

## **J-Economy, J-Corporation and J-Power since 1990**

From Mutual Gain to Neoliberal Redistribution

Enno Berndt

# **1 J-Economy: Caught Between Lack of Structural Congruence and Mistaken Policies**

**Summary** 1.1 Introduction. – 1.2 Bubble, Bubble How Much Trouble: Liberalisation, Asset Inflation and Deflation. – 1.3 Public Deficit Spending: Avoiding the Worst, but Inefficiently. – 1.4 Replacing Fiscal Expansion by Structural Reform after 1998: Deflating Labour Cost. – 1.5 'Distributional Coalition' Between State and Large Corporations.

The appeal to national character is generally a mere confession of ignorance.

(Max Weber, *The Protestant Ethic and the Spirit of Capitalism*, [1905] 1958, 56)

If I want to imagine a fictive nation, I can give it an invented name, treat it declaratively as a novelistic object, create a new Garabagne, so as to compromise no real country by my fantasy (though it is then that fantasy itself I compromise by the signs of literature). I can also – though in no way claiming to represent or to analyse reality itself (these being the major gestures of Western discourse) – isolate somewhere in the world (faraway) a certain number of features (a term employed in linguistics), and out of these features deliberately form a system. It is this system which I shall call: Japan.

(Roland Barthes, *Empire of Signs*, [1970] 1982, 2)

## **1.1 Introduction**

Any subject of academic research and teaching is strongly influenced by the interests of those who decide what resources will be granted to which extent and how they can be used. Representatives are executing this power through institutionalised procedures. This tends to produce issue selection and resource distribution, both driven by fashion: changes in what issues are chosen as being worthy of resources often replicate waves of public attention. These waves are generated by mass media, initiated by mighty actors and swinging between the extremes of positive and negative perception.

One might say, that this is the very nature of change: a former synthesis becomes a dominating thesis by selection due to its superiority in fitting new conditions, and it is retained as such until an antithesis appears and becomes strong enough to challenge the thesis – unless external change undermines the match between the retained mainstream position and its

environment. If internal opponents do not appear and grow, change will be enforced externally. Meanwhile, the mainstream is resisted only by those, who still believe that academic research and teaching are provided with resources not exclusively to reconfirm the mainstream, but to question it, to raise issues, to explore related connections, to identify driving forces, consequences and alternatives, which influence the thinking and acting of collective subjects in societies and organisations but are being overlooked or ignored.

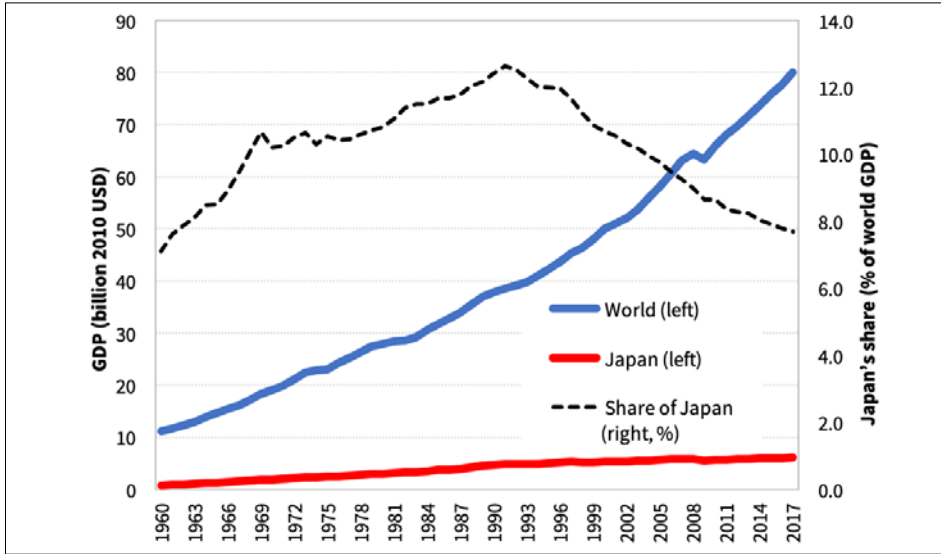
Japan is a case in point. Its post-war development is mainly told as the story of rising from the ashes of World War 2 towards an economic superpower (Vogel 1979) and a prototype of Post-Fordism in the '80s (Kenney, Florida 1993), then falling into stagnation after inflated real estate and stock markets crashed in the early '90s and having failed to break out of deflation since then. In view of signs of deflation somewhere in the world, Japan is often a synonym for the worst case: 'Is xxx (not) the next Japan?'.<sup>1</sup> Indeed, long-term statistics suggest Japan to be an example for the rise and fall of national economies (chart 1.1).

But even after two decades of stagnation, Japan's economy is still too big to be considered negligible: as of 2017, it had the 3rd largest nominal Gross Domestic Product (GDP; 4.9 trillion USD), the 4th largest export volume (0.698 trillion USD), the 2nd largest Foreign Direct Investment (FDI) outflow (160.4 billion USD) and FDI outwards stock (1.52 trillion USD), the 2nd largest Foreign Currency Reserves (1.264 trillion USD) and the 4th largest Official Development Aid (ODA) budget (11.9 billion USD) in the world (UNCTAD 2018; IMF 2018; World Bank 2018a, 2018b). Ranked in terms of the total revenue in 2017, 52 companies or 10.4% among the Fortune Global 500 (Fortune 2018) and 228 companies or 11.4% among the Forbes Global 2000 (Forbes 2018) had their headquarters in Japan.

However, in terms of labour productivity (measured as GDP output per hours worked), Japan's performance is lower than that of other G7 countries, and lower than the OECD average (chart 1.2). Japan's rank in terms of other outputs per capita is also considerably lower than that of absolute output volumes: in 2017 it was 23th in nominal GDP per capita (38,440 USD), 28th in GDP per capita based on purchasing power parity (PPP) (42,659 USD) and 40th in export per capita (5,496 USD). Japan's rank in terms of GDP per capita based on PPP has fallen from its peak of 17th in 1996 to its preliminary bottom of 34th in 2009 (IMF 2017).

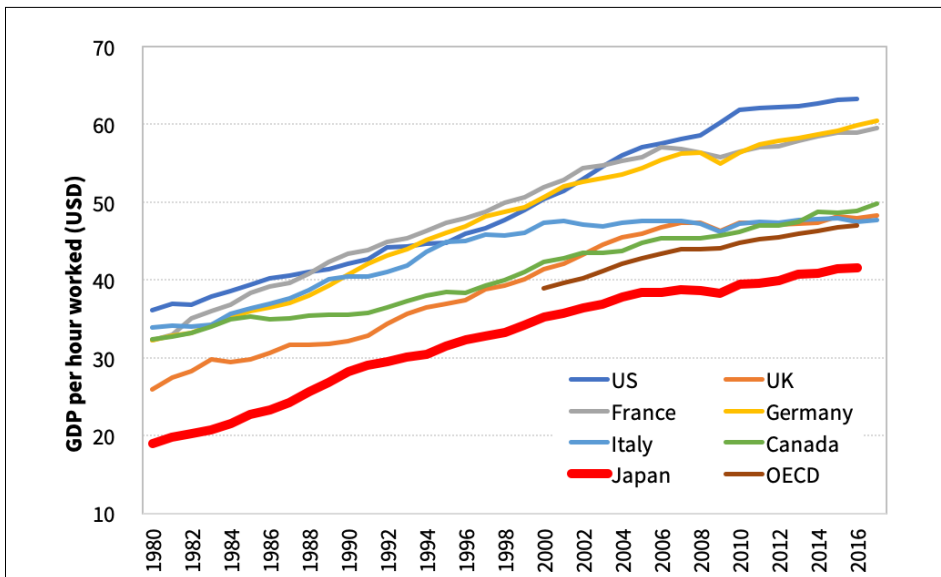
1 See Elyatt 2014; Klingholz, Slupina 2017, 35; Keyu Jin 2016; Summers 2016, 4. Karabell is doubting this common perception. His argument is that GDP growth does not necessarily reflect increasing prosperity and well-being, rather that both can be increased without GDP growth. Indeed, Japan has achieved a relatively high average life expectancy and level of public security. But he is mistaken when he states that "there is nothing really wrong with Japan" (Karabell 2016, 50).

Chart 1.1 Real GDP of the world and Japan (in 2010 USD)



Source: Author, based on World Bank 2018a, 2018b

Chart 1.2 Labour productivity as GDP per hour worked (in USD)



Source: Author, based on OECD 2018

Rapidly increasing capital expenditures, production capacity and a slightly growing workforce with long working hours on the supply side (Yoshikawa 2016, 78-85), and an expanding number of households and domestic purchasing power on the demand side have been driving Japan's economic growth until the early '90s.<sup>2</sup> In line with Japan's relatively low level of labour productivity, its national competitiveness has been globally ranked lower by the International Institute for Management Development (IMD) since the late '90s<sup>3</sup> (chart 1.3).

From this perspective, the outlook for Japan's economy with an ageing population, shrinking workforce and domestic demand appears bleak (chart 1.4) – unless Japan achieves higher productivity by eliminating structural obstacles on the supply side enabling innovation of products, processes and business models (Hayashi, Prescott 2002, 206-35). But over the last 25 years Japan has been caught in economic stagnation. For the neoliberal mainstream, this is evidence enough, that Japan has not been consequently transforming towards a liberal market economy.<sup>4</sup>

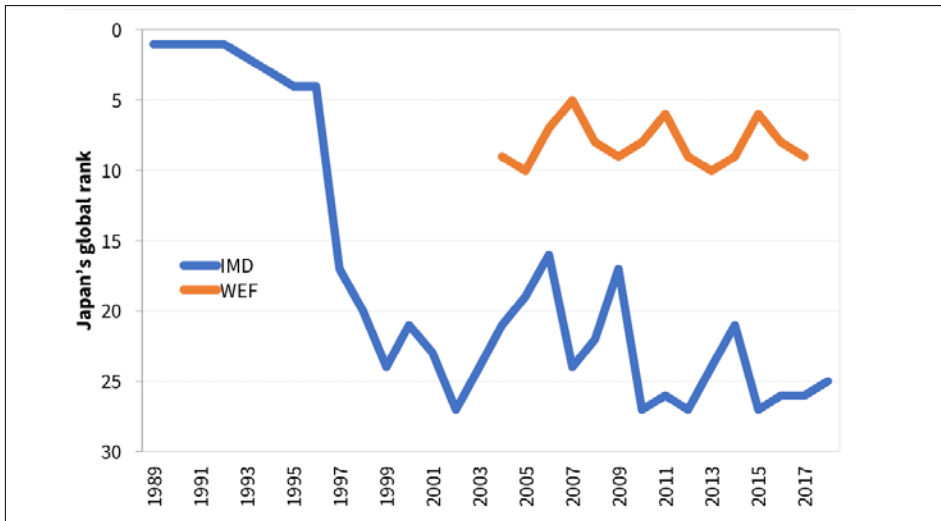
Thus, Japan is perceived as an example of failing to unleash the power of the markets as well as competition and creative destruction through structural reforms, doing too late and too little to strengthen the supply side by deregulating, privatising and liberalising (Lincoln 2001). But has Japan not changed from its traditional system towards what was declared by the neoliberal mainstream as global standard? And what if stagnation is not an evidence for the absence of such change, but, on the contrary, an outcome of it or the attempt to implement it?

2 Such macro (average) data represent various sectors, industries, regions, forms and sizes of corporations. Japan's economy has been characterised by several dual structures: the contrasting existence of a few large corporations vs. many small firms (often dependent suppliers or traditional retailers); private vs. public sector; domestic (service) vs. exporting (manufacturing) industries; modern industry vs. traditional wholesale, retail sector and agriculture; urban centres vs. rural areas, etc. Much of Japan's Total Factor Productivity (TPF) growth was due to economy-of-scale effects and the related increase of capital expenditures in large manufacturing corporations. Since the '80s, the majority of Japan's workforce has been absorbed by an expanding service sector, which consists of traditional and dispersed structures lacking productivity. Recent research measuring productivity as operating profits per employee from 2000-2015 and comparing large corporations from the first division of the Tōkyō Stock Exchange with their peer corporations among the Fortune 500 ranking shows that large corporations in Japan are improving their productivity, which is still lower than that of their foreign peers mainly due to lower output performance (Nagayama 2017, 71-86).

3 The consistently higher ranking of Japan by the World Economic Forum (WEF) might reflect the relatively high average life expectancy and level of public security in Japan (WEF 2017).

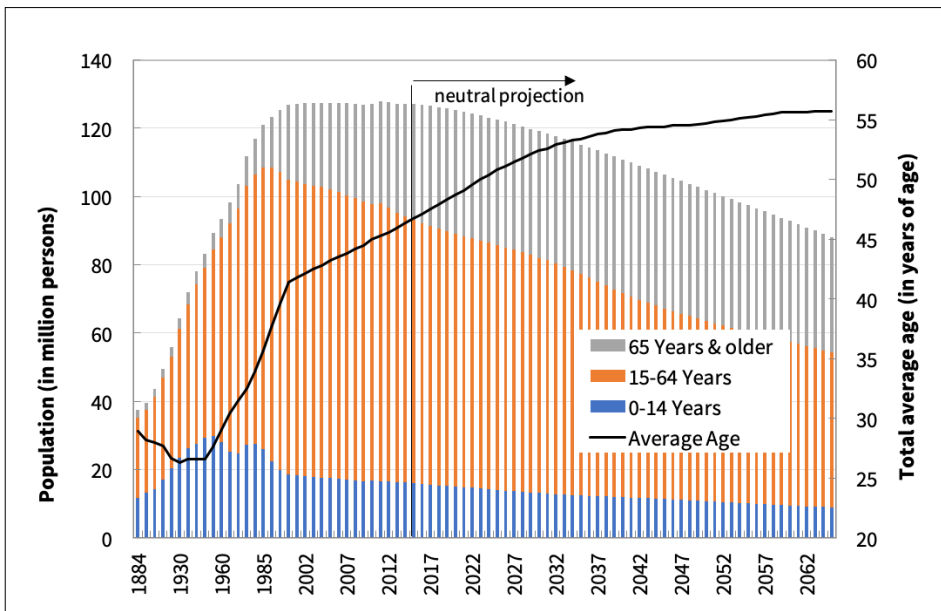
4 Vogel, taking the position of institutional economics, indicates an active external labour market, a market for corporate control (corporate governance induced by capital markets) and free market entry and exit (free competition) as the central sub-systems, urged to be established by neoliberals and the US government through structural reforms for a shift towards an US-like liberal market economy (Vogel 2006, 6-7).

Chart 1.3 WEF- and IMD-World competitiveness rank of Japan



Source: Author, based on IMD 2018, WEF 2017

Chart 1.4 Population of Japan by age groups and average age (CY)



Source: Author, based on NIPSSR 2017

Rejecting the popular view, that not only corporations, but also nations are competing,<sup>5</sup> Krugman (2013) has seen Japan as a challenge for applied economics: here the neoliberal mainstream dogma of strengthening supply power by lowering interest and increasing money supply as well as deregulation has proved ineffective. According to him, the core problem of Japan's stagnation lies in a lack of demand. This should be solved rigorously by fiscal and monetary expansion (Krugman 1997). In 2015, Krugman stated, that productivity (measured as real GDP per employed person) has grown faster in Japan than in the US and Europe since 2000. Japan's productive (i.e. income-earning and consuming) population is shrinking though. Thus, demand growth remains dependent on fiscal stimulus, despite public spending not being expandable faster than economic growth. The zero-interest-level monetary policy, too, has lost impact and cannot replace fiscal expansion either. Hence, fiscal stimulus should be continued along with monetary expansion, until future expectations have raised to a level, where higher prices are generally accepted without reducing consumption (Krugman 2015).

For Keynesians like Krugman Japan is not an exceptional case that exhibits the consequences of not complying with or converging to a perceived global standard. To them, this economy is more a learning case to apply their models of how to cope with stagnation, the relation between business cycle and structural evolution and other limits to economic expansion (Krugman 2014a, 2014b). In their view, the critical state of Japan's economy results from a misperception of causes, mistaken policies and wrong choices made by government and central bank (Posen 1998, 143-57). Similar to their neoliberal opponents, the Keynesians respond to discrepancies between their theoretical models and empirical data by urging government and central bank to do what they have recommended and to do more of it: just try harder, which explains why they support the policy measures taken by Japan's government under Shinzō Abe und the Bank of Japan (BOJ) under Haruhiko Kuroda. But why have they been ignored so long, despite the fact that the outcomes of policies proposed by their neoliberal opponents have been obviously unsatisfying in terms of economic performance? Have their own recipes not been applied (at least partly and temporarily) and resulted in what they expected? Have Keynesian recipes simply not worked?

5 Krugman's argument is threefold: (a) nations do not go out of business, if failing to meet external competitive benchmarks; (b) instead, their primary goal is to improve the standard of living for their citizens. The ability to achieve this goal in economies like the US and Japan, where the exposure to external markets through exports is relatively low (10-15% of GDP), is driven mainly by domestic productivity. (c) International trade between nations is not a zero-sum game, as it generates mutual benefits based on comparative advantages, allowing each to focus on sophisticating their own advantages (Krugman 1994, 1996).

Werner (2005) criticises both standard theory positions for not reflecting the limitations of their unrealistic model assumptions, for ignoring empirical evidence and being unable to explain long-term developments, such as the rise and fall of Japan's economy. All policy measures proposed or legitimised by mainstream proponents of both economic theories – such as fiscal expansion (public deficit spending), monetary expansion (lowering interest rate, increasing money supply) and structural reform (deregulation, liberalisation and privatisation) – have failed to ignite sustainable growth in Japan. Instead of following deductively generated conclusions, Werner calls for an inductive approach in the form of pattern finding and testing of theoretical explanations to understand reality. For him, not interest rate level and public deficit spending, but the quantity and quality of credit money creation is critical: creating credit money enables modern economies to allocate capital (purchasing power) towards demand for investment or consumption without being limited by the amount of prior (i.e. available) savings. For what purpose (consumptive, speculative or reproductive) and to whom banks are lending to are crucial questions and can explain the economic performance also in the case of Japan. How effective credit creation in stimulating or depressing economic activity is depends on decisions to invest into productive assets for increasing productivity and generating utility or economic value or non-productive assets for pure asset price speculation beyond the level of past internal streams of earnings and the related demand for funding.

Koo (2003, 2009, 2015) shows empirically that the classical approach (e.g. economic textbooks') of stimulating an ailing economy by lowering interest rates, increasing money supply and pushing for structural reform has not worked in response to Japan's asset bubble burst, and then he explains why no substantial funding demand occurred in the private corporate sector. Heavily overleveraged balance sheets of the private corporate sector rendered monetary stimulation ineffective: in view of imploding asset prices, corporations that had financed their asset purchases through borrowing were confronted with huge write-downs on their assets value, while liabilities remained unchanged.

