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Enforce Japan's anti-discrimination laws How to raise wages

During last year's Lower House election campaign, Prime Minister Shinzo Abe said that, while he had heard a lot of criticisms of Abenomics, he had not heard any proposals that would offer improvement. He's got a point. So, we take him up on the challenge in regard to raising real wages.

Abe has tried, and failed, to get firms to raise wages in any substantial manner for the typical Japanese worker. In fiscal 2014, even nominal base wages per worker (i.e., pay for scheduled hours of work) actually fell 0.4% (while total real wages fell 3.0%). So far, in fiscal 2015, nominal base pay per worker is up only 0.4% and real wages are down 0.7%. Firms don't raise wages just because some politician asks them to.

So, what could Abe do that would have real impact? The answer is surprisingly simple: enforce Japan's existing labor laws against discrimination in wages and promotion. In cases where court decisions have neutered those laws, he should push workarounds through the Diet.

The 2008 Part-Time Workers Act requires that firms pay regular workers and part-timers the same wage if they are doing the same job. Part-timers amount to about two-thirds of all non-regular workers, and therefore about 25% of all non-managerial employees. Yet, non-regulars are typically paid 40% less per hour and, contrary to the law, are not paid bonuses.

As for women, nearly half of all non-managerial employees, the Labor Standards Act states: "An employer shall not engage in discriminatory treatment of a woman as compared with a man with respect to wages by reason of the worker being a woman." The Equal Employment Opportunity Law (EEOC) forbids discriminating against women on matters of promotion, or even using criteria that appