

Japan's Structural Reform – What is it Really All About?

Part 1 Changing the Structure of Ownership

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In connection with the Koizumi Cabinet's structural reform, a wide variety of opinions are starting to appear. Due to the initial overwhelming popularity of Prime Minister Koizumi, there were few people who differed with his slogan "economic recovery is impossible without structural reform," but in response to the continuing economic recession and the turmoil in political circles, we are seeing increasing criticism and calls for changes of policy. Voices of disappointment are even starting to be expressed overseas, but what this structural reform was initially trying to achieve is quite difficult to understand due to the political disputes. In this paper I will examine the true purpose of Japan's structural reform from the perspective of changing the structure of ownership, and the impact that it has on the economy and the real estate market.

To begin with, the basis of structural reform is that the distribution of capital in the Japanese economy, i.e. the structure of ownership of capital, no longer meets the needs of the times, and is becoming a barrier to the efficiency of the economy. Systems which were well-suited to the period of rapid economic growth after World War II are no longer efficient today in Japan which has become an economic superpower and the world's largest creditor country. Frankly speaking, money, the blood flow of the economy, is mal-distributed and retained inappropriately. However, the structural reform that appears in the newspapers is about expressways and post offices, so there is a tendency for the public to misunderstand that these are problems of budget allocations and administrative systems. This results in an extreme lowering of the image of structural reform, and results in one-sided opinions such as "rather than doing that, we want to see measures to boost the economy." This being despite the need for short-term economic measures and medium to long-term structural reform to be discussed separately. Whether it be expressways or post offices, the problem is the need for structural reform in the ownership of capital, i.e. money, and in this regard the statement that "no steady economic growth is impossible without structural reform" is correct.

Let's take a look then, at how the flow of capital, the blood flow of the economy is mal-distributed and retained inappropriately. The situations today (2000) and before Japan became the largest creditor country (1981) are shown below.

(Unit: trillion yen, excl. TOPIX)

	1981		2000		Increase
Nominal GDP	261	(calendar yr)	512	(calendar yr)	196%
TOPIX	564	(fiscal yr)	1,442	(fiscal yr)	256%
Bank loans	179	(calendar yr)	464	(calendar yr)	259%
Bank deposits	169	(calendar yr)	482	(calendar yr)	286%
Postal savings	70	(fiscal yr)	250	(fiscal yr)	360%
Postal life insurance	15	(end of fiscal yr)	121	(end of fiscal yr)	783%
Employees' pension	32	(end of fiscal yr)	132	(end of fiscal yr)	414%
Treasury investment & loans	194	(end of fiscal yr)	440	(end of fiscal yr)	227%
Govt. debts	107	(end of fiscal yr)	537	(end of fiscal yr)	503%

The following observations can be made from this table:

- 1) Bank lending has increased at a rate much higher than that of GDP, and if the amount of what is commonly referred to as bad debts is deducted from this figure, it roughly corresponds to the growth in nominal GDP.
- 2) Lending is financed by bank deposits. This is in turn supported by the Japanese people's love of saving, at that, the disproportionate importance that is placed on savings.
- 3) The capital from the postal savings which have exhibited explosive growth, through the system called treasury investment and loans which was created to efficiently redistribute that once scarce domestic capital, has flowed through to public investment which may be described as excessive for the Japanese economy whose weight has moved from manufacturing to service industries. This has ultimately led to a drop in the efficiency of capital.
- 4) The symbol of economic inefficiency in the form of the massive blowout of government debt is backed by the disproportionate emphasis placed on bank deposits, and the sudden expansion in government-affiliated finance (postal savings, postal insurance and employees' pensions).
- 5) A massive one-third of Japan's financial assets of households of 1400 trillion yen is left to public management.

What does it mean that the structure of ownership of capital is "places excessive performance on deposits" and "there is an excessive rate of public operation." Looking back in history, it is a fact that Japan achieved high economic growth by using the Deposit Encouragement Policy to gather the limited amount of capital within Japan for the development of industry efficiently and at low cost, and by using cross shareholding to lower equity cost, and the Main Bank Scheme and Financial Investment and Loan Scheme to distribute capital in line with policy. However, as a result of Japan's becoming a creditor nation, this system has resulted in having more downsides than benefits. In fact, the reform in the structure of ownership which is currently being advocated is something that should have been carried out in the 1980s, when Japan became the largest

creditor nation, and was continuing to generate a current account surplus, with the result that the yen was at twice its current value. In this sense, before the lost decade of the 1990s, there was another lost decade that was hidden, and occurred during the 80s. The cause of the delay in this structural reform is actually this disproportionate emphasis on savings and excessive percentage of assets in public management.

Then, how is this problem of structure of ownership of capital in this mal-distribution and retention of capital connected with the problem of reform in ownership of the country's two greatest assets, shares and real estate?

- 1) The problem of cross-shareholding, a major problem in terms of supply and demand of stocks, and caused by the main bank system which emphasizes indirect financing
- 2) Preservation of unprofitable operations and lowering of ROE due to the suppression of the cost of capital which may be described as artificial
- 3) Banks' excessive real estate lending during the 1980s and bad debt problems
- 4) The disproportionate emphasis on collateral caused by indirect financing, and the resultant lowering of ROA and inclination of companies to own real estate

These large problems which are evident in the Japanese economy today are directly linked to the problems in the structure of ownership of stocks and real estate, and the structure of ownership of capital and the structure of ownership of stocks and real estate are two faces of a coin, and whether or not the Japanese economy can restore its capability for growth and efficiency depends on reform in the structure of ownership. This shift in the structure of ownership is in this sense the driving force for the creation of anomalies from market inefficiencies, and also creates an equity scenario that provides the potential for medium to long-term growth.