If a decrease in assets value cannot be absorbed by reducing the capital (or equity) base, liabilities exceed assets. To prevent insolvency corporations have to shift from profit maximisation to debt minimization (preferring the latter over reinvesting cash flows into business). Output and demand for funding in the private corporate sector declines, and so does the aggregate demand. Consequently, deflation occurs. The deflationary downwards spiral continues until general deleveraging and the value of remaining assets reach a level, where new corporate investments and the related impacts on the balance sheet can be justified in the name of future incomes, and when the related funding demand recovers. But if corporations generally deleverage (that is, reduce borrowing and pay-

ing down debts), the general demand is affected negatively. Therefore, it was inevitable in '90s to avoid to avoid an overall contraction of Japan's economy by means of fiscal expansion. But under which conditions will private corporations see their balance sheet as sufficiently recovered to start investing and stop cutting the prices?

Vogel (2006) reflects on the current change of the Japanese economic system. This system was regarded by Aoki (1990, 1998) as horizontal coordination, that is, integrating the long-term interest of government, companies, employees, banks and suppliers by balancing competition and collaboration. For his own analysis, Vogel applies a model where the macro level (government policy) constraints the micro level (corporate behaviour) through legal and regulative limits. At the micro level, actors are aggregating their interest in response to incentives and constraints set up at the macro level. This induces patterns of policy demands and corporate adjustments, which are transmitted back to the macro level through political institutions. Accordingly, institutional change evolves in the form of interaction between macro and micro levels as policy reform modifies the conditions for corporate adjustment, which in turn modifies preferences towards further policy reforms. Although demands and interests, aggregated on the micro level, are influential, the macro level appears to be the strategically initiating side. Enlarging his model of change by means of social and political factors, Vogel (2006, 16-21) concludes that the Japanese system with its pillars - internal labour markets, main bank credit-based financing and corporate control, horizontal and vertical corporate networks through cross holdings and *keiretsu* (conglomerates) - has changed, following its own institutional incentives and constraints, but that the system has not simply and totally converged into a liberal market. This raises the question of what characterises such an economic system, if it is neither converging to US style nor remaining a variation of its own past.

In this chapter, several reasons will be provided why Japan is far from being a positive case for a post-growth society. The focus is not exclusively on the perceived macro-level players, government and central bank. Undoubtedly, they both do hold big power and exert strong influence on all other actors through fiscal, monetary and structural policy (Grimes 2001). But they are not the only systemically relevant subject nor do corporations and private households just passively respond to policy measures by government and central bank. Corporations and private households do have a strong influence on which priorities are set on the macro level, which political measures are taken and what the final outcomes are. Therefore, a wide view needs to be taken on how crucial players of Japan's economy have interacted: What interests have driven their actions? Who has gained and who has suffered from economic developments since 1990? What are implications and alternatives for Japan's economy and society in the future? Based on analyses of macro-economic statistics, Japan's economy



is described as the accumulated outcome of the action and interest of relevant players, particularly corporations and their stakeholders. Due to their systemic, economic and political importance, corporations and their stakeholders are taken again into focus in the second chapter of this book, but then from a micro-level perspective.

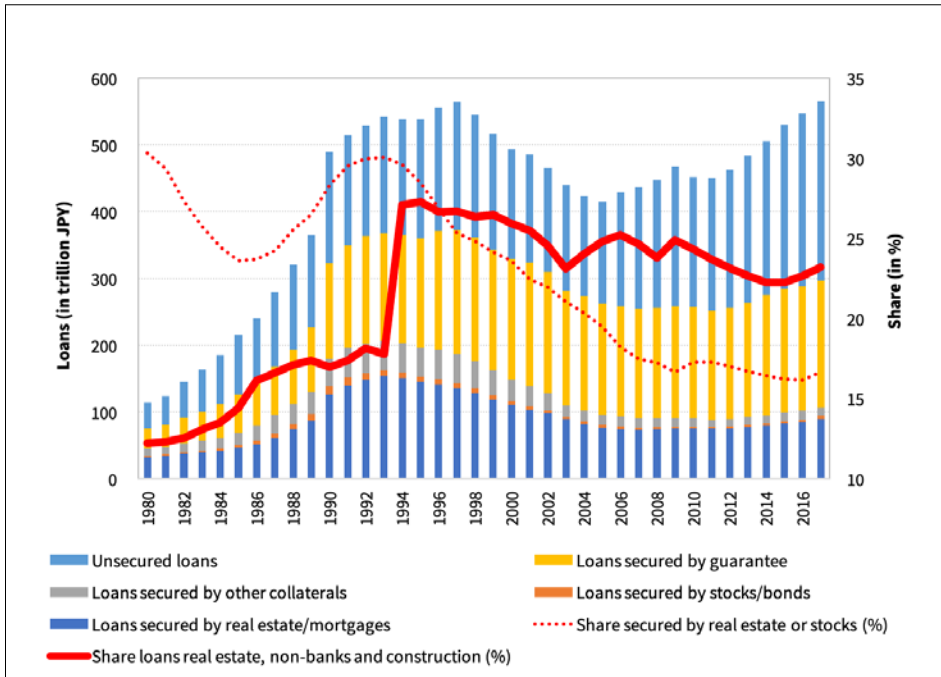
## 1.2 Bubble, Bubble How Much Trouble: Liberalisation, Asset Inflation and Deflation

Since the early '80s, Japan's financial industry has been deregulated – following demands by the US government to grant foreign banks and investors access to the Japanese market and Japanese investors access to foreign financial markets and to promote a shift from bank funding to capital market funding (stocks, bonds, derivatives). Restrictions were relaxed or removed to make Japan attractive as an off-shore capital market (Miyazaki 1992, 109-48; 1995, 59, 164-5). Simultaneously, the Japanese government shifted its economic policy from promoting export to stimulating domestic demand. The BOJ lowered interest rates – in response to an unprecedented appreciation of the Japanese Yen (JPY) (from 250 JPY/USD to 120 JPY/USD) as well as shrinking exports and an economic downturn after the Plaza Agreement (1985), which was initiated by the US government to curb trade imbalances with Japan and get its own economy recovered. Big corporations shifted their financing towards capital markets. In need of alternatives for lending, banks started to focus on the asset markets (land and stocks) as well as small to medium enterprises (SME). Consequently, capital funds flowed into Japan's asset markets, where speculative demand was ignited by liberalisation and the purchased assets could be treated as loan collaterals (Miyazaki 1992, 149-70; Werner 2005, 232-7) (chart 1.5). Most of these asset purchases were heavily leveraged.

The speculative demand called for further speculative demand: many market players were not only generating, but assuming a continued rise of assets prices and returns higher than their financing cost. This boosted capital gains for borrowers, collateral value for lenders and demand for purchasing more assets, related borrowing and lending. Commercial banks competed over market share in lending, while assuming that their credit risk was sufficiently covered by the increasing value of asset collaterals. Fuelled by rising asset prices and capital gains, consumption and capital expenditures expanded faster than incomes or earnings.<sup>6</sup> This resulted in

6 Morinaga emphasises that the bubble economy of the late '80s should be understood as the final stage or reappearance of the high growth economy in the '60s and '70s and that it was not limited to the asset markets, but it also affected common lifestyle and social spheres such as family, education and mobility (Morinaga 1998, 107-42).

Chart 1.5 Loans of banks by collateral and borrowers in Japan (CY)



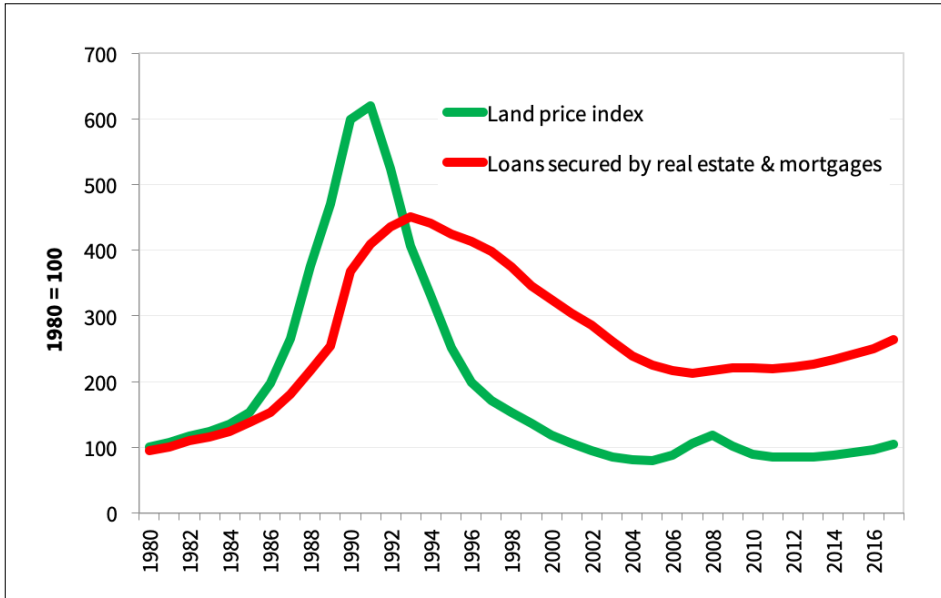
Source: Author, based on BOJ 2018

average prices for land and stocks increasing by about six times within '80s to 1990-1991. But demand and asset prices could only increase as lending was extended. Thus, the upwards spiral turned downwards after interest rates had been raised several times, lending restrictions had been applied, banks had started to reduce lending for asset purchases, and finally purchasing demand for assets had shrunken while selling supply had surged (charts 1.6a-b).

What happened then is described by Werner (2005) as a vicious circle of credit crunch recession: bad loans increase, banks become more risk-averse, lending shrinks, corporations fail to secure funding, bankruptcies surge, wages decline, jobs get lost, demand contracts and bad debts rise (229-30). However, the amount of extended loans decreased only twice, namely 1998-2004 and 2009-2010, when banks faced contracting value of their capital base (chart 1.7).

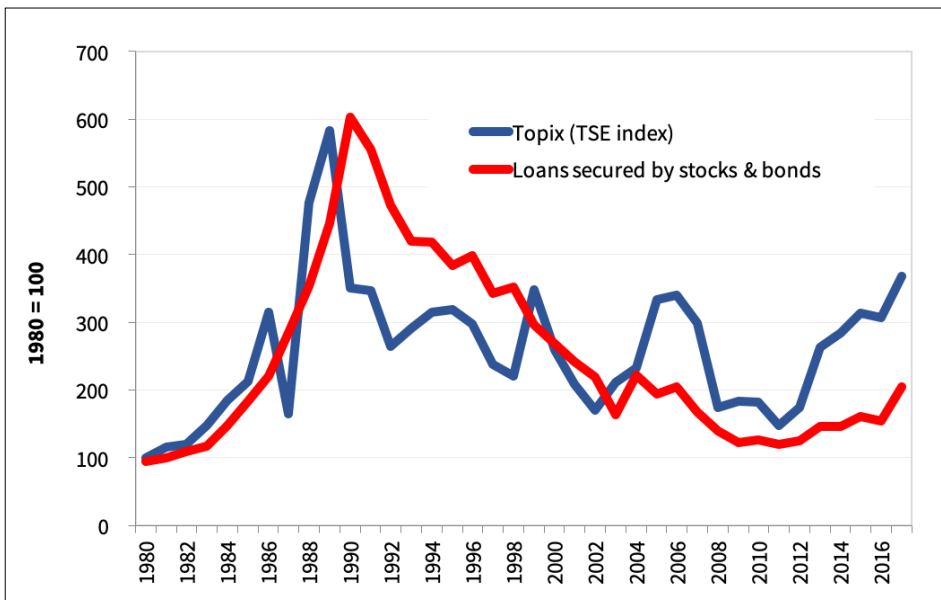
SME (representing 99% of all corporations, 70% of the workforce and more than 40% of all sales in Japan) suffered from credit crunch heavier and longer but not earlier than large corporations (which had expanded the capital base by equity or bond financing). Most of new corporate loans

Chart 1.6a Land price average and related lending in Japan (CY)



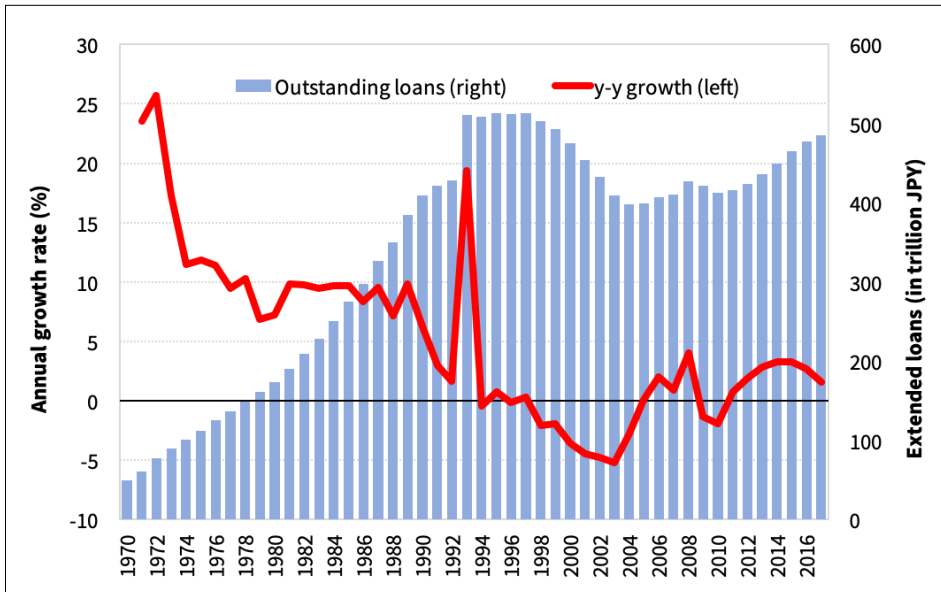
Source: Author, based on BOJ 2018; JREI 2018

Chart 1.6b Stock price average and related lending in Japan (CY)



Source: Author, based on BOJ 2018; JPX 2018

Chart 1.7 Outstanding bank loans and annual growth rate (CY)

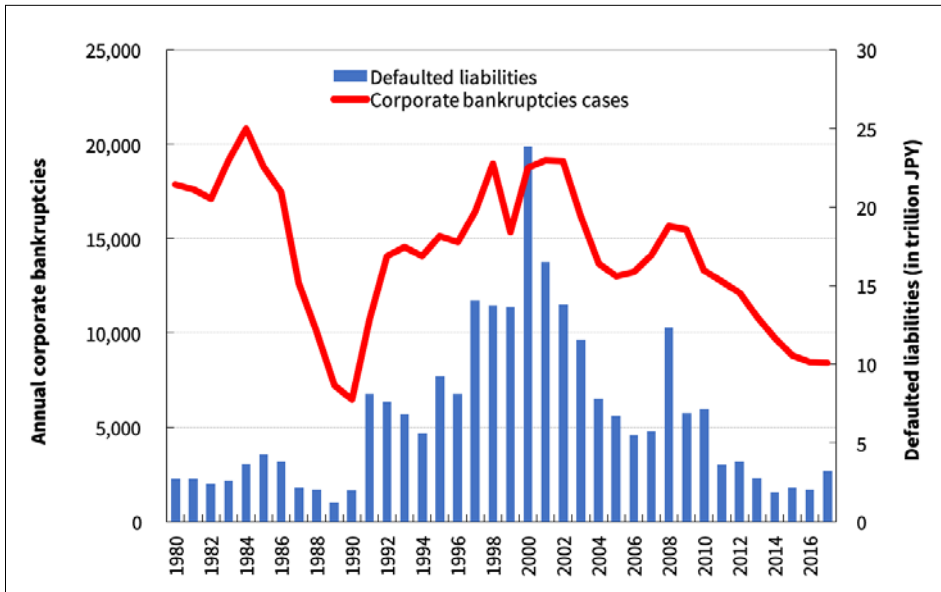


Source: Author, based on BOJ 2018

given to real estate, construction and non-banks between 1986 and 1991, were secured by real estates, mortgages or stocks and became ‘non-performing’. Their total volume can be estimated at 80-100 trillion JPY (16-20% of all loans). The total of defaulted corporate liabilities between 1991 and 2003 amounted to 152 trillion JPY. They included debt, which was not directly related to speculative asset purchases, but affected by the burst of the bubble, the cyclical downturn and the financial crisis of 1997-1998 and the related credit crunches (chart 1.8).

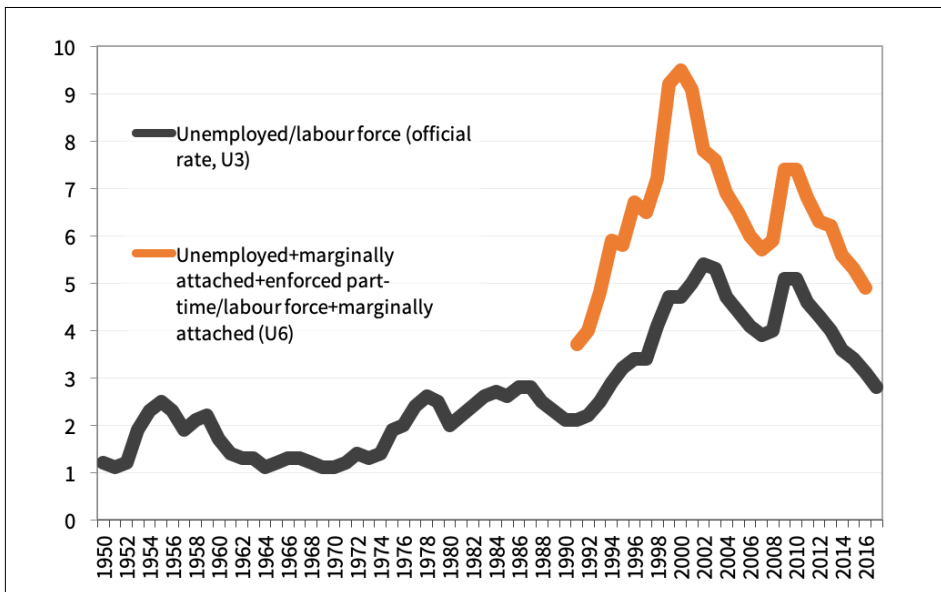
Unemployment increased to an unprecedentedly high level (chart 1.9a). A rising number of persons committed suicide, often hoping that life insurance companies would pay the death benefit to their families (chart 1.9b). Many were owners of small enterprises, affected by the credit crunch and unable to pay their debt, or so-called regular employees, who lost managerial positions or their job when non-regular employment became abundant.

