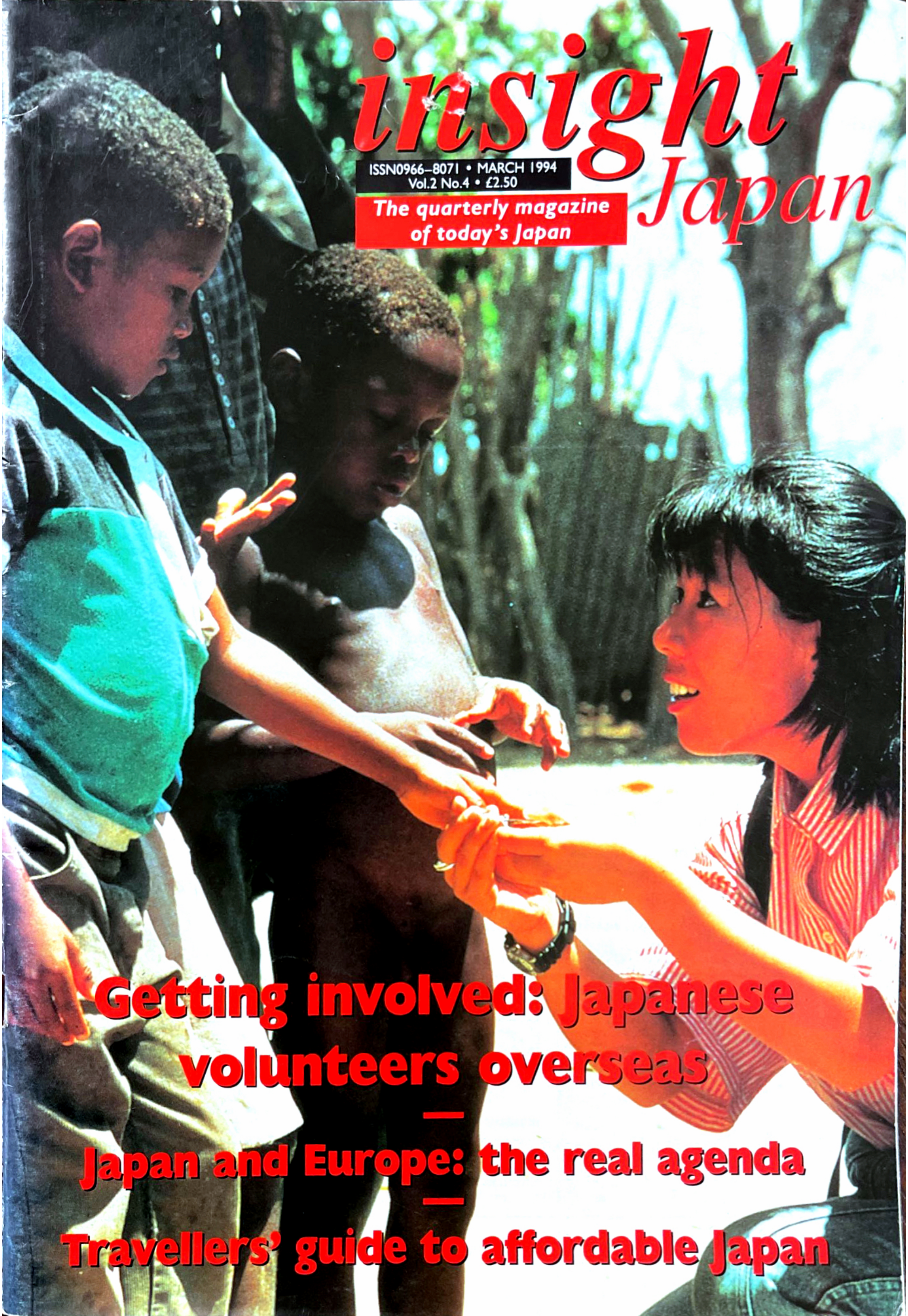

Getting involved: Japanese volunteers overseas

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Japan and Europe: the real agenda

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Travellers' guide to affordable Japan

A positive response

As taxes go up in Germany and Britain, they are falling in Japan where the public sector – now being cut back across Europe – is also receiving a boost. GERARD LYONS examines the contrasts in economic policy making, and the prospects ahead.

