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The end of Japan as we know it

By Chan Akya

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A few weeks ago, my Asia Times Online colleague Spengler (channeled by David P Goldman) wrote a missive on the eve of the US elections entitled "[Barack Obama and America's Decline](#)" (Asia Times Online, November 6, 2012), which included a plaintive plea for voters to cast their ballots on issues over and above their narrow personal interests. Predictably, my cynical response to him was on the lines of "why would turkeys vote FOR Thanksgiving?"; this being a family publication I shall not delve on his response to that missive.

As it turned out, the turkeys did vote against thanksgiving, and Obama is back in the White House to give Keynesian policies another shot. Specifically, the arguments that will be aired in the next few weeks and months will echo those of Professor Paul Krugman, who has himself filched a lot of ideas from the work of Professor Richard Koo and his book, the very modestly titled *The Holy Grail of Macroeconomics* which I have reviewed in this column many moons ago. (See [We are all Japanese now](#), Asia Times Online, September 5, 2009.)

The central thesis of the book is that Japan failed to enact appropriate monetary and fiscal easing to counter the collapse in leverage engendered in the household and corporate sectors after the collapse of the economy in the late eighties and early nineties. Since the late '90s though, Japan's government has run a series of deficits while the central bank has kept interest rates at below zero through the liberal use of quantitative easing measures.

In fits and starts, the strategy has allowed Japan to remain afloat; however as the most recent trade deficit numbers make clear last week (a horrifying collapse in exports) and the travails of

electronics giants Sony and Panasonic (both downgraded to junk credit rating last week by the Fitch agency), the path is nowhere near smooth; and indeed results appear to run counter to the best intentions of both Koo and by extension, Krugman.

At many levels, I have a deep admiration for the Japanese people; their work ethic, aesthetic values and personal discipline all set them apart from the globalized mainstream. Equally, a lot of people have called the death of Japan already; somehow the old lady didn't notice those obituaries and has continued to plod on despite all the deprivations that two decades of economic recession bring. A cat with the proverbial nine lives, in some ways.

Economics though is an unforgiving taskmaster, and eventually extracts change from the most obdurate societies. There are in particular a few specific factors that argue that the cat's nine lives are indeed up this time around.

Exacerbating the current situation in Japan is the collapse in the political system where, yet again, a coalition government is set to fail and new elections announced in December. Alternatively one could argue that political paralysis, much like in the case of the US and Europe's lame duck governments, is merely the populist rendition of a sclerotic economy. The reason for the linkage of course is that the Japan is the living (ahem, some may argue that point) embodiment of the situation where the turkeys not only outvoted thanksgiving, they also allocated all the gravy to themselves.

The Liberal Democratic Party (LDP) has done all the usual gimmicks - promises of more subsidies, the vaguely worded reforms and of course obligatory visits to the Yasukuni shrine designed to get geriatric Samurai warrior votes on its side; with the active support of the farming and construction lobbies it appears that the LDP is headed back to power albeit in a coalition framework.

We do not know yet how the incumbent Democratic Party of Japan is likely to fare, so convoluted are the fortunes of the party when examined against the popularity of its individual politicians. After trying various approaches, the party has now settled itself on the bandwagon of expanding the middle classes - presumably through more tax breaks and other ideas that run counter to the current orthodoxy around value-added taxes; however the party led by the outgoing prime minister has also embarked on a controversial policy to secure funding for grandiose construction projects with the issue of bonds to which it would like the Bank of Japan to directly subscribe.

At the other end of the spectrum, the right wing has become more active with the triumvirate of Shintaro Ishihara and Takeo Hiranuma's the Sunrise Party and Toru Hashimoto's Resurrection Party. All the politicians in the triumvirate have a somewhat unfortunate history of egging on xenophobic tendencies; the triumphalism of Ishihara in the late '80s with his call for Japan to become more assertive against the US; and the unfortunate racial stereotypes he espoused which brought to mind the propaganda of Goebbels have not been forgotten yet anywhere in Asia or the US.

Take stock for a moment: an ancient political party that seems hopelessly anachronistic, an incumbent political party that appears altogether confused, a right-wing organization that is built

on idolizing an extinct past; does anyone hear the faint echoes from the future of other democracies in Europe and perhaps the US?

The economy as a cause ... and effect

I asserted earlier that the political sclerosis of Japan was a result of its economic mortification, a view that is against the conventional wisdom, which reverses the cause-effect relationship. My thinking is quite simply that Japan has reached an economic point of no-return; this will be now played out politically to provide a dignified burial of the country's ambitions.

There are multiple elements of Japan's economic orthodoxy that are all coming unstuck at about the same time; some by design and others decidedly not.

First is the country's position on top of the global supply chains of the most complex products imaginable - electronics and automobiles. In the old days, electronic products relied on bulky components for assembly, be they cathode-ray tubes (CRTs) in televisions or drive units in tape recorders and belt drives in high-end CD players. These components necessarily had to be made by patent holders, with shipping costs and import levies becoming important barriers to entry.

Along the way though, in a quest for efficiency, Japanese manufacturers moved a number of their key components and in particular the vexing business of manufacturing liquid crystal displays offshore to China and elsewhere. They designed micro components - circuit boards and memory chips - that worked with these screens to produce a range of electronics products that powered the post-CRT world.

However, the difference in technology platforms allowed other entrants, most notably the Koreans, to exploit their own pricing advantages in lower-end products such as mobile phones and bring those to bear in higher-end products.

Then there is the business with cars, wherein a number of product recalls and component disruptions have meant that factories in Japan lost their advantages in production and quality against lower-tier manufacturers even as they failed to move ahead in the design stakes in terms of new technologies including hybrids.

It is somewhat telling that the most interesting fuel-efficient car to hit the production lines this year was the Tesla-S model out of California, rather than a new iteration of the Prius or Leaf models that pioneered the hybrid / plug-in categories.

The supply chain itself has become hugely complicated for Japanese manufacturers, as last year's floods in Thailand showed. This year, a number of Japanese factories in China had to shut down after the incident involving islands disputed by Japan and China. Add in the disruptions from the Fukushima tsunami last year, and we are talking an inexorable shift in manufacture away from Japan.

The second aspect is power generation and sources, an area where Japan's peculiar geography seems set to punish the country against its competitors. At the one end, the US is in the middle of

a shale gas revolution that may turn energy math into the positive side of the current account equation for the country over the next decade or so (health warning: I do not yet subscribe to the shale story with the same degree of enthusiasm espoused by America's oil lobby). The focus on renewables as a source of energy has therefore diminished at least over the near-term. This makes technologically intensive products such as those involving wind and solar power commercially unviable as investment sources over the next few months and years.

The blows to technology to one side, it is also a legacy of Fukushima that Japan eschews the one source of plentiful power that may have turned the tables to its advantage. Without nuclear power and with no oil around its borders, Japan faces a long and dark road on its energy front, with every step promising to bring the country closer to an economically unviable future.

That is where the third aspect of Japan's economy really hurts. Confronted with a rapid decline in economic relevance over two decades ago, Japan chose the path of least social resistance; an echo of Dumas' "one for all, all for one" philosophy wherein real-wage deflation took the place of workforce cuts. That slow death, though, was simply insufficient to force the issue of competitiveness; it merely bought time from an inevitable fate that the political grandees refused to prepare the country for adequately.

Conclusion

Inflection points are hard things to call, particularly in the case of Japan where the patient has been declared dead many times over the past few years. Even so, recent events, ranging from the declining fortunes of electronics majors to the uncertain policies around power consumption and generation, may well mean that Japan is on its last stretch as a major global economy.