Chart 1.8 Corporate bankruptcies and defaulted liabilities in Japan (CY)



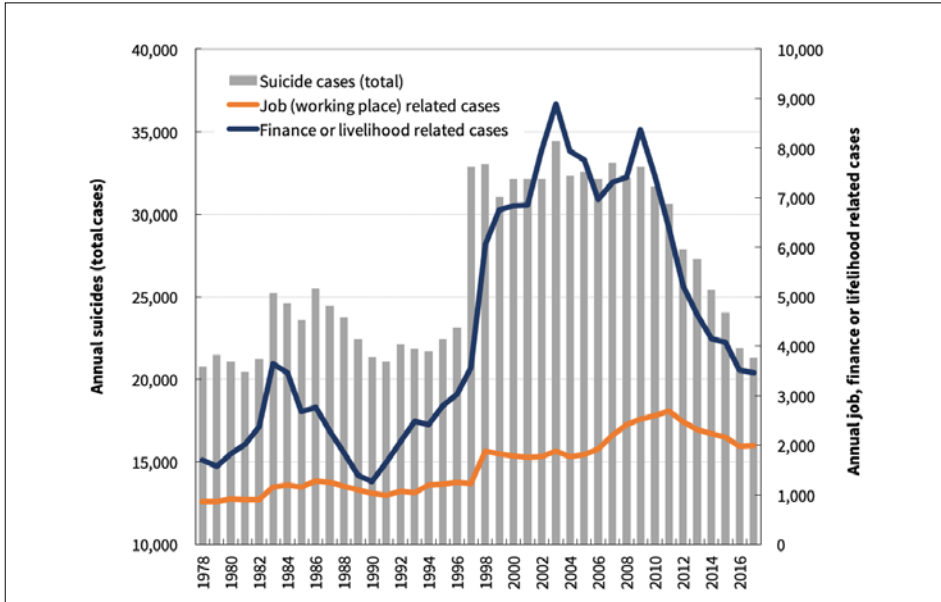
Source: Author, based on TSR 2018

Chart 1.9a Unemployment rate in Japan (% , CY)



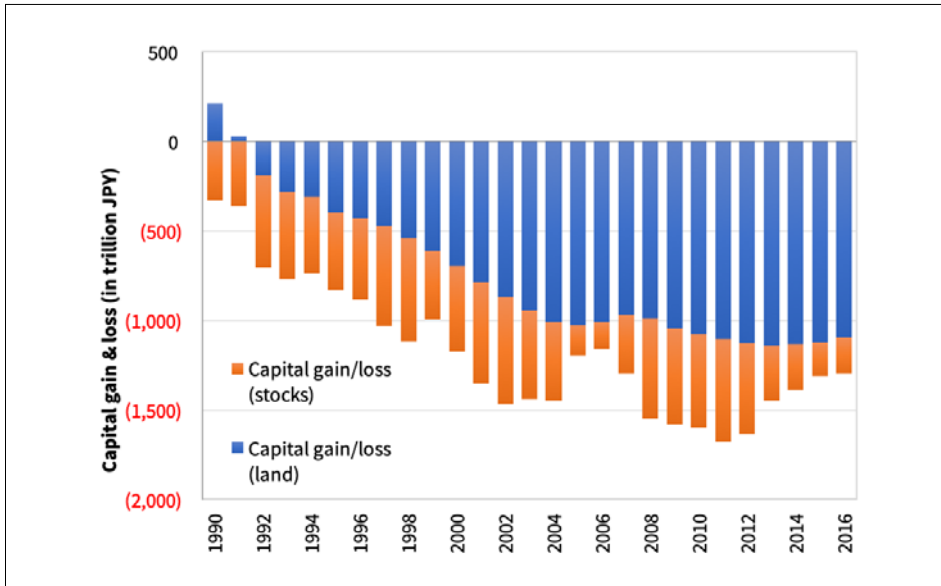
Source: Author, based on MIC 2018a, JILPT 2018

Chart 1.9b Suicides in Japan (CY)



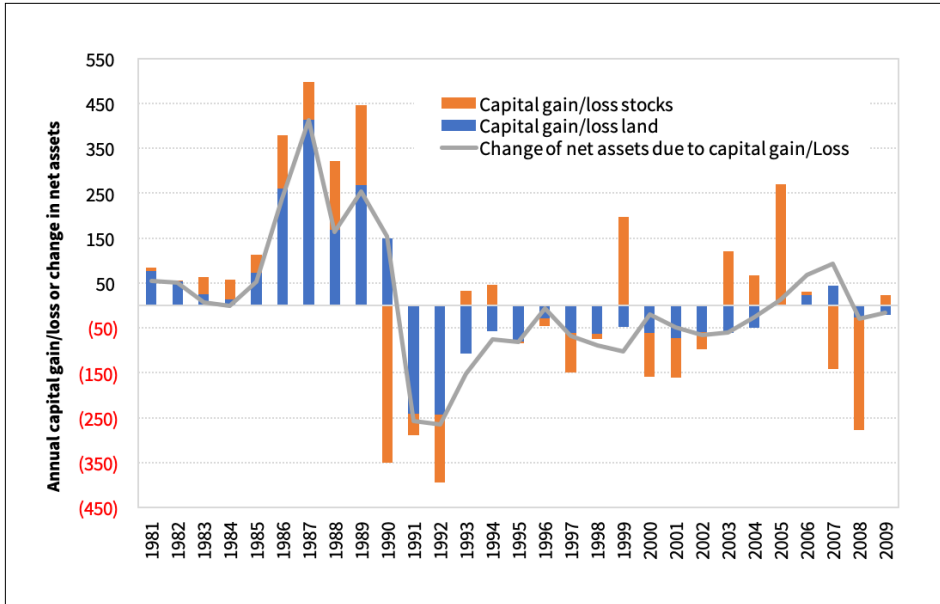
Source: Author, based on NPA 2018

Chart 1.10a Total capital gain/loss on stocks and land in Japan vs. 1989 (2011 Base, 2008 SNA, CY)



Source: Author, based on CAO 2018a (CY)

Chart 1.10b Annual capital gains or loss on holdings of land and stocks in Japan (in trillion JPY)



Source: Author, based on CAO 2018a

Instead of a typical credit crunch, which in Japan was an outcome rather than the root cause, Koo points to the impact of falling asset prices on the balance sheets of the private corporate sector and the related absence of demand for borrowing as genuinely most important (Koo 2009, 45-7). To illustrate how huge the asset price fall and its impact were, he refers to the Cabinet Office’s National Account Statistics: assuming that the total difference between peak and bottom of the asset market price within the period chosen was impaired as capital loss into the balance sheets, he estimates that asset value, amounting to more than three times of Japan’s GDP, evaporated due to the decline of land and stock prices (chart 1.10a). Subsequently, Japan’s economy suffered from a “balance sheet recession” (Koo 2009, 16-7).

Already in 1992, Miyazaki pointed to the relation between accumulated wealth (stock) and GDP growth (flow): he described the aftermath of the asset bubble as ‘combined recession’ (*fukugō fukyō*) triggered by the contracting value of financial assets and resulting in an unprecedented cyclical downturn. For his analysis, he used the Adjustment Account Section 2b of National Accounts (Miyazaki 1992, ii/iii; 1995, 42-58, 158-9). Based

on these data for capital gains or losses on land and stocks holdings from 1980 to 2009 (93 SNA, prices of 2000), capital gains during the bubble (1986-1989) amounted to 1,644 trillion JPY, while capital losses in the post-bubble period (1990-2002) accounted for 1,588 trillion JPY (chart 1.10b).

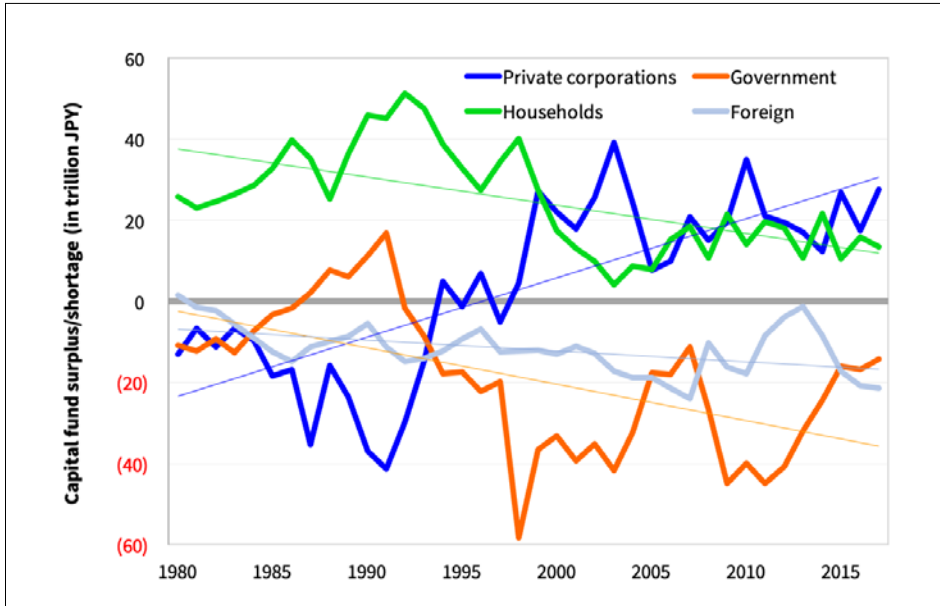
Capital gains of the non-financial sector (private and public corporations) on land holdings in the period of 1986-1989 were estimated at 266 trillion JPY (14% of total assets 1989) and those of stock holdings at 119 trillion JPY (10% of total assets 1989). From 1990 to 2002 capital losses on land holdings amounted to 308 trillion JPY (16% of total assets 1990) and those on stock holdings to 228 trillion JPY (12% of total assets).<sup>7</sup>

Under these conditions, many corporations, which had taken loans to finance asset purchases but lacked cash income to repay their loans and which were refused by their borrower to postpone or temporarily reduce their loan repayment, went bankrupt (chart 1.8). Corporations, staying in business had to keep operations running and pay off their debts instead of investing and procuring external funding. BOJ statistics about the flow of capital funds between private households, private corporations, government and foreigners in Japan during 1980-2016 indicate how large the scale of corporate deleveraging was and how long this trend persisted (chart 1.11).

7 In the financial corporate sector capital gains on land holdings from 1986 to 1989 amounted to 47 trillion JPY (2% of total assets 1989) and to 172 trillion JPY (7% of total assets 1989) on stock holdings. From 1990 to 2002 this sector suffered from capital losses of 76 trillion JPY (3% of total assets 1990) on land holdings and of 208 trillion JPY (8% of total assets 1990) on stock holdings. How big the actual impact of the asset price changes on the quality of balance sheets in the private non-financial corporate sector was can be estimated by comparing the trends of liabilities, net assets (total assets minus liabilities) and net worth ratio (net assets divided by liabilities): during the bubble period (1985-1990) these corporations increased their net assets by 590 trillion JPY or 141 trillion JPY above the historical average growth (1970-1985). Meanwhile, liabilities rose by 293 trillion JPY or 91 trillion JPY less than the historical average growth. From 1970 to 1985 liabilities increased by an annual average of 11%, while net assets have risen by 13% per year. The net value ratio averaged at 0.93. These data can be compared with those of the bubble period (1985-1990) and the post-bubble period (1990-1997): in the bubble period (1985-1990) net assets rose by an annual average rate of 16% in the private non-financial corporate sector, and liabilities increased by 9% per year. In the post-bubble period (1990-1997) net assets decreased by 4% per year, while liabilities increased by an annual average of 2%. This means that during the bubble period (1985-1990) net worth improved by 298 trillion JPY (equivalent to 15% of total assets in 1990) and 232 trillion JPY (equivalent to 12% of total assets in 1990) above the historical average growth (1970-1985). The net worth ratio rose from 0.93 (average 1970-1985) to 1.31 in 1990. From 1990 to 1997, liabilities increased by 136 trillion JPY, 1,012 trillion JPY less than the historical average growth. Simultaneously, net assets contracted by 282 trillion JPY and were short by 1,329 trillion JPY versus the historical average growth. Therefore, net worth shrunk during the post bubble period (1990-1997) by 418 trillion JPY (equivalent to 23% of total assets in 1997) and by 317 trillion JPY (equivalent to 17% of total assets in 1997) versus the historical average growth. The net worth ratio declined to 0.85 in 1997. Thus, net worth gains from the bubble period were completely erased. In the post-bubble period the balance sheet quality of the private non-financial corporate sector deteriorated generally towards a level worse than that of the pre-bubble period.



Chart 1.11 Flow of funds in Japan by main sectors (FY1980-2017)

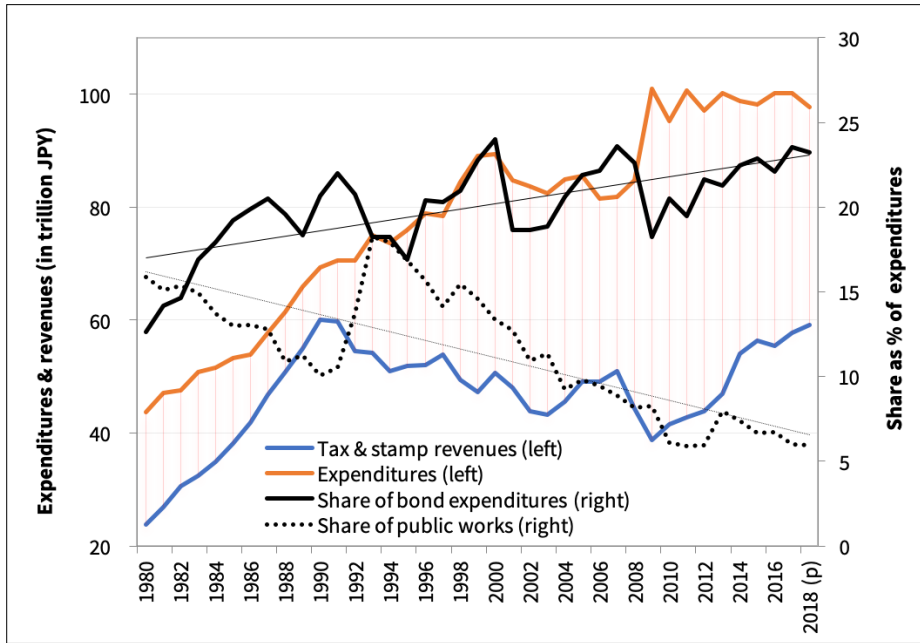


Source: Author, based on BOJ 2018

### 1.3 Public Deficit Spending: Avoiding the Worst, but Inefficiently

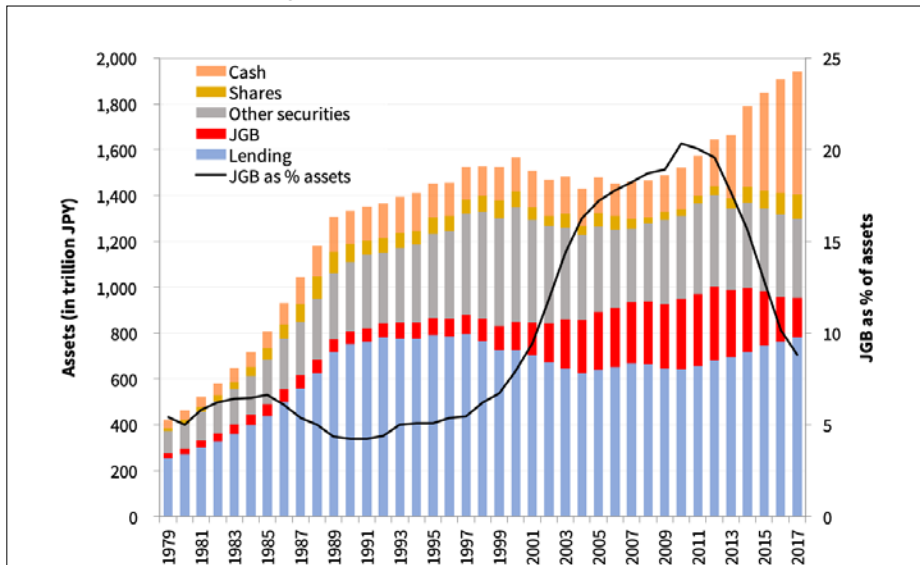
Normally, private households spend less than their earned incomes on current consumption to save for eventualities that will exceed the regular income flow, or to prepare for periods with less or no income. Private corporations are supposed to invest in new business or the expansion of existing business using internal and external funds, i.e. savings of others. In times of cyclical downturn, the government is expected to stimulate demand by deficit spending and absorbing otherwise unused savings. Foreign investors provide or procure funds depending on interest rate differentials and currency rates. Financial institutions are supposed to intermediate flows of capital between all parties. But from 1998 to 2016 the corporate sector saved 22 trillion JPY per year or 412 trillion JPY in total, while private households saved 15 trillion JPY per year. The government filled the

Chart 1.12 Government budget general account in Japan (FY)



Source: Author, based on MOF 2018c

Chart 1.13 Assets of saving banks (FY, excluding derivatives, foreign investments, non-performing assets)



Source: Author, based on BOJ 2018

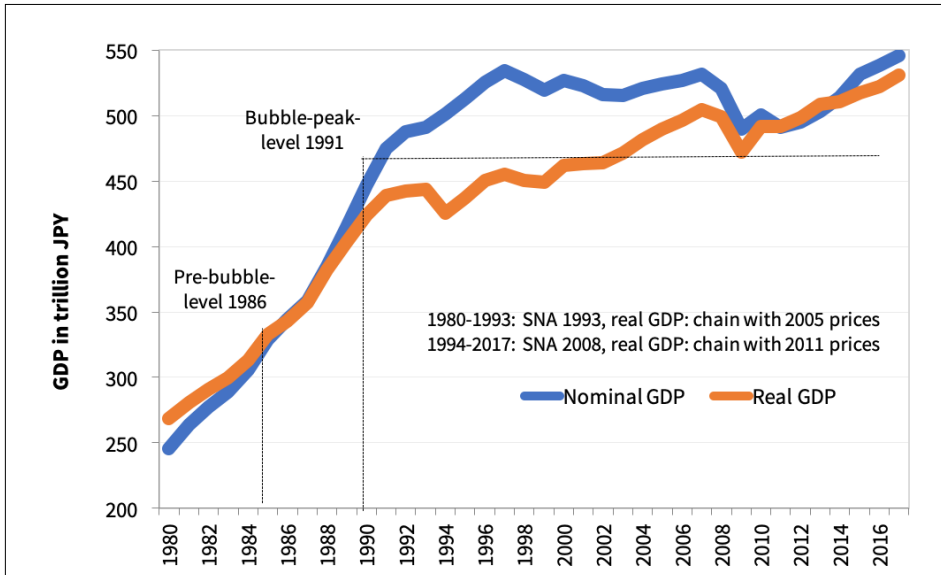
gap<sup>8</sup> left by deleveraging private corporations: from 1991 to 2016 it spent through its general account a deficit of 37 trillion JPY per year or 968 trillion JPY (equivalent to 182% of GDP FY2015) in total. About 232 trillion JPY were spent 1992-2016 on public investment programmes (chart 1.12). Using also other financing sources and investment budgets, from 1994 to 2002 the government invested an annual equivalent to 6% of GDP into the public capital stock, i.e. infrastructure.

The claim that public deficit spending works efficiently to stimulate economic growth in cyclical downturns has been contested, politically by neo-liberal proponents of structural reforms and also academically. In their view, public deficit spending is inefficient, because it crowds out private investment and fails to stimulate private consumption due to protective saving by private households against future tax raises. In Japan, public spending programmes were focused on large scale infrastructure projects such as road building and nuclear power generation, favouring established corporations in construction and heavy industries with close ties to politicians. Often, these projects ended up to be barely productive assets, huge empty boxes made of steel and concrete without budgets for content-wise activities or productive operating. However, Werner (2005, 37-48) does not generally reject fiscal expansion as an important instrument of macro-economic policy. Implying that borrowing (investment) demand existed in the private sector but was not sufficiently served by risk-averse banks, he criticises how fiscal expansion in Japan was financed, namely by issuing government bonds (JGB) and thereby crowding out private lending (chart 1.13).