There are many similarities between recent economic developments in Japan and most European countries: recession, low inflation and falling interest rates. However one crucial difference has been the role of the Government. While governments throughout Europe have been in retreat the Japanese Government has been playing an active role, relaxing fiscal policy aggressively.

In recent years in Europe the talk was of the need to achieve the convergence criteria of the Maastricht Treaty. This included the need to restrain public spending and budget deficits Although a single currency seems some way off, the deflationary mentality enshrined in Maastricht lives on. Fiscal policies remain tight, particularly in Britain and Germany. In both these major European economies there will be large tax increases this year and next. In Britain, this will dampen the recovery, while for Germany, higher taxes will prolong the recession.

These developments are in complete contrast to events in Japan. Despite the recent political upheaval in Japan, with the LDP losing power last year and the Political Reform bill taking months to be passed, the Government has responded to the recession in a positive way. Fiscal policy has been relaxed on a large scale.

As consumption has weakened and investment fallen, the Government has unveiled a total of four fiscal packages. In August 1992, April 1993 and September 1993 the Government announced a total boost of ¥30 trillion, equivalent to £180 bn. Then, in February this year, another huge economic stimulus was announced of ¥15.1 trillion (£93.6 bn).

INCOME TAX CUTS

Why should we be optimistic that the February stimulus will benefit the economy when the three previous fiscal packages appear to have not prevented the economy from remaining in recession? The answer is that things are slightly different now. There were two major drawbacks with the previous packages. First, the spending increases that were announced were not implemented immediately, and have thus taken time to feed through into the economy – in fact, the April and September fiscal boosts are only now having an impact. Second, the fiscal packages announced in the last two years failed to give a boost to Japanese consumers. This February's economic stimulus is avoiding these problems. In particular, the Government has announced ¥5.3 trillion (£33 bn) in income tax cuts, equivalent to £60 per household each month.

So as taxes go up in Germany and Britain, taxes are falling in Japan. While the public sector is being cut back across Europe it is receiving a boost in Japan. This contrast between economic policy in Japan and Europe is not explained solely by the current state of the economy.

PROTECTING JOBS

This year unemployment across Europe will rise to over one in eight people. By contrast the Japanese are concerned about their deteriorating labour market, as unemployment has risen to 2.9 per cent! Many European governments seem to view unemployment as 'structural' and thus out of their hands. The Japanese Government takes a more sensible approach They realise that government can play a key role in stabilising the economy and in protecting jobs. The Japanese should be congratulated on their accommodating approach. By undertaking a fiscal stabilising role the Japanese Government will prevent recession from becoming slump, and their actions should allow the economy to improve in the next two years, albeit at a sluggish pace

At G7 meetings in recent years the Japanese Government has come under tremendous pressure to boost its ailing economy. As Europe moved into recession and the US economy continued to disappoint, attention focused on Japan. The combination of Japan's large trade surplus and weak domestic demand pointed to the need for a fiscal boost. As far as most of the international world was concerned their argument was strengthened by Japan's low level of government debt.

But not everyone in Japan supports the Government's stance. Hardly surprisingly the Ministry of Finance is concerned. It remembers how Japan's public debt rose sharply in the 1970s and realises that there will be tremendous future constraints because of Japan's ageing population. The Finance Ministry claims that Japan's financial position is not as healthy as other countries think – ageing points to a large future pension liability, which more than offsets the current surplus of the social security system.

The Ministry of Finance's caution means that from 1997 the consumption tax will rise from three to seven per cent. This is the equivalent of Europe's VAT and although the Japanese rate may appear low by European standards it should be remembered that the introduction of a consumption tax prompted widespread criticism back in 1989. None the less an independent Tax Commission decided last November that a move from direct to indirect taxes is necessary in Japan. A similar trend has already been seen in Europe but there the similarity ends.

European Governments are keen to keep budget deficits under control this year, even though their economies are weak. By contrast the Japanese are ensuring that any attempts to boost revenues are delayed until the economy is stronger So, in Japan income taxes will fall this year, helping recovery. But it is only in three years time, when the Government expects the economy to be fully recovered, that it will attempt to boost revenues.

