

LETTER FROM JAPAN



The Frog in the Boiling Water

BY BARRY D. WOOD

Recent visitor Martin Feldstein of Harvard University observed that “Japan is a mixture of prosperity and failure, and its prosperity makes its failures harder to address.”

That conundrum rings true as Japan struggles to free itself from nearly a quarter-century of stagnation and deflation.

Nearly four years after the arrival of Abenomics’ three arrows—fiscal and monetary easing and structural reform—the economic data remain perverse. In July, the International Monetary Fund marked down its GDP growth forecast for Japan to 0.3 percent for 2016 and 0.1 percent for 2017. An *Asahi* business survey depicts an economy that is standing still. And despite three years of recovery into 2016, the Nikkei 225 languishes at 16,300, 58 percent below its December 1989 bubble peak.

It was in February 2013 that Prime Minister Shinzo Abe declared in Washington that, “Japan is back.” It is an assertion possibly as hollow

as Harvard Professor Ezra Vogel’s 1979 prediction in *Japan as Number One*, that Japan’s GDP would surpass that of the United States. (Today the U.S. GDP is nearly four times the size of Japan’s, \$18 trillion versus \$4.8 trillion.)

As Feldstein suggests, the prosperity observed by a casual visitor masks a more disturbing reality. Randall Jones, head of the Japan desk at the OECD, argues that Japanese living standards are falling with per capita incomes 10 percent below the level of 1990. Because of a rapidly aging population, the labor force is shrinking and productivity is low. Jones argues that the economy is so constrained that its growth potential is below 2 percent. Japan’s population has dropped by one million in the past five years and demographers say that trend will continue.

During my visit, I’ve encountered few analysts who are optimistic. However, “Mr. Yen,” former vice-finance minister Eisuke Sakakibara, is upbeat. Animated and forthright

in his book-filled study in an Ark Hills Tower, Sakakibara asks a visitor, “What’s the problem?” He rejects the notion that Japan has endured lost decades and adds, “I don’t worry about the deflation.” Neither does he worry about government debt, which Japanese households continue to buy.

Now a professor at Tokyo’s Aoyama Gakuin University, the 75-year-old Sakakibara argues, “Japan has matured.” Growth rates that he puts at a 4 percent-plus average from 1974 to 1990 are no more, but he finds the 0.9 percent average that has prevailed since not a problem.

Calling Abenomics a success in its first two years, Sakakibara blames the strengthening yen for the current slowdown. He would like to see the yen-dollar exchange rate between ¥110 and ¥130, which he calls “very good,” while “¥105 to ¥110 is OK, but ¥80 to ¥90 would be a problem.”

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Sakakibara argues that Japan “will continue to enjoy its maturity,” growing at 1 percent per year as Prime Minister Abe carries on for two or three more years.

I could find few who embrace Sakakibara’s rosy scenario, especially concerning government debt, which is approaching 250 percent of GDP. Jones of the OECD says, “We’ve never seen this level of debt and we worry about its consequences.” Former IMF chief economist Olivier Blanchard is more specific. The Peterson Institute fellow believes Japan will experience a solvency crisis when foreign Japanese government bond buyers replace tapped-out domestic savers and demand a higher rate of return. If the Bank of Japan is then forced to directly fund the government, he says, deflation could quickly become rampant inflation.

Yoichi Funabashi of the Rebuild Japan Initiative Foundation says demography is the principal reason that Japan will not regain the dynamism and rapid growth of earlier decades. The former journalist and author of *Managing the Dollar: From the Plaza to the Louvre* (1989), regrets Japan’s

failure to use the period of a strong yen to build a more competitive economy. He attributes much of the current malaise to the legacy of non-performing loans, a problem he suspects is being replicated in China.

While supportive of Abenomics, Funabashi worries that without approval of the Trans-Pacific Partnership, Abe’s third arrow of structural reform will fail. He sees an assertive China

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trying to drive a wedge between the United States and Japan, whose military alliance is central to Japanese security policy. Funabashi worries that failure of the TPP will erode U.S. influence while enhancing China’s.

Dealing with a rising China is an enormous challenge for Japan. China’s population is ten times larger and its economy arguably twice the size of Japan’s. Despite a history of enmity,

economic links are strong and growing. Japanese firms are big investors in China, and Japan now exports more to China than to the United States.

Some pessimists argue that Japan increasingly sees itself as a spent force and is pulling back from the global stage. There is some evidence to support this erroneous prediction, for example, the decline in the number of young Japanese studying abroad.

The Institute of International Education in New York reports that in 2015, 19,000 Japanese students were enrolled at U.S. universities. That’s a 60 percent drop from 1997. By comparison, 304,000 mainland Chinese are studying in the United States, as are 74,000 students from South Korea, a country with not even half Japan’s population. These data make it easier to understand the disappointingly low level of English fluency in Japan.

But it also reflects the insular, conservative side of a culture with limited rewards for foreign language proficiency. Glen Fukushima, the Japanese American scholar and executive who lived several years in Tokyo, says Japan clings to old ways and changes only when forced to do so by external shock. “Continuity, stability, and predictability,” he says, are core Japanese values. He says that at the present time the Japanese feel there is no crisis. Andrew Rose, the Japan specialist at Schrodgers in London, adds, “People talk about Japan’s lost two decades, but it has been going gradually down bit by bit, almost as if we didn’t notice—like the frog in the boiling water.”

While there’s no crisis today, perhaps one is looming over the horizon. With negative interest rates, consumers buying home safes in which to put their cash, with monetary policy approaching its limits, and debt at nosebleed heights...can this go indefinitely? No, it can’t. ◆

Everything Is Wonderful



Eisuke Sakakibara

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