Funds were allocated from corporate lending to JGBs and returned from the government to the private sector without generating new purchasing power through credit creation, making the economic effect of public deficit spending totally dependent on the accelerator effect of public expenditures. Due to Werner (2005), fiscal expansion should have been combined with quantitative monetary easing (QE) by BOJ or bank lending to the government: Credit money generates new purchasing power, because lenders' assets increase by the amount of lending to the borrower, while the borrower's bank account is credited with the same amount as deposit. These deposits remain in the banking sector and stimulate demand by providing new purchasing power, even when the borrower withdraws deposits, because the receivers of these funds will put the money into their bank accounts (246-60; see also Iida 2017, 134-5). Werner assumes again that demand existed and could have been realised, if only credits would have been provided by private banks, or measures would have been taken by the government and the central bank to stimulate private banks to do so. As

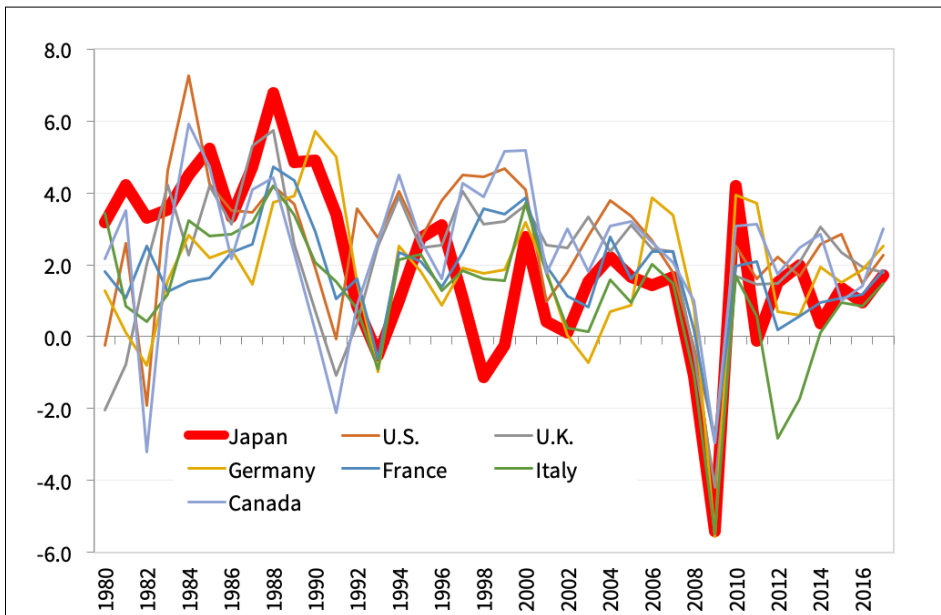
8 Foreigners were also borrowers: between 1998-2016 foreign financial institutions borrowed 14 trillion JPY per year or 265 trillion JPY in total at low interest rates in Japan, mainly to invest these funds into higher yielding foreign bonds ('Yen Carry Trades').

Chart 1.14a Real and nominal GDP of Japan (CY)



Source: Author, based on CAO 2018a

Chart 1.14b Real GDP annual growth rates of G7 (% vs. previous year)



Source: Author, based on IMF 2018

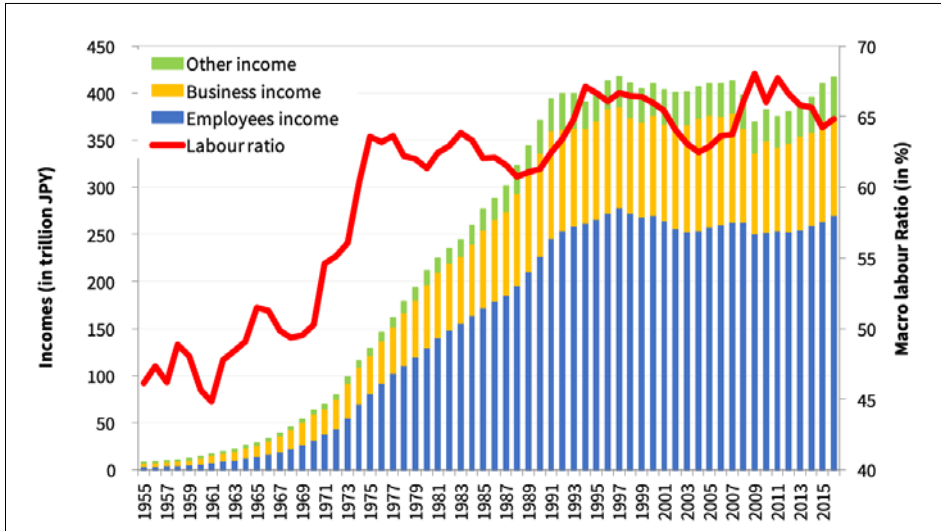
inefficient as public deficit spending might have become due to bond-based refinancing, i.e. without credit creation, delayed or restrictive implementation and unsustainable projects, at least, Japan's economy measured as flow was kept above the peak level of the Bubble Economy (chart 1.14a).

Except for 1997 and 1998, Japan's GDP growth rate was not significantly lower than those of other developed economies (chart 1.14b).

This is remarkable if one recalls what happened elsewhere after the asset bubble bursts of 1929-1932, 2000-2003 and 2008-2009. At least in the '90s, Japan's economy was spared from further deterioration. Deterioration could have been the case during the downturn in 1998, when the government shifted to fiscal consolidation (raising the consumption tax from 3% to 5%) and banks deleveraged in response to the critical accumulation of bad loans and the declining equity capital base. The latter were caused by falling stock prices in the wake of the Asian financial crisis and the subsequent bankruptcy of financial institutions (e.g. Yamaichi Securities, Hokkaidō Takushoku Bank, Nissan Life Insurance, Long-Term Credit Bank). However, the main cause for deflation remained: public spending only allowed private corporations to continue deleveraging and re-strengthening their equity capital base, while not encouraging investments. Fiscal stimulation stabilised not only the GDP level, but also prevented the share of employment income within national income from falling drastically until 1998 (chart 1.15). Normally, an increase of unemployment results, with a time lag, in a declining income share of labour. Short-lived cyclical recoveries in 1995 and 1999 could have had the opposite effect, but here, too, public deficit spending prevented the worst, at least temporarily.

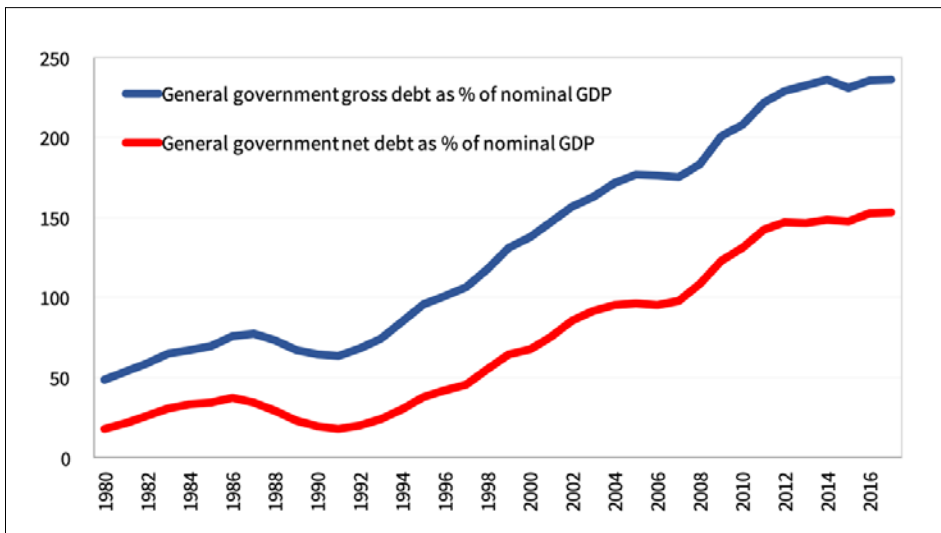
One consequence of avoiding the drastic elimination of over-supply capacities and bad debt and, thus, economic turmoil and social hardship was the increase of public debt to a level only seen in wartimes, that is, amounting to 236% of the GDP, including all debts of the central government and local municipalities (chart 1.16a). In general, public debts are income-bearing assets for lenders, and they are not problematic, as long as the government can refinance without crowding out private funds but utilising them to fill the lack of demand by investing into meaningful economic activities, maintaining precious resources and infrastructures and improving the conditions for economic recovery (Ono 1998, 91-111, 172-98). And, indeed, Japan's central government had no problems to sell JGBs to domestic public and private banks and to raise funds for its expansive fiscal policy at low interest rates (chart 1.16b). But expenditures paid by the central government for JGBs have been accounting for 18-26% of the total general account since the late '90s. Including all other investment and social insurance accounts these costs amounted to 38% of all expenditures in FY2017. For the banks, investing into JGBs was attractive as far as spreads between interest to be paid to saving account holders and

Chart 1.15 Macro labour ratio in Japan (FY)



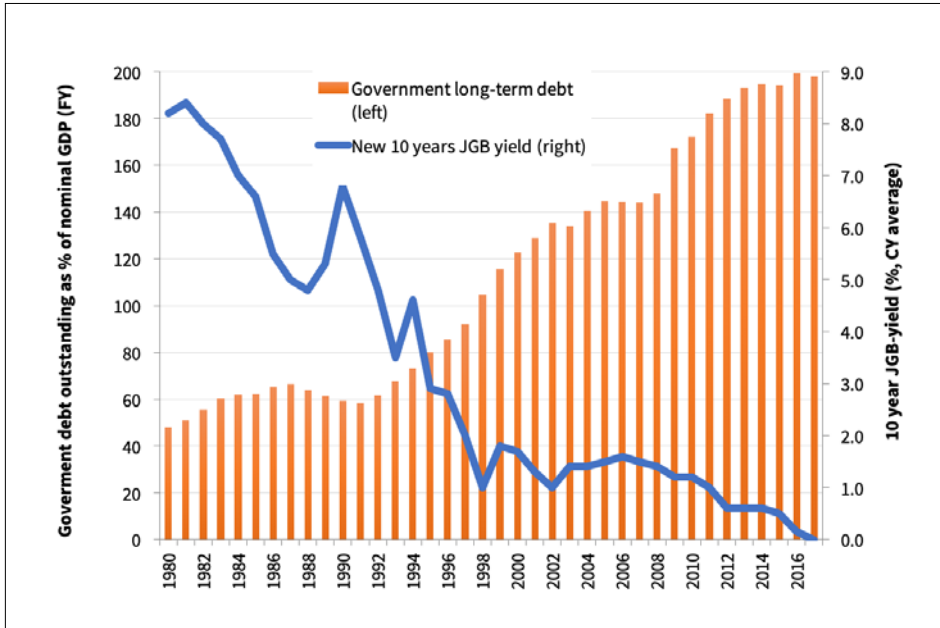
Source: Author, based on CAO 2018a (1955-1979: 1968 SNA, 2000 Prices, 1980-1993: 1993 SNA, 2000 Prices, 1994-2016: 2008 SNA, 2011 Prices)

Chart 1.16a Total general government gross and net debt of Japan as % of nominal GDP (FY)



Source: Author, based on IMF 2018

Chart 1.16b Central and local government long-term debt (FY) and 10 year-JGB-yield (CY)



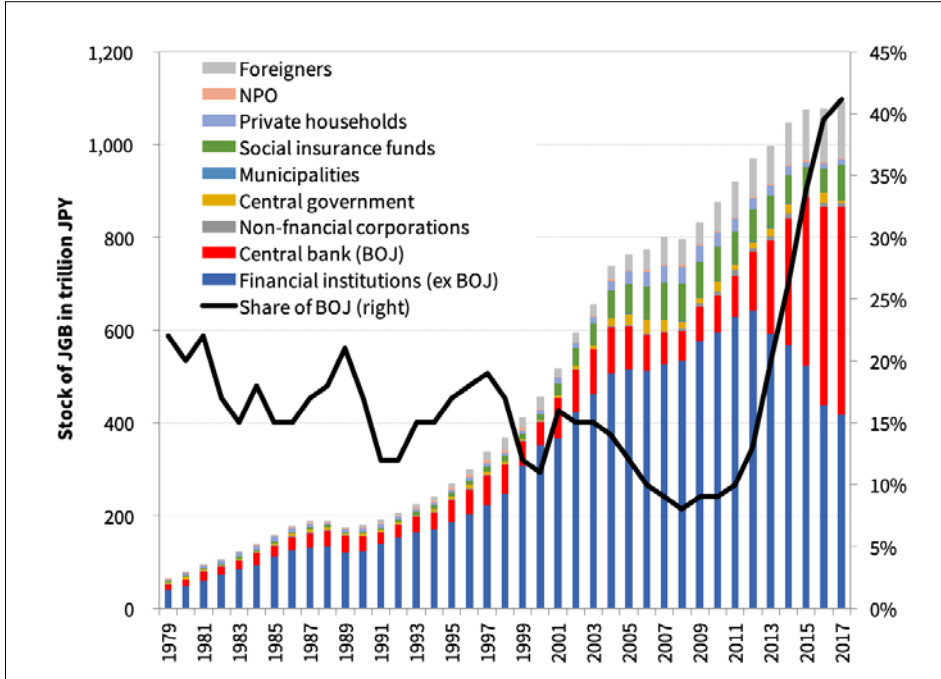
Source: Author, based on MOF 2018c; CAO 2018a; BOJ 2018

interest to be received from JGB holdings were big enough to cover operating costs. These costs were relatively lower than those for lending to SME or private households and allowed a sufficient profit margin, under the condition that the JGB prices did not fall during the holding period to a degree, that enforced a write-down of these assets.

In response to concerns by private banks about the JGB price (falling as a result of the future rise of interest rates) and as part of an expansive monetary policy through quantitative easing, from 2010 onwards the BOJ expanded its buying of JGBs from financial institutions in order to lower short-term interest. These purchases were aimed at expanding money supply, promoting credit creation and depreciating the JPY vs. the USD to push exports and inflationary pressure through increased import prices. As of late 2017, the BOJ has boosted its balance sheet towards an unprecedented volume of nearly 100% of Japan’s GDP, holding 41% of all outstanding JGBs (charts 1.17a-b).

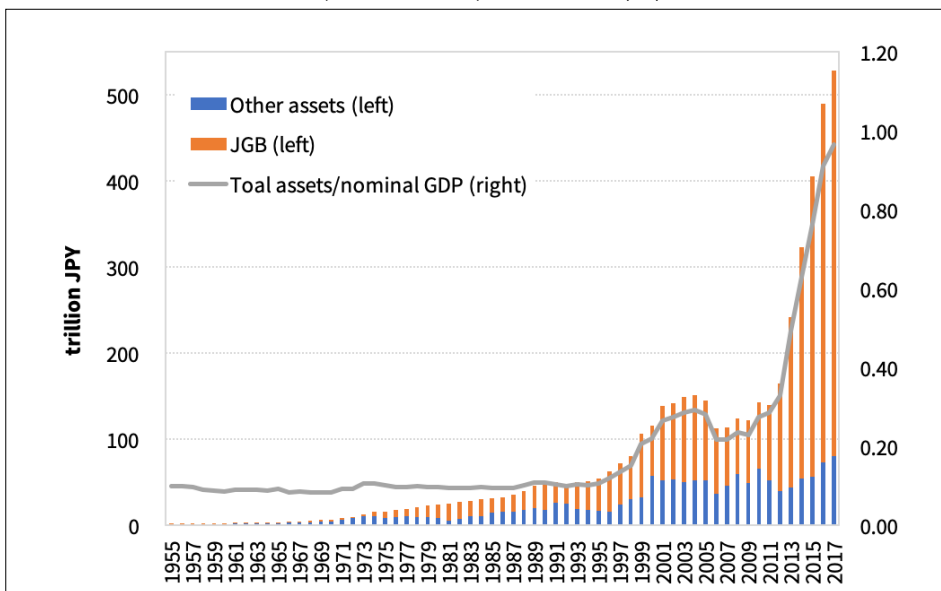
Pushing the JPY downwards supports those manufacturing corporations, especially in the car manufacturing and electronic industries, that are still exporting directly from Japan. And, indeed, the JPY-nominated volume of exports from Japan nearly doubled from 1992 to 2007. But after the financial

Chart 1.17a Stock of Japan government bonds (JGB) by holders (FY)



Source: Author, based on BOJ 2018

Chart 1.17b BOJ asset volume, JGB and asset/nominal GDP (CY)



Source: Author, based on BOJ 2018; CAO 2018a



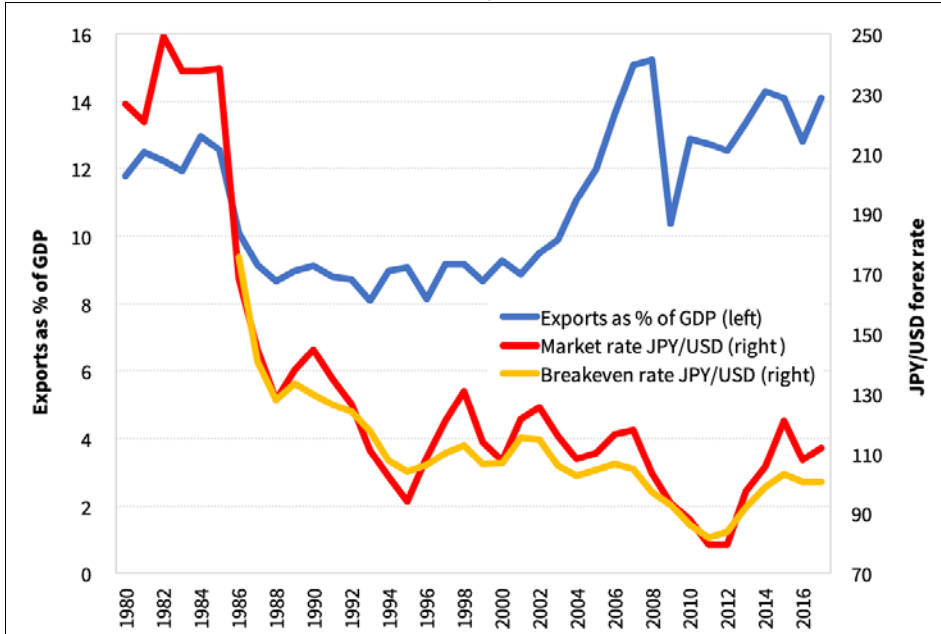
of crisis of 2008 Japanese exports did not return to this peak level until 2014. Many of the big manufacturing corporations, including their Tier-1 and Tier-2 suppliers, had already built up new production capacities in foreign markets, mainly the US, as a preventive response towards former JPY appreciations and trade frictions. Thus, a cheaper JPY translated into higher JPY-nominated profits from foreign subsidiaries, higher share prices of Japanese parent companies and foreign investment into shares of Japanese exporting corporations. But the effect of expanding exports and related domestic demand on the whole economy of Japan has been limited, as is evident from the fact that exports are equivalent to not more than 15% of the GDP (charts 1.18a-b).

Japan's payment balance, too, indicates, that the connection of its economy to the world economy is not anymore trade, but investment centred.<sup>9</sup> Instead of investing domestically, large corporations have been expanding foreign direct investment, often spending huge funds on Mergers & Acquisition (M&A). Thus, policy aimed at boosting export cannot be justified by claiming to be beneficial to all. Rather, such policy favours a handful of large corporations at the expense of all others: Depreciating JPY means higher prices and increasing costs for USD-nominated imports of food and energy resources. These import-cost rises are shifted by oligopolistic corporations (general trading houses, gas, electric power and food processing firms) towards the domestic consumer: Finally, private households pay the bill for the extra profits of big corporations. The worsened terms of trades for Japan (dividing export by import prices) indicate a decline in competitive pricing power of Japan's export. This has resulted in a loss in domestic purchasing power for almost all private households to an extent that exceeds the income gains of those who are working for exports (chart 1.18c).

By increasing inflationary pressure and raising import prices, government and BOJ try to make the private households spend more on consumption. In theory, inflation can push capital expenditures and related borrowing, as it decreases real interest or funding cost (Īda 2017, 229-34). In practice, decisions for capital expenditure or investment into productive assets are more complex. Besides core issues like product configuration, demand projections and price setting, such decisions reflect assessments of the future, that is, risks and potentials related to stakeholder response and the corporate environment (including politics, economy, society and technology).

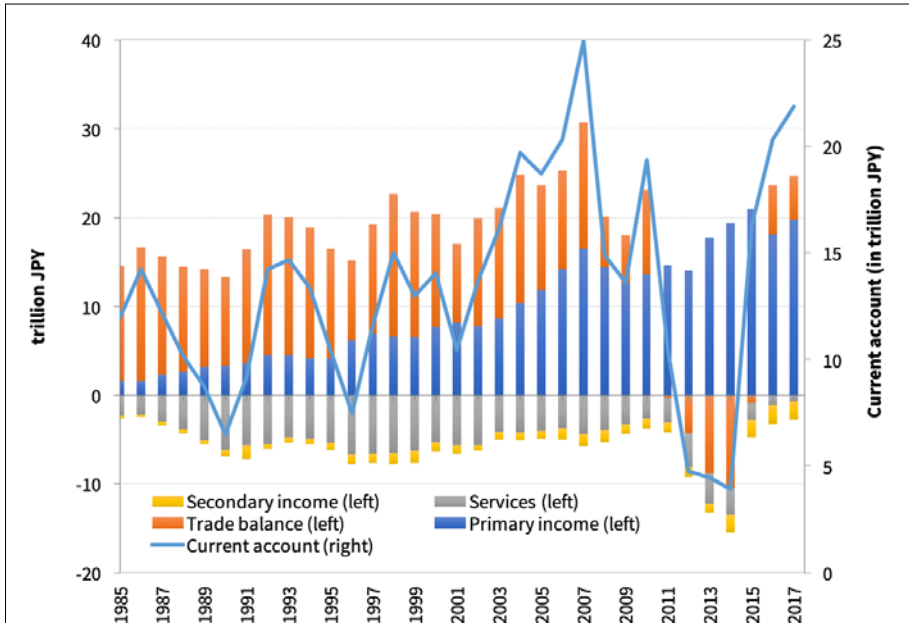
<sup>9</sup> The sudden decline in Japan's trade balance and current account from 2012 to 2014 were caused by increased imports of gas and oil at market-price peaks and the weakening of the JPY by 33% (from 80 JPY/USD to 106 JPY/USD), related to the aftermath of the meltdown of four nuclear reactors in Fukushima in March 2011 when thermal power plants replaced nuclear power plants.

Chart 1.18a Japanese exports and JPY exchange rates (CY)



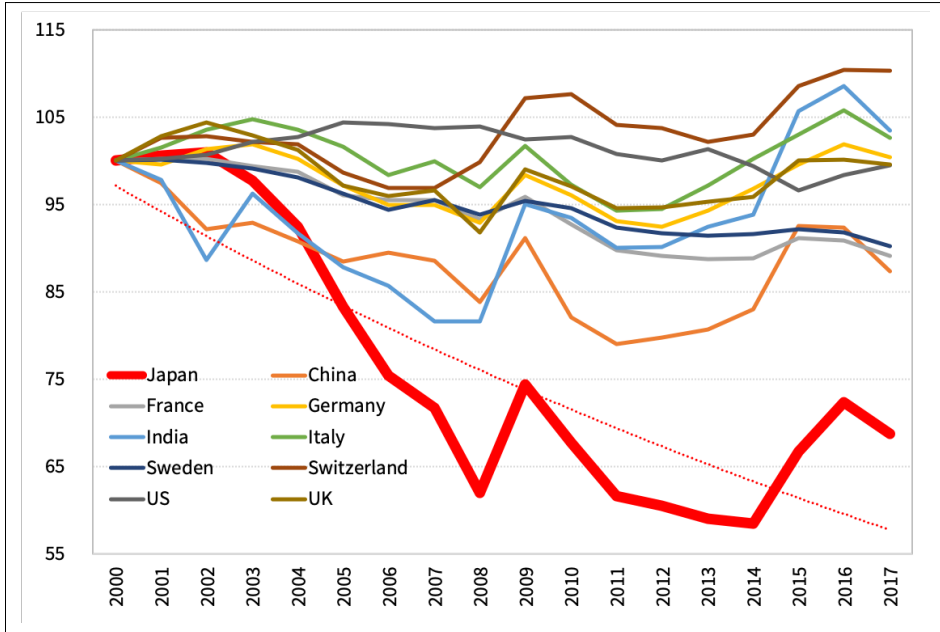
Source: Author, based on MOF 2018a; CAO 2018a; BOJ 2018

Chart 1.18b Payment balance of Japan (CY)



Source: Author, based on MOF 2018a

Chart 1.18c Terms of trade (export/import prices, 2000=100)



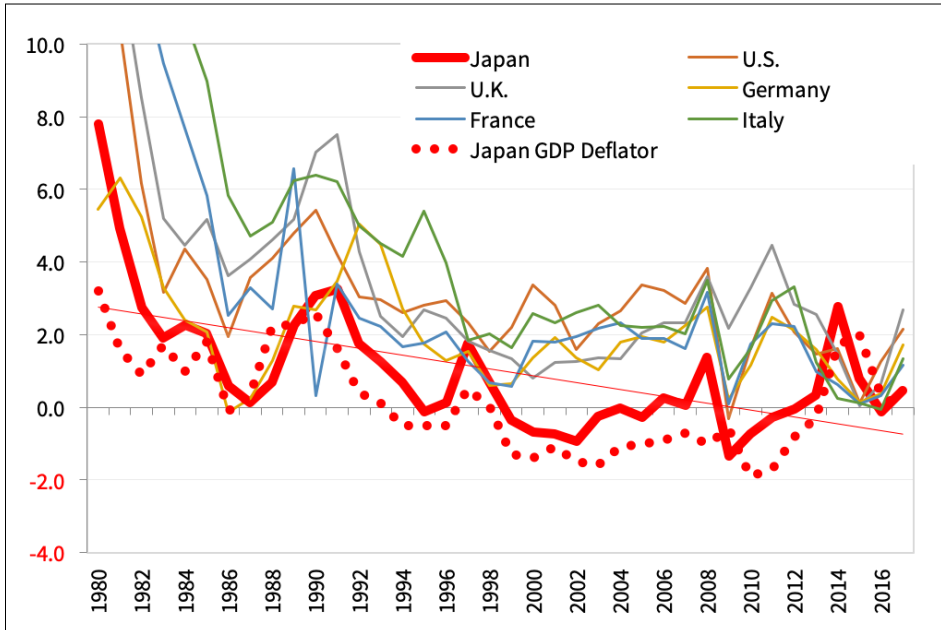
Source: Author, based on UNCTAD 2018

### 1.4 Replacing Fiscal Expansion by Structural Reform after 1998: Deflating Labour Cost

To what degree has deflation really occurred in Japan? How much progress in repairing their damaged balance sheets have corporations made, being granted the time to do so by an expansive fiscal policy? Has monetary policy accomplished its goals of (a) price inflation to push private households to spend incomes and savings on consumption, of (b) securing and improving the availability of capital funds and of (c) igniting economic expansion? And how much have the stakeholder relationships between main banks and their corporate clients, corporations and their employees been affected?

Japan’s inflation rate has been consistently lower than in other economies of developed countries (chart 1.19). This indicates intense competition, overcapacities due to expansive capital expenditure in the past as well as to current efforts to utilise existent capacities, generate cash and pay down debts. After the asset bubble burst, deflation - measured as year-to-year change of the consumer price index - occurred clearly from 1999 to 2003 and from 2009 to 2011. Inflation, measured the same way, occurred shortly in 1997, 2008 and 2014. Precisely at that time the consumption tax was raised (1997: 3% to 5%, 2014: 5% to 8%), and commodity prices

Chart 1.19 Consumer price change and GDP deflator (y-y %)



Source: Author, based on IMF 2018, CAO 2018a

hiked in 2008. Overall, neither a strong deflation nor inflation persisted. Shirai (2017, 3) called this a mild deflation as, in her view, it did not result in a severe deflationary spiral, but prevented private corporations from taking an optimistic view on business opportunities and investing in new products, production capacities and technologies. Morinaga (2001, 86-91) argues that deflation should be measured as GDP deflator. After all, actual deflation had occurred already since 1994 and by 1-2% higher than officially indicated in the consumer price index (chart 1.19).<sup>10</sup>

However, for private households that have kept jobs and incomes, deflation means that the purchasing power of their incomes and savings is stable or slightly increasing. At the same time, deflation creates pressure on their income, and on small and medium sized corporations with

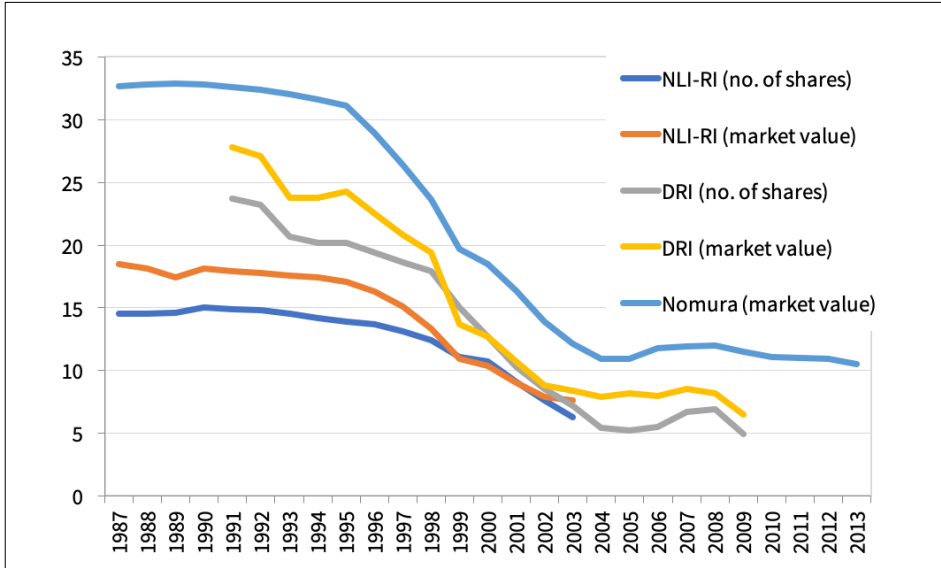
<sup>10</sup> Morinaga refers to the Laspeyeres bias, which occurs because the consumer price index, based on Laspeyeres, measures what a certain good, bought in the previous base year, would cost if bought  $\times$  years later (cf. also Īda 2017, 27-31). This bias overlooks that real consumers often shift their purchasing choice towards other (cheaper) goods, if they encounter an increased price for a formerly chosen good (Morinaga 2001, 86-91).

heavily leveraged balance sheets. Often external effects, caused by the worldwide financial crisis of 2001 (the so-called IT-stock market crash) and 2008 (the so-called subprime mortgages or asset-backed securities crash), were made responsible for the decline in economic performance and the occurrence of deflation in 1999-2003 and 2009-2011. But given the size of Japan's domestic market and the asserted importance of fiscal and monetary policy, internal factors must also be considered. And why has inflation not occurred until now? Werner (2005) sees BOJ as the power centre (without an election-based mandate) of promoting an agenda of structural reform – the trinity of privatisation, deregulation and liberalisation – under the slogan of 'being helpful by being not helpful', instead of contributing to overcome the credit crunch and deflation (307-20). BOJ had introduced a zero-interest rate in 1999 but resolved it already in 2000 and reduced money supply. With a de facto restrictive monetary policy, it resisted the introduction of an inflation target and the growing demand for monetary relaxation in the face of falling stock prices, a shrinking equity capital base of commercial banks and the subsequent credit crunch. BOJ saw deflation as a signal for a fundamental shift in the global economy towards information technologies and cost-competitive suppliers from China, both creating structural pressure on cost and prices of traditional products and services and indicating Japan's need to adapt towards open competition, lower cost and higher flexibility.<sup>11</sup>

One consequence was a fundamental change in the composition of equity capital owners, those who deserve to be treated as prime corporate stakeholders under the neoliberal paradigm of global shareholder capitalism. Rattled by bad loans, fallen stock prices and regulative pressure to clean up their balance sheets and reduce their leverage and asset volume, banks and other financial institutions accelerated the dissolving of share crossholdings (*mochiai*) between themselves and corporations from the non-financial sector (chart 1.20a). These crossholdings were built up in three phases: 1949-1965, when the former conglomerates (*zaibatsu*), once dismantled by the US General Head Quarter (GHQ), reorganised themselves and protected each other from corporate raiders, with banks buying

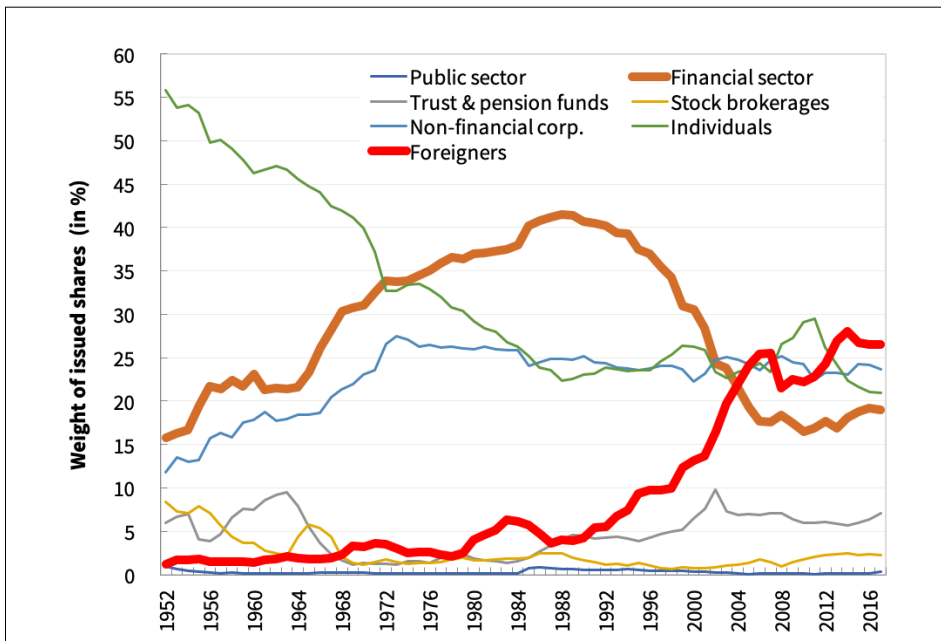
11 Besides a traditional anti-inflationary stance at BOJ, Morinaga points to an internal interest in protecting particularly regional banks from value losses on their expanded JGB holdings (caused by inflation), because regional banks were the preferred employers (*amakudari saki*) for BOJ cadres after retirement (Morinaga 2001, 84-119). Interestingly, BOJ corrected its stance later and initiated an expansionary monetary policy as quantitative easing, significantly increased in two other rounds 2010-2013 and 2013-2016 (following Werner's previous criticism). BOJ bought JGBs and other assets from commercial banks, providing liquidity to them in return. But the lately declared inflation target of 2% has not been accomplished. The increased liquidity went into the asset markets (stocks and real estate) and into financing large scale M&A activities abroad, rather than into increasing domestic capital expenditures (productive investment) and stimulating economic growth.

Chart 1.20a Estimations of cross-holding ratio of listed companies in Japan (% , end of FY)



Source: Author, compiled from market reports by Nomura Securities, Daiwa Securities, Nippon Life Insurance

Chart 1.20b Composition of stock holdings by investors in Japan (FY, issued shares in %)

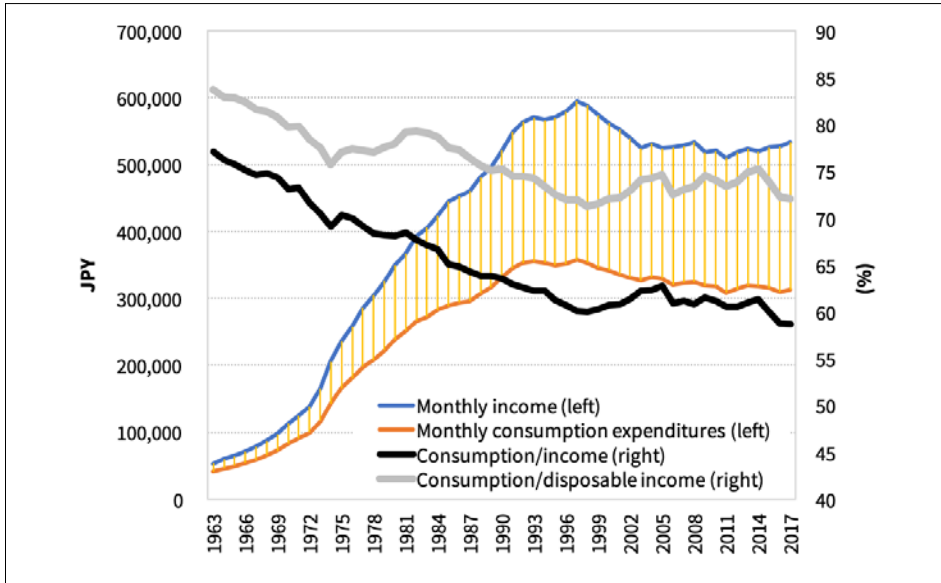


Source: Author, based on JPX 2018

shares of their conglomerate peer companies from individuals; 1965-1973, when during the stock market crisis of 1965 shares were bought from ailing investment funds and then sold to domestic financial institutions and related corporations in order to shield each other from takeover risks, which were expected to occur due to market liberalisation in the late '60s; 1973-1989, when mainly banks increased their corporate stock holdings to offset their declining influence caused by deregulation and shifted from lending to equity related finance. While domestic financial institutions reduced their corporate stockholdings, foreign institutional investors increased their shares in Japan's corporations (Itō 2011) (chart 1.20b).