So the Japanese also seem to be able to get the timing right. History shows they have adopted the same strategy on spending. When they haven't needed to spend, the Japanese have kept their expenditure under control. Obviously the need to spend only a small amount on defence spending has helped. Interestingly, one area where Japanese Government spending has been consistently higher than other countries is capital investment. Such control on spending in good economic times has thus allowed the Japanese Government to be able to have a stabilising influence on the economy now.

INFRASTRUCTURE

There is another key difference between Japan and other industrialised countries. Surprising as it may sound, Japan's infrastructure is not as well developed as other industrialised countries. Japan has an excellent rail system and a sophisticated telecommunications network, but in other areas it lags. Anyone who has made the bus journey from Narita airport to Tokyo can testify to the inadequacies of Japan's highway system. This problem has been recognised.

In the late 1980s the Japanese Government signed the Structural Impediments Initiative (the SII) with the USA. The main aim was to address the bilateral trade imbalance. In 1989 Japan's trade surplus with the US was just under $45 bn. Last year, it had risen to $50.2 bn. A key aspect of the SII agreement was a commitment by the Japanese Government to boost demand. They agreed to spend ¥430 trillion (£2,670bn) on the infrastructure during the 1990s. Additionally, in 1990 the 'Basic Plan for Public Investment' pledged the Government to increase public investment with the priority on areas such as sewers and parks.

It would be wrong to attribute the different emphasis placed on the role of the Government to recent events only. What we are seeing in Japan and Europe is a reflection of a different economic philosophy. Monetarist orthodoxy has come to dominate economic policy making in Europe throughout the last decade. By contrast, the Japanese Government has pursued a more traditional Keynesian approach. If one looks at the 1930s a similar trend can be seen.

Although the Japanese stayed on the Gold Standard a long time, prompting a deep recession, they responded by engaging in a fiscal reflation, years before Keynes had written his *General Theory*. Unfortunately, that reflation went too far, inflation rose and the then Finance Minister, Mr Korekiyo attempted to reduce demand, mainly by cutting military spending. Incurring the wrath of the military he was assassinated.

No doubt many Europeans would gladly adopt this strategy for dealing with unpopular finance ministers. Despite what befell him, the way in which Mr Korekiyo adopted Keynesian style policies illustrates that even in the 1930s the Japanese recognised the importance attached to active fiscal policy. And, as we are now seeing, quite rightly the Japanese continue to recognise this importance.

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Honda's family spirit

There is some irony in the coincidence that BMW's predatory purchase of 80 per cent of the Rover Group despite Honda's 20 per cent holding took place at the beginning of the United Nations' Year of the Family. *Insight Japan*, drawing attention to several fascinating aspects of the Japanese family and its lifestyle in this issue, can also point out that it was precisely the family feeling in Japanese corporate behaviour that so affected Honda when Rover ran off with a stranger.

The idea floated by some commentators that the deal would anger Japanese industrialists generally and deter future investment into the United Kingdom from Japan was wide of the mark. Nonetheless, Honda and other Japanese companies were shocked to be forcefully reminded of the often profound clashes between styles of capitalism.

Talking to Michiyo Nakamoto of the *Financial Times*, Honda's president, Nobuhiko Kawamoto, gave a succinct, significant explanation of the world of difference. Honda believes that cars are so important that the companies should stay in the hands of the citizens where their main manufacturing is done. "Because Rover was the last, and the only, car company that is British, we judged that it should be left British. That is not out of sympathy. We think it is too simple to judge everything in terms of value for shareholders and customers alone." In other words, all those who work for a substantial enterprise, and the country which fosters it, have a claim to its loyalty too, like a family.

"I don't think manufacturing, which is a process involving the combined efforts of an enormous number of people, is so simple that the fate of a company can be decided in two or three months," Mr Kawamoto added. Sentimentalism or realism?

As Japanese business is being pressurised itself to move closer to a different style of capitalism – hire-and-fire just beginning to jostle with lifetime employment – Honda's president makes it clear just where its principles still hold, and, like Akio Morita, waits for responses to his challenge to the British and Europeans: "The money game is fine and there must be a business logic to it all but how do people expect to make a living in future. I must study this some more. I would like to know."