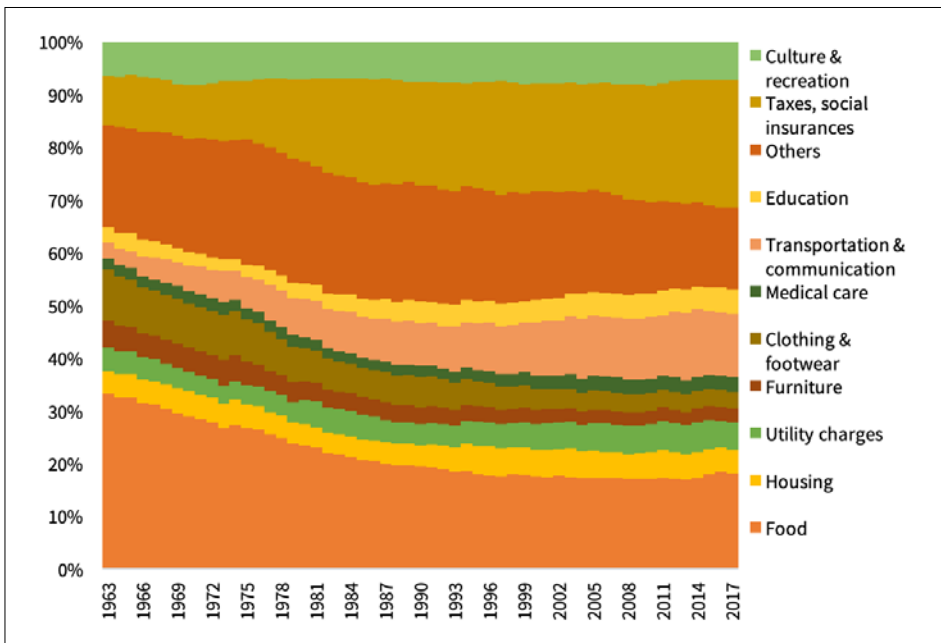
Continuous public deficit spending requires political legitimacy, especially if a government has already run deficits and accumulated huge debts as the Japanese did in the early '90s. The interest of governing politicians is mostly focused on getting reelected, and so they aim for short-term effects rather than mid- and long-term consistency. Apart from these political cycles, the volume of public work programmes, taken by the Japanese government under different prime ministers, reached its peak in 1993. Since then, it has been steadily shrinking from nearly 20% towards less than 5% of all general account expenditures or 1% of the nominal GDP (chart 1.12). Different reasons have been given, such as that short-term cyclical recovery made fiscal stimulus needless, or that policy shifted to austerity. But, most importantly, expansive fiscal policy was declared ineffective, not generating the expected outcome, but only protecting outdated structures and privileges, in short, becoming an obstacle to urgently needed structural reform of the capital and labour markets in Japan. Consequently, Koo has criticised the governments under prime ministers Ryūtarō Hashimoto (1996-1997) and Junichi Koizumi (2001-2006) for applying supply-side reforms as replacement for macro-economic policy, which resulted in economic and social destabilisation and even larger public deficits (Koo 2015, 51-2). Nevertheless, Koizumi's political popularity stemmed from a deep disappointment among voters with old elites unable or unwilling to overcome the crises and from high expectations to promoting entrepreneurial initiative, in particular a liberated market entrance for private corporations (through privatisation of public companies and postal savings), and reducing obstacles for new businesses such as legal restrictions and high cost, for example, by enlarging non-regular employment. Sawa (1994) agrees that deregulation reduces costs and increases corporate profits, but he also maintains that it does not necessarily translate into lower prices for goods and services at the same quality or new business opportunities for new entrants into commodity markets, because big corporations attempt to keep the prices high or defend their dominating market position by pricing new entrants out. For this reason, the growth stimulating effects of deregulation is extremely limited, if not negative in the first years (181-8). The consumption by private households represents 66% of the

Chart 1.21a Employee household income and consumption expenditures in Japan (CY)



Source: Author, based on MIC 2018d

Chart 1.21b Composition of employee household expenditures in Japan (CY)



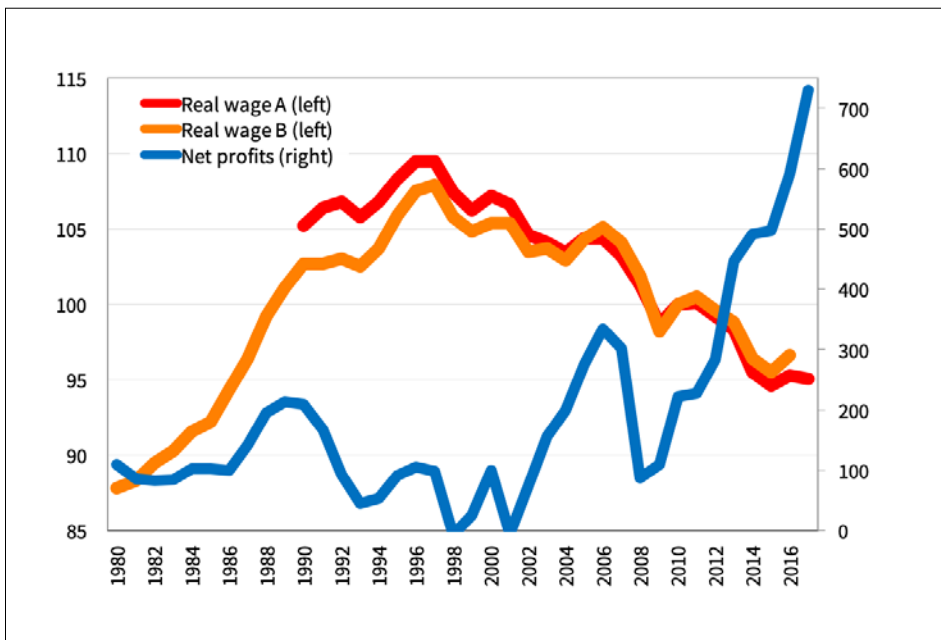
Source: Author, based on MIC 2018d



GDP (average 1994-2015). But private households do not expand consumption beyond fundamental needs, if working incomes continue to fall, job security or pension incomes deteriorate and capital income gains from savings shrink. Under such circumstances, private households postpone or avoid costly replacements and upgrades of goods. That applies all the more, if taxes and the costs for social insurance as well as for services necessary to participate in society (mobility, communication) steadily rise (charts 1.21a-b).

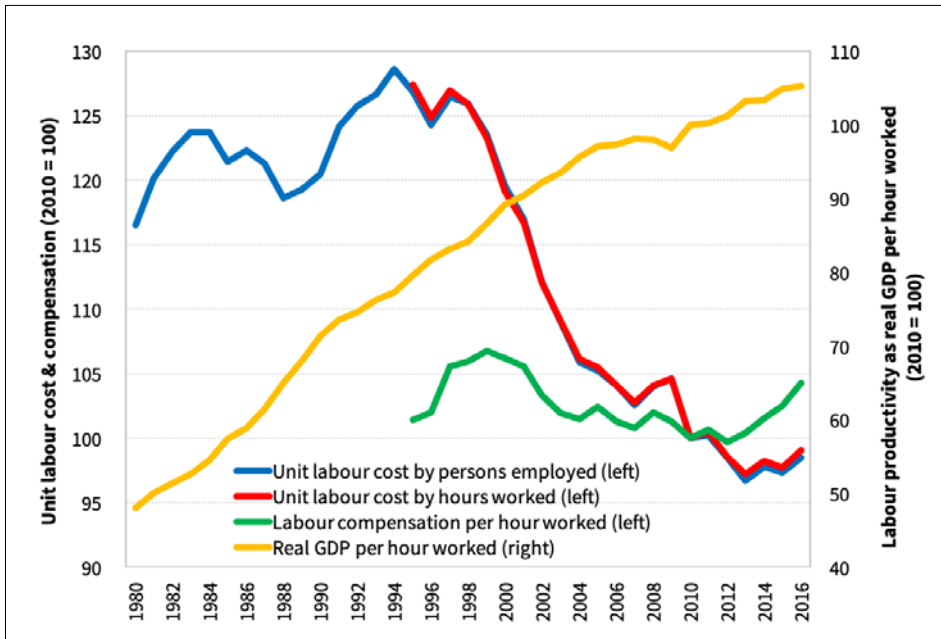
On the other hand, private corporations do not invest only because of lower cost of external financing or the need to meet regulations: they do invest in new production capacities or enlarge them if demand grows or demand growth can be expected to reach profit margins that exceed the cost of internal and external capital funds. Otherwise, private corporations keep supply capacities at the status quo, and secure cash flows by selling at or under market price and ensures profits by reducing input cost.

Chart 1.22a Real wages (CY) and net profits (FY) index in Japan (2010=100)



Source: Author, based on MLHW 2018a: real wage A = firms with 5 and more employees, B = firms 30 and more employees), MOF 2018b: net profits, all industries and sizes

Chart 1.22b Labour cost, compensation and productivity in Japan



Source: Author, based on OECD 2018

This explains why inflation is almost absent and why deregulation does not lead immediately and necessarily to productive investment: structural reforms, aimed at strengthening the supply side, enable corporations to regain and improve their profitability, often by reducing cost. Such behaviour might be rational for a single corporation but, on the whole, it diminishes the purchasing power of private households and aggregate demand. Japanese corporations have been doing exactly this, mainly deflating employees’ working income.<sup>12</sup> From 1997 to 2015, real wages fell to the level of 1986, while the net profits of corporations (of all industries and sizes) grew tremendously, particularly after 2000 (except 2007-2008) (chart 1.22a). This means that another central feature of the traditional stakeholder relationship, here between capital and labour, has vanished: employers have abandoned the post-war period golden rule of sharing productivity gains (chart 1.22b).

12 In the second chapter the implications for corporate strategy and culture will be examined in detail. This chapter focuses on the macro-economic repercussions.

Already in 1995, the former Japan Federation of Employers' Associations (Nikkeiren)<sup>13</sup> had released their vision of 'Japanese-Style Management in a New Age'. It emphasised the need for increasing flexibility and cost competitiveness, and adding 'Western rationality and market mechanisms' to the existing system through the implementation of a workforce portfolio consisting of three categories of employees: (a) a long-term type for managerial functions with promotion, capability-based payment and unlimited contracts, (b) a highly specialised type in planning, marketing, research and development (R&D), with performance-based compensation and contracts of limited duration, and (c) a flexible type for assisting or performing simple functions with time-based compensation and short-term contracts (Nikkeiren 1995, 7, 33). Top managers of corporations, supported by politicians, mass media and academics, urged the necessity of overhauling, if not overcoming, the traditional stakeholder relationship,<sup>14</sup> pointing to hidden bad loans, insufficient equity capital base and possible bankruptcy, the appearance of demanding foreign shareholders and the increasing competition from foreign companies.<sup>15</sup>

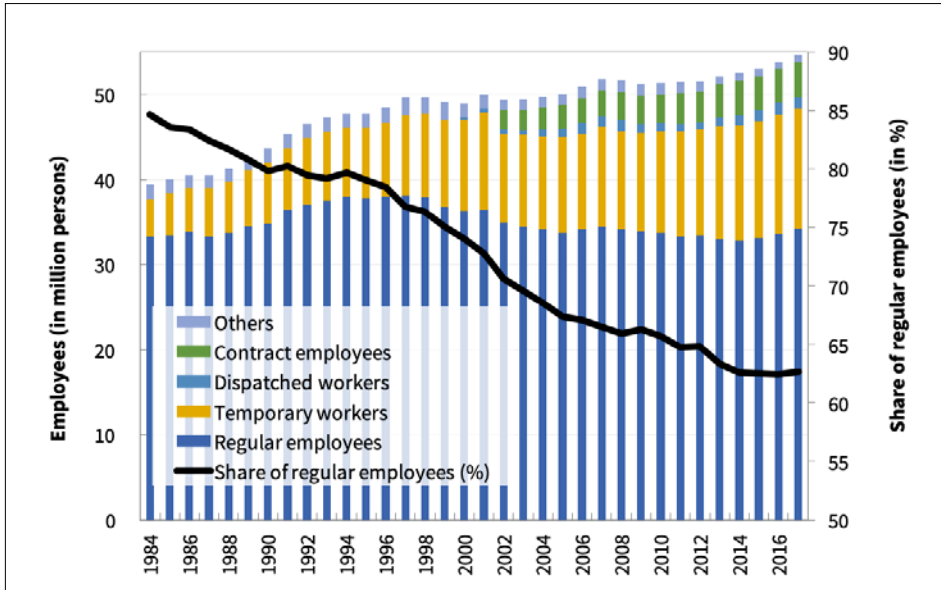
Practically, corporations and their managers have been doing what they are supposed to do, namely control and reduce the cost for procuring external supply and labour. For that, they utilised the growing fear of losing jobs and income to exert pressure on their counterparts (charts 1.8, 1.9). But this time the big cut was executed not only by means of (a) reducing 'non-regular' working force and working time, (b) cutting 'bonuses' (accounting for about 1/3 of an annual salary) on short notice by 5-20% of the annual salary, (c) freezing the employment of college graduates as regular employees, and (d) laying off senior employees through early retirement. Since 1998 corporations have covered their demand for new labour primarily through hiring non-regular employees (Kuroda, Yamamoto 2006, 121-51). These employees have limited work contracts ranging from one month to three years and are paid only 50% or less of regular employees with similar work tasks mainly due to the absence of bonuses and fringe benefits. As of 2017, they represented 37% of all employees in Japan (chart 1.23).

**13** In 2002, former Keidanren and Nikkeiren merged to the Japan Business Federation (Keidanren).

**14** Morinaga illustrates this new attitude among Japanese top managers through the example of how fast and radically Akio Morita, founder of Sony Corporation, changed his mind about the legitimacy of the Japanese-style management 1992-1993 from defending the traditional way towards accepting the market for corporate control and global competition without political interference (Morinaga 1998, 102-6).

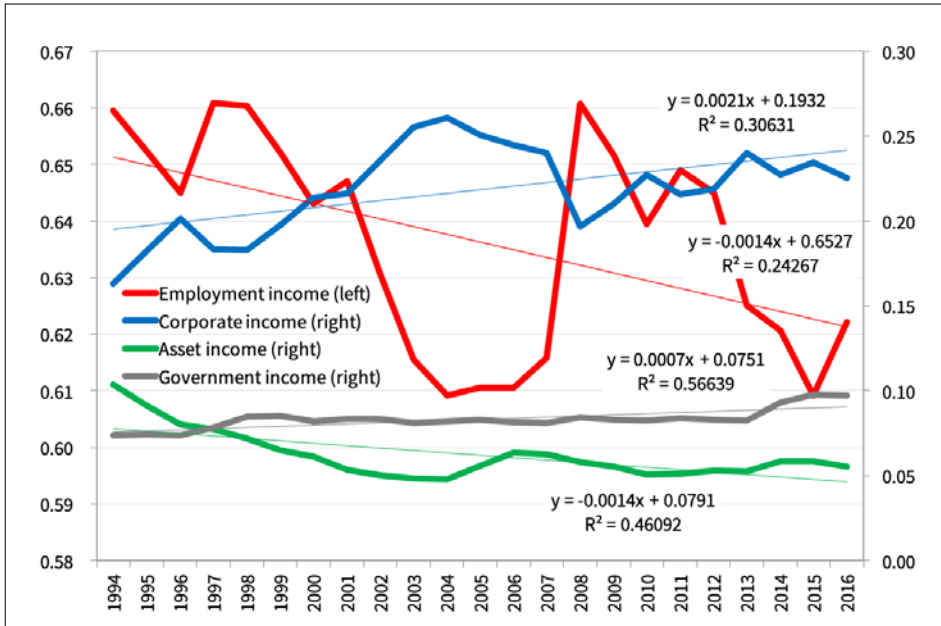
**15** Between the late '90s and the early 2000s, not only financial institutions mainly in the life insurance and real estate industry went bankrupt and restarted under the control of their former foreign competitors (AIG, Prudential, GE Finance), but also big car manufacturers (except Toyota and Honda) were taken over or had to accept controlling stakes by foreign competitors (Nissan, Mazda, Mitsubishi Motors, Suzuki, Isuzu).

Chart 1.23 Employees in Japan by types of employment



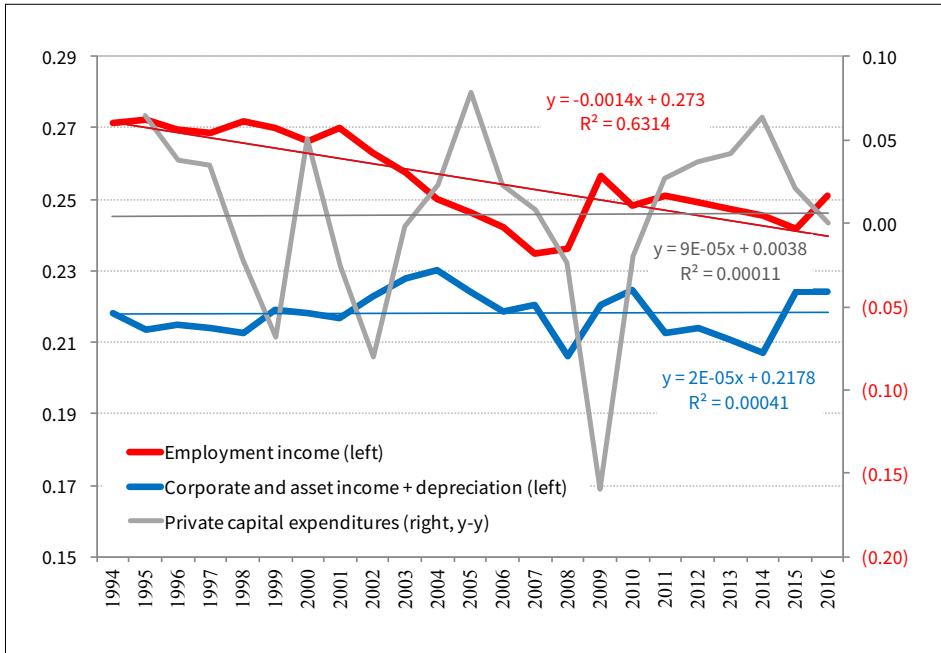
Source: Author, based on MIC 2018c

Chart 1.24a Macro income distribution in Japan (FY, SNA 2008)



Source: Author, based on MIC 2018c

Chart 1.24b Capital and employment income vs. production output and growth of private capital expenditures in Japan (CY)



Source: Author, based on CAO 2018a; Mizuno, Sakakibara 2015, 117

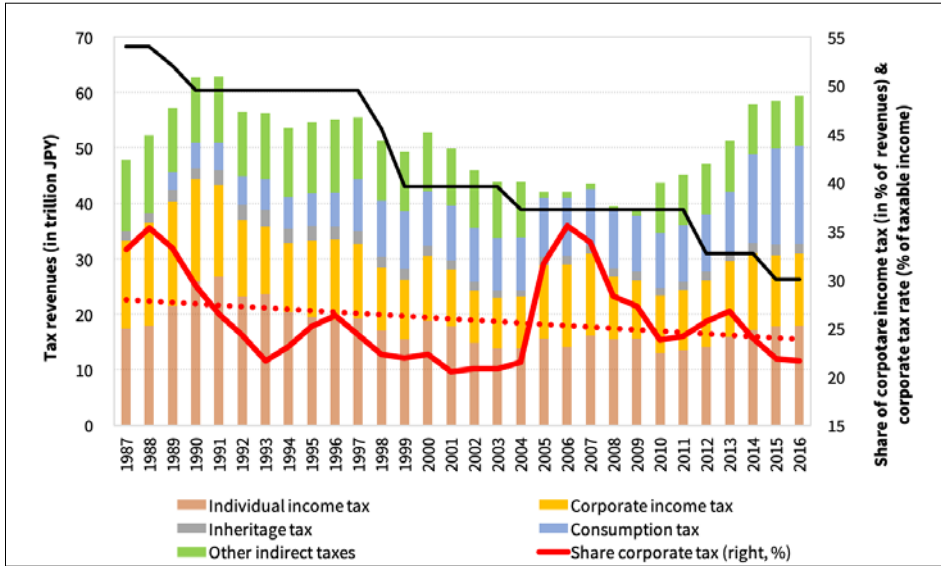
Some researchers explain that the tremendous increase in non-regular employees between 2002 and 2012 was caused by changes in the sector structure, i.e. the growth of the service sector, and in labour supply, i.e. the gender and age composition of the Japanese workforce, namely, the increased entrance of older and female workers into the labour market, particularly in health care, education, retail and the restaurant business. About 50% are seen as due to ‘changes in corporate policy (measures)’ (Ōhashi 2017, 69-83). But, in general, there are no reasons not to hire women or older people as regular employees in the service sector, besides a corporate interest in cost saving and flexibility and a lack of social service infrastructure (i.e. child or senior care facilities), which prevents women from entering the market for paid labour. Consequently, the labour ratio, indicating the share of employee income as % of the value added, has been declining, even under the consideration that the total number of employed persons has increased and that remunerations for directors are included in the employment income data (charts 1.24a-b).

If we measure employment income on the one side and corporate income, assets income and depreciation on the other side and both against the total production output from 1994 to 2015, the resulting trend indicates a steady decline of employment income weight, whereas corporate income, assets income and depreciation have moved in line with production output (Mizuno, Sakakibara 2015, 15). In the same period, capital expenditure fluctuated around zero. Labour was not replaced by investment in fixed assets (machinery), as the price of labour was sufficiently deflated (chart 1.24b). Thus, the profitability of corporations increased mostly by deflating working incomes and decoupling wages from productivity. Precisely for this reason – and not anymore because of stressed balance sheets, the related fighting for survival or a post-bubble trauma – corporations had no incentives to take the risk of investing. After all, improvement of corporate profitability has been achieved without it.

With respect to secondary income distribution, Japanese corporations have succeeded in lowering the taxation rate on corporate income by 24%, that is, from 54% in 1987 to 30% in 2016. Consequently, the share of corporate income tax revenues among all tax revenues has fallen from 33% to less than 22%. Meanwhile, relative share and absolute amount of indirect taxes, which are mostly paid by private households, have steadily risen (chart 1.25). Thus, private households have shouldered also increasing payments for taxes and social insurance, and they will have to shoulder more in the future. Further, private households have been paying the cost of the expansionist monetary policy: as permanent net savers, they hold most of their financial assets in bank saving accounts, not yielding a positive return.<sup>16</sup> Therefore, the strong correlation between the return on the financial assets of private households and the return on net assets of big corporations (shareholder capital plus retained profits) has not only just diminished, the gap between them has widened since 2001 (chart 1.26). Mizuno calls this the divorce between state and citizens. Most citizens have been excluded from economic and social gain sharing, but encountered higher risks of unemployment, further falling incomes and higher expenses with regard to taxes and social insurance (Mizuno 2016, 13-26).

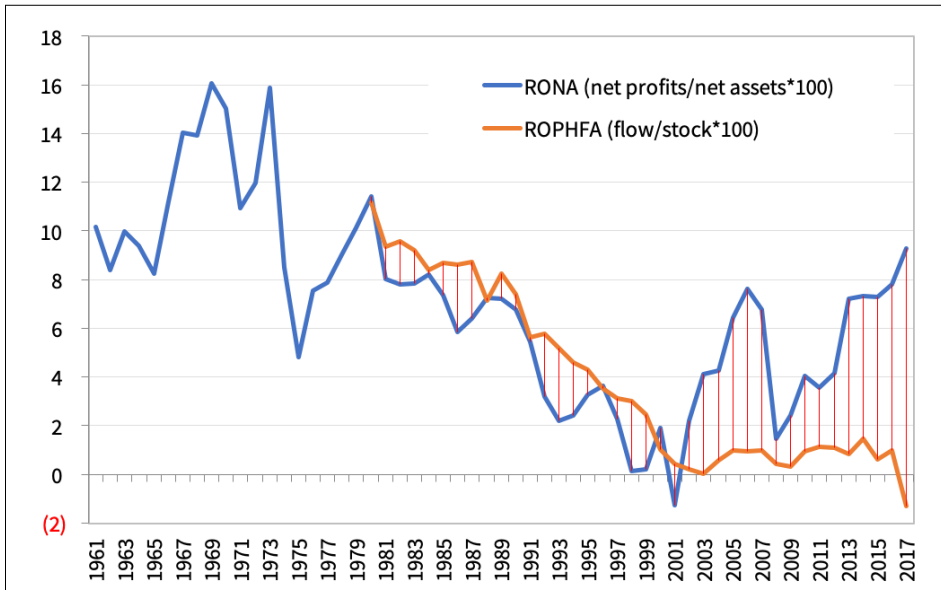
**16** There have been different explanations for the long-lived low interest rates: first, it is explained as a result of expansionist monetary policy. Second, responsibility is ascribed to rich or excessive supply of savings due to demographics (growth of high saving population groups), inequality (high-saving rich) and financial integration of developing countries (with fast rising income and savings). And third, falling prices of investment goods have allegedly lowered capital expenditures. Induced by low interest rates and reflecting the lower user cost of housing, house prices have risen by the same rate as household debts (Sajedi, Thwaites 2016, 636-7). Referring to low interest periods in history and connecting low interest to falling terms of trade as well as average profit rates, Mizuno qualifies the current low interest period as a sign of the death of capitalism (Mizuno 2014, 14-25). Whatever the explanation, if interest rates are the price of capital and their level remains low for over three decades, then capital is not scarce, but abundant and should not be treated as the most important resource, its maximisation as the ultimate prime goal of economic activities.

Chart 1.25 Tax revenue and corporate income tax in Japan (FY)



Source: Author, based on MOF 2018c

Chart 1.26 Return on net assets of big corporations with more than 1 billion JPY capital (RONA) and return on private households financial assets (ROPHFA) in Japan (FY, in %)



Source: Author, based on Mizuno 2016; BOJ 2018; MOF 2018b

Besides demographic change an inevitable outcome of continuously falling working income is the decline of savings,<sup>17</sup> even if the total and average amount of financial assets of all private households might slightly increase or stay stable: apart from private households without any savings, the median saving amount of employee households with two persons and more has been declining since the beginning of data collection in 2001 (chart 1.27a).

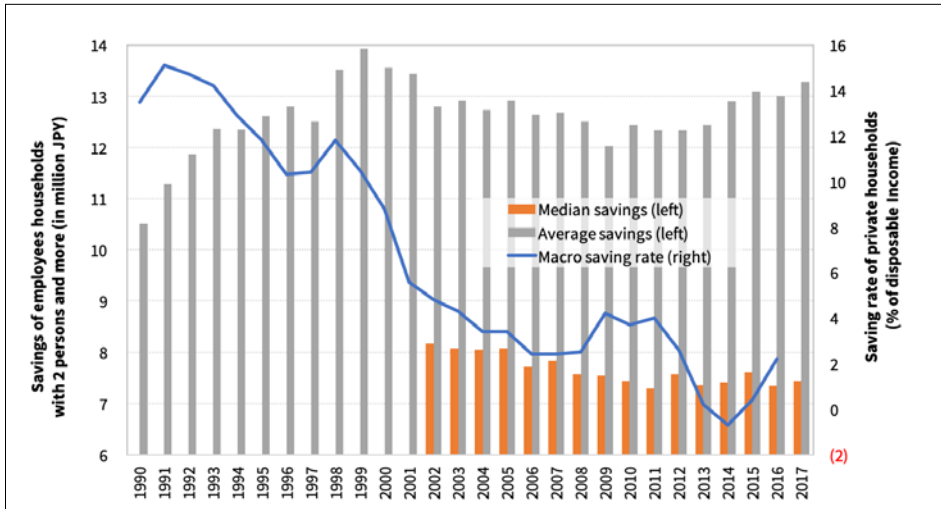
Simultaneously, the debts of these households (mainly for housing) have steadily risen, resulting in growing net debt for more than half of all private households in Japan. By now, net debt is amounting to 81% of the average annual income of employee households (chart 1.27b). Reaching its peak in 2003, the number of individual insolvencies (natural persons) had been continuously declining. But in 2016, it started to rise again for the first time in twelve years, staying slightly, but clearly over the level of before 1996. This, too, may indicate, that an increasing number of employee households has reached their financial limits (chart 1.27c). At the same time, the number and share of private households, which hold no financial assets at all, is rising (chart 1.27d). Systemic compensation for falling working income cannot be sought in gainsharing or participating in asset value increases and receiving additional income from dividends through common stock ownership. One third to one half of all private households is affected, including the poorest, those who lack knowledge and cash funds to buy stocks, absorb volatility and hold stocks long-term. Of course, not all poverty is directly caused by private corporations that cut costs of labour and external supplies. In the decades after World War 2, the majority of Japan's population was focused on expanding the economy, the corporate sector and especially the single organisation they individually belonged to, which, in return, was expected to provide welfare and prosperity to its stakeholders and individual members.

Thus, interrupting the linkage between contribution and return has more severe implications in Japan than in those countries where public welfare is supposed to play a correcting role. In Japan corporate slashing of labour cost and working income decreases the potential of private households to cope individually with hardships and to support others, such as children and the elderly. Corporate cost cutting has also weakened public finances through reduced income and consumption tax receipts. Consequently, a rising poverty rate (i.e. the share of households with less than 50% of median disposable income per person) and a growing number of households that depend on social welfare have resulted from the corporate cutting of labour cost and the deterioration of working incomes (charts 1.28a-b).

17 The saving rate is measured as the remaining disposable income after subtraction of consumption expenditures, divided by disposable income.

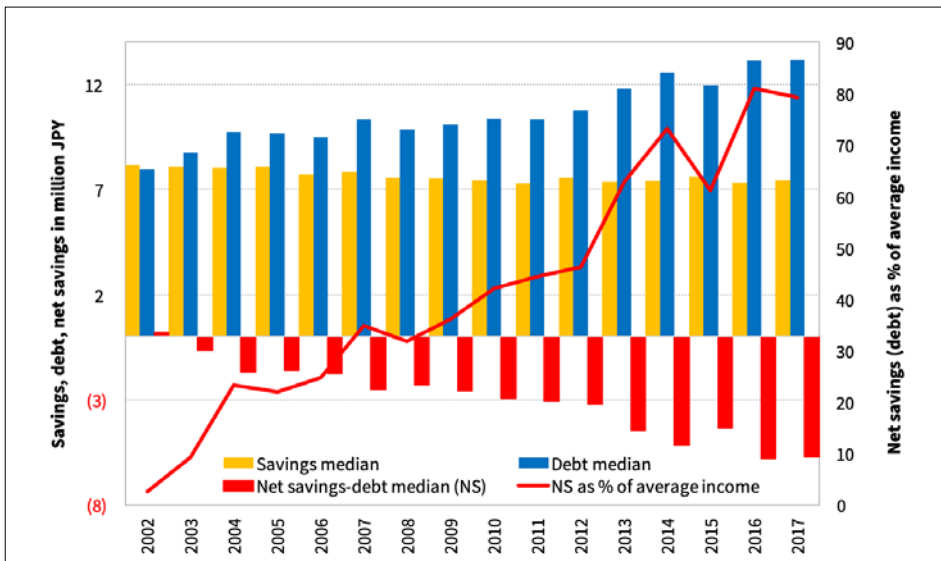


Chart 1.27a Macro saving rate, average and median of savings of employee households with 2 persons and more in Japan



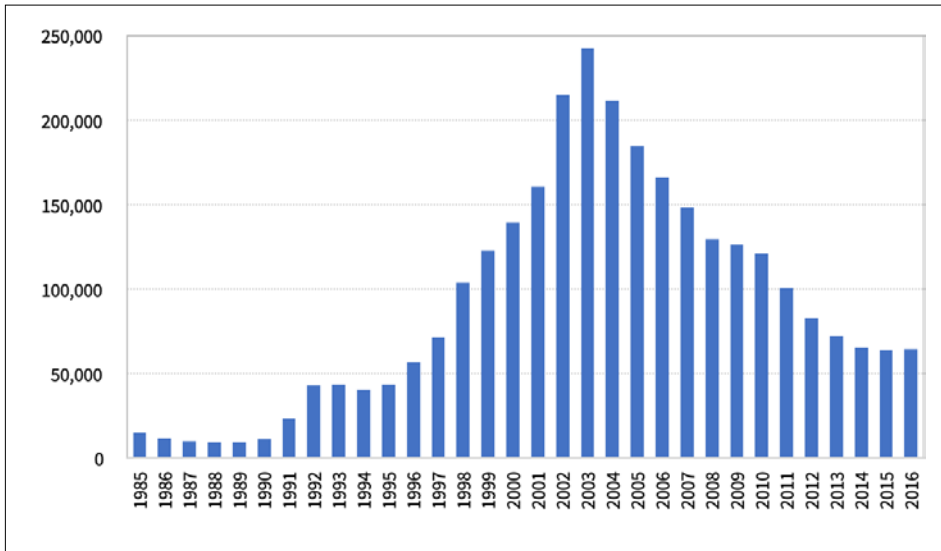
Source: Author, based on CAO 2018a; MIC 2018b

Chart 1.27b Median savings, debt, net savings (debt) as % of average income of employee households with 2 persons and more in Japan



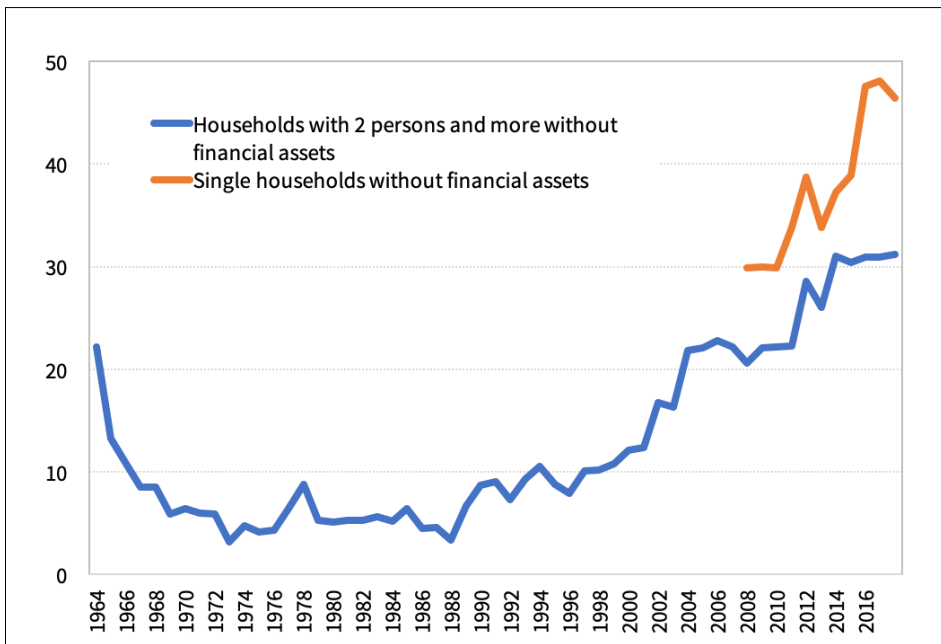
Source: Author, based on MIC 2018b

Chart 1.27c Insolvencies of natural persons in Japan (FY)



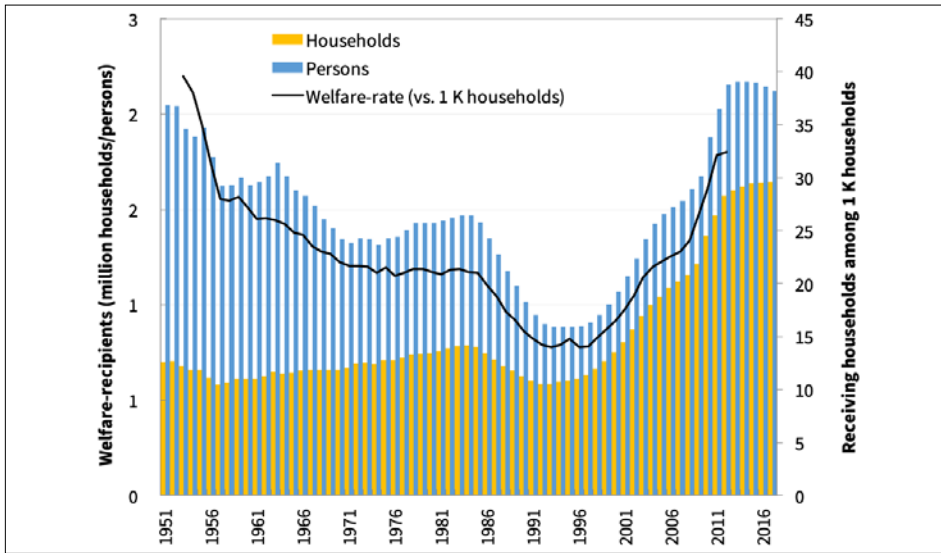
Source: Author, based on SCJ 2017

Chart 1.27d Share of households in Japan without financial assets (%)



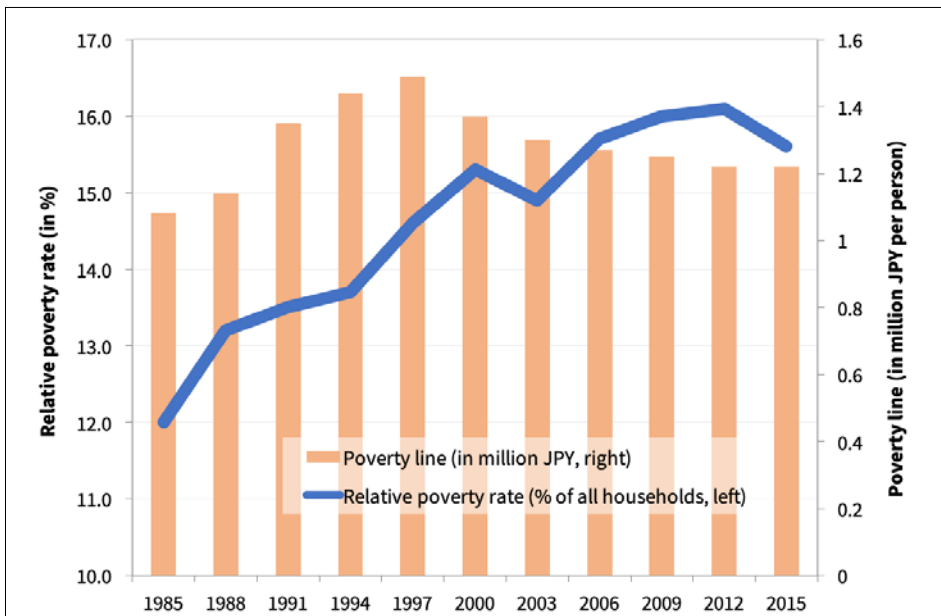
Source: Author, based on CFSI 2017

Chart 1.28a Recipients of social welfare in Japan (CY)



Source: Author, based on MHLW 2018b

Chart 1.28b Poverty rate in Japan (% of households with less than 50% of median disposable annual income per person)

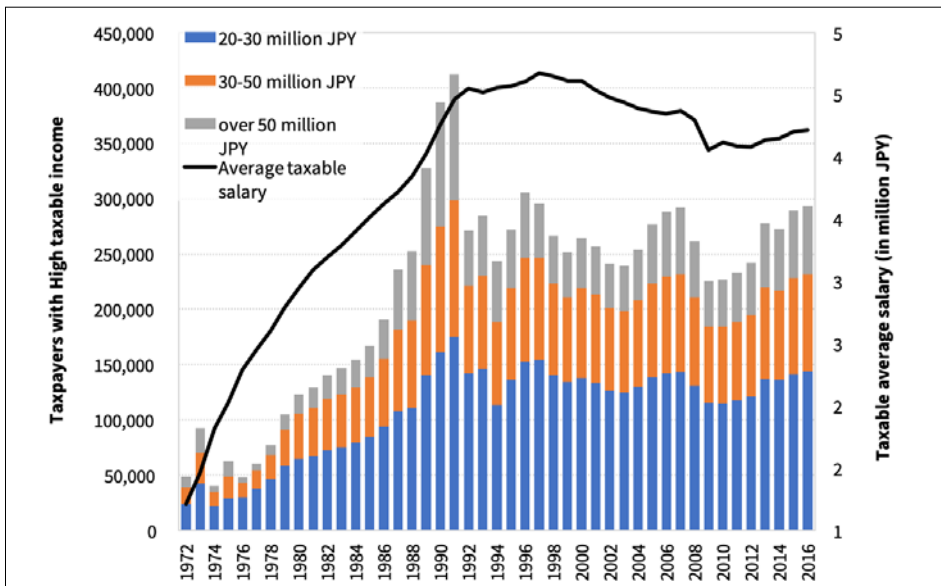


Source: Author, based on MHLW 2016

Not surprisingly, the long-term trend of the Gini coefficient for Japan shows that inequality in assets and total income distribution has been increasing. The number of taxpayers with high taxable income (i.e. an annual income of 20 million JPY and more) had grown until the early '90s. Afterwards it fluctuated, but it has not drastically risen anymore since the burst of the bubble (chart 1.28c).

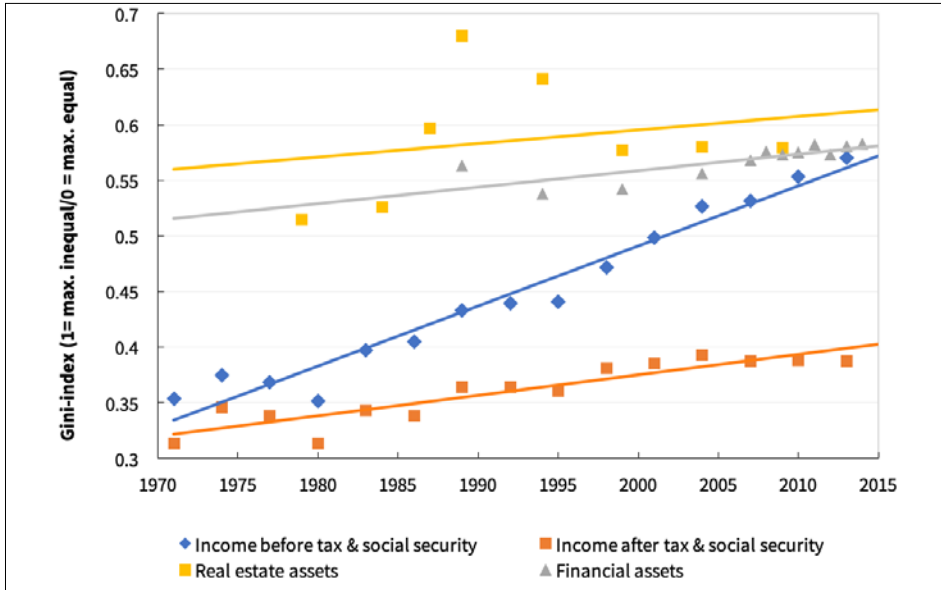
Therefore, the deflation of working income mainly through expanding non-regular employment has to be regarded as the main driver of the rising inequality in incomes since the late '90s (chart 1.28d). A general deflation of working incomes exerts a negative macro-economic impact: it reduces aggregate demand, spurs the deflationary spiral and increases inequality through lowering the bottom. But, obviously, labour cost cutting cannot be justified as a rational response by private corporations to their once damaged balance sheets. Since 1998 Corporate Japan has been a permanent net saver at an average amount of 20 trillion JPY per year (i.e. around 5% of the GDP) (chart 1.11), and its balance sheet is now stronger than ever: the equity ratio, indicating to what degree total assets are financed internally (through retaining profits), has doubled since 2000 from 20% to 42% (chart 1.29).

Chart 1.28c Number of taxpayers in Japan with high taxable income



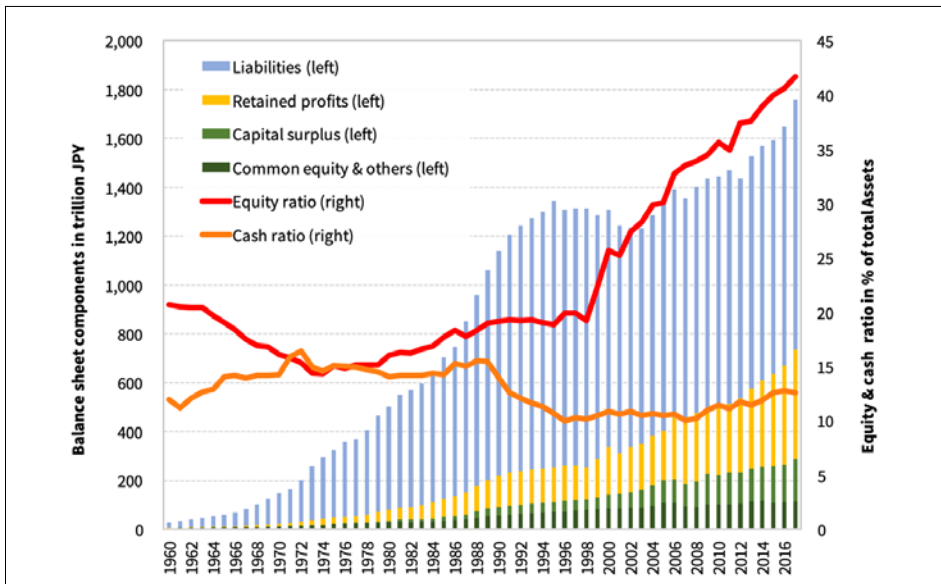
Source: Author, based on NTA 2016

Chart 1.28d Gini coefficient for income and assets in Japan



Source: Author, based on MHLW 2015. Assets until 1987: Takayama, cited in Ōtake 2005, 30, from 2007: CAO 2018a

Chart 1.29 Balance sheet composition of Japanese corporations (all sizes, excluding financials)



Source: Author, based on MOF 2018b

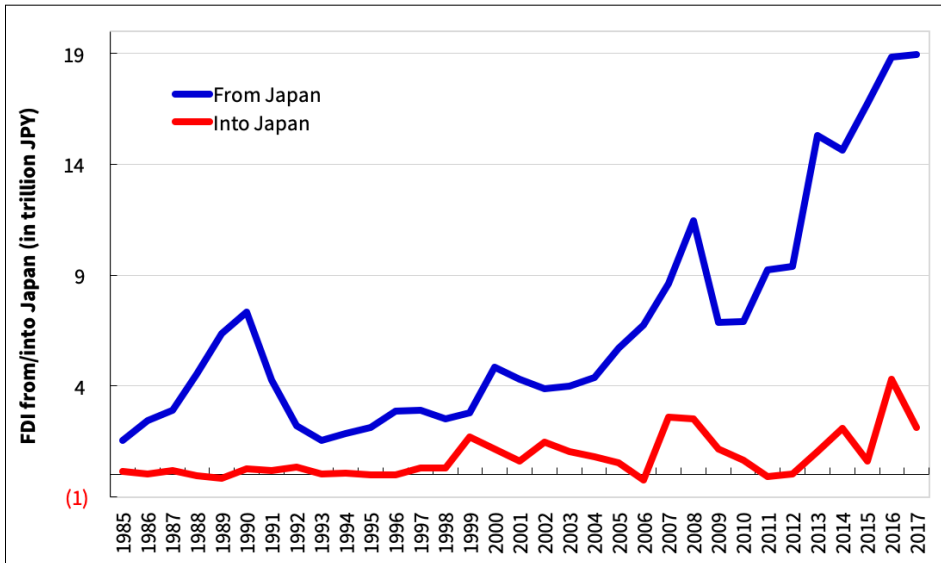
## 1.5 ‘Distributional Coalition’ Between State and Large Corporations

Expansionary fiscal policy has prevented Japan’s economy from collapsing in the ’90s: public investment programmes filled the demand gap that had been left by a debt repaying, cash hoarding and not investing private corporate sector. After the turn of the millennium, the government, shifting to ‘structural reform’, gave private corporations free hand to reduce their labour cost drastically in the main through increased non-regular employment. But despite reduced public investment programmes (now more or less confined to the reconstruction of disaster-hit regions like Fukushima and Kyūshū) public expenditures have exceeded tax receipts twice, and the total public debt has accumulated to unsustainable 250% of the GDP. Nevertheless, the government lowered the corporate income taxation rate as well as tax payments and introduced various new taxation privileges for private corporations (e.g. exempting dividends paid by foreign subsidiaries, and deducting R&D expenses), while continuing to subsidise them – even after corporate profitability had recovered significantly.

Instead of investing domestically into new business models, large corporations increased their equity capital and expanded foreign direct investment (spending the domestic surplus outside of Japan at an amount of 18.5 trillion JPY or around 3.5% of the GDP in 2016), often deploying huge funds for taking over foreign rivals with apparently better conditions for profitable growth (chart 1.30). Together with the central bank, interventions were taken to depreciate the JPY in favour of large exporting manufacturers and importing trade corporations. Private households, already hit by deflated working incomes, have been forced to shoulder both more than 2/3 of all tax burden and the increasing costs for imported fossil fuels and food.

During the period of high economic growth in the ’60s and ’70s, large corporations (organised as *keiretsu* or conglomerates), the majority of their small and medium sized suppliers (as part of a *keiretsu* network) and employee households (as ‘life-long’ regular employees) benefited from economic expansion. This time, however, facing a balance sheet crisis and stagnating demand, government and large corporation formed a “narrowly based distributional coalition” (Olson 1965, 3) excluding all others; they legitimised “the exploitation of the great by the small” (3) as a necessary precondition for overcoming deflationary stagnation or balance sheet recession, regaining global competitiveness and achieving general prosperity. But a balance sheet recession does not exist anymore. In the ’90s, reducing cost without reinvesting returns into business might have been inevitable for many corporations to avoid extinction. Beyond that, it means to give preference to exploiting over exploring. Exploration or investment is an entrepreneurial commitment to an uncertain future, while exploita-

Chart 1.30 Foreign direct investment into and from Japan (Flow, CY)



Source: Author, based on MOF 2018a

tion or cutting cost of existing business means to prolong the past, and this is justifiable only insofar as it generates surplus that can be invested. To aim for a balance between exploitation and exploration is what corporate strategy and decision making should be about (March 1991, 71-87). But, short-term profitability at the expense of employees, suppliers and the public without long-term gainsharing and investing is backward-looking. It carries heavy economic and social costs as it accelerates deflation, widens the gap between rich and poor, shifts the cost of private failures to the public or the weakest and undermines individual initiative as well as collective risk taking.

Labelled as structural reforms, chronic corporate cost cutting without investing is the opposite of it. It is structurally conservative: large and often oligopolistic corporations stick to their business models and defend their dominant positions in saturated industries such as utilities, car manufacturing, construction and trading, by utilising close connections to government and bureaucracy to receive political protection, access to subsidies, public funding and taxation privileges.<sup>18</sup> But nothing of this has

18 Olson has convincingly explained, giving the example of an (auto)industry that the ability to obtain extraordinary profits and pay exceptionally high wages to a limited number of workers through cartelization or monopolisation forces similarly skilled labour and

prevented the loss of global market share in electronics, heavy industries and car manufacturing (chart 1.31). In these industries, South Korean or Chinese corporations have caught up their Japanese rivals based on the same conventional business models of scaling up and improving efficiency. At the same time, new rivals, mainly from the US, with IT-based business models have started to rewrite the rules, turning towards innovation-driven postindustrial competition. Japanese self-assertions of becoming the gainer from Asia's economic growth, prime provider of industrial infrastructure and central role model for Asia have been maintained even after the nuclear disaster of Fukushima in March 2011. In view of increased industrial competition from inside Asia and lacking innovation strategies, these Japanese hopes appear illusionary.

Striking examples are the shortcomings in the combat against global warming (chart 1.32) and the response to the nuclear disaster of Fukushima. Japan's government is still privileging domestic monopolies in the electric power industry, their outdated nuclear and fossil fuel power generation and their vendors in the heavy industry, instead of enforcing and promoting a consequent shift towards a decentralised network and energy system, based mainly on renewable power.<sup>19</sup>

Large corporations remain dominant. For Japan's post-war economy it was essential to protect certain sectors, industries and corporations and promote long-term investment and general prosperity. This was structurally supported by lasting relationships and gainsharing between banks and industrial corporations, capital and labour, large, medium-sized and small corporations. But in the pursuit of 'structural reform' these former 'encompassing' interest alliances have been downgraded to 'narrowly based distributional coalitions' between large corporations, factions of ruling parties and the government, where only these parties reap the gains at the expense of all others and block substantial moves to alternatives.

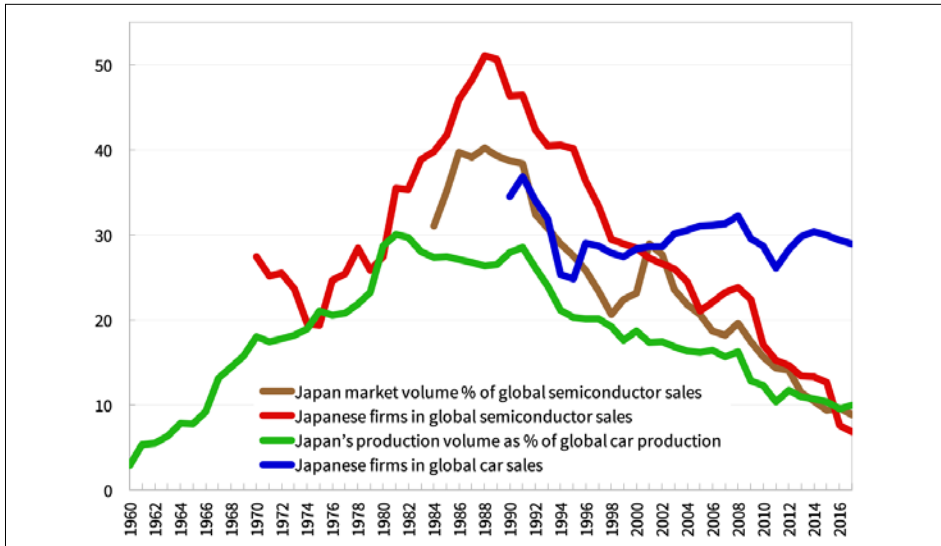
"Secular stagnation" (Summers 2016) can be understood as an "opportunity for re-connecting and re-balancing the relation between economy and ecology" (Klingholz, Slupina 2017, 7). Trends towards digitalisation, decentralisation, networking and resource sharing can be seen as facilitators of investing into a socially and ecologically sustainable system and into problem solutions. To utilise this potential is essential to get out of the stalemate caused by the neoliberal redistribution of income and wealth and the outdated pursuit of growth. Large corporations and the competi-

capital to flow into less organised sectors, finally reducing productivity, returns and even the national income. In the same way, lobbying of certain industries, firms and unions for special interest legislation (e.g. tax loopholes or subsidies) makes an economy as a whole less efficient (Olson 1986, 180-6).

<sup>19</sup> For the electric power industry in relation to the nuclear disaster of Fukushima in March 2011 see the third chapter of this book.

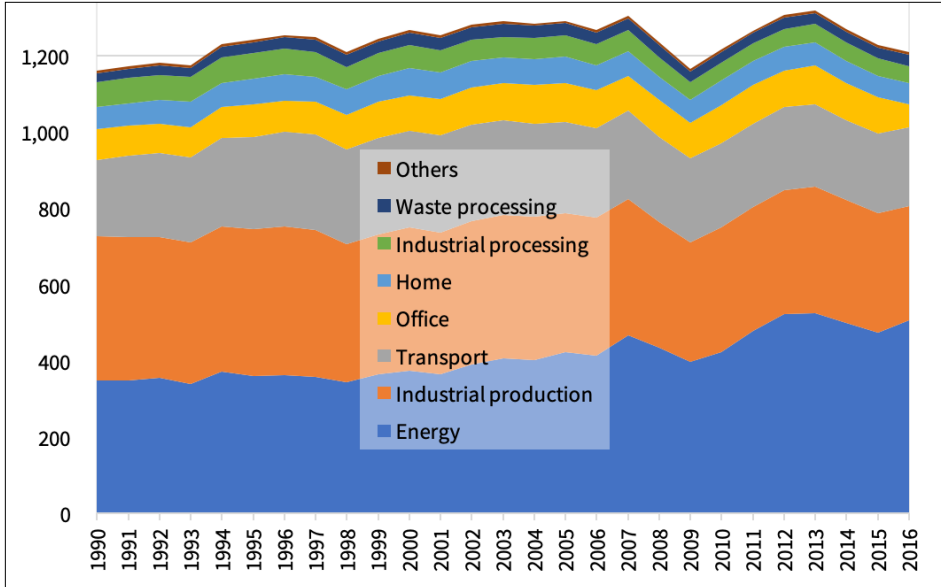


Chart 1.31 Global market shares of Japan or Japanese firms (%)



Source: Author, based on market reports (JAMA/FOURIN/Dataquest/IC Insight/iSuppli/WSTS)

Chart 1.32 Trend of Japan's CO<sub>2</sub> emissions (CY, in million tons)



Source: Author, based on GIO 2018

tion among them do not automatically generate a fundamental correction; they must be forced into this path against their inherent tendencies towards exploitation, expansion, congruence and centralisation. But in today's Japan, such agency cannot be expected to come from the current macro-economic actors, neither the government, central bank or political parties nor corporate labour unions, mass media and academia. Political reform, providing the executive with legal rights to implement state control, is aimed at the opposite: a preventive protection of the privileged few against potential resistance and democratic intervention from the exploited many. Complementary constitutional reform (i.e. abolishing Article 9) is intended to make military conflict again a feasible political option, legitimising further militarisation and the building up of a domestic military-industrial complex.

It can be concluded that the current economic state of Japan is not a special case, neither due to a lack of structural congruence with a perceived global standard of a capital market centred economy (i.e. not consequently implementing the neoliberal recipes), nor due to faulty economic policy (i.e. not consequently implementing Keynesian policy measures). Japan is rather an early indicator of how economic policy, intended to implement change, fails to regain former growth. Large corporations, in the defence of their traditional business model of mass production, improve profitability mainly by reducing their cost of labour and procurement and by strengthening the financial quality of their balance sheets instead of fueling retained profits into domestic capital expenditure as well as product and process innovation. This is the outcome of a system, where large corporations, managerial and bureaucratic elites, core workforces, big shareholders, factions of ruling parties and central unions utilise state and markets for their interest at the expense of the majority of workers, consumers and citizens (Crouch 2011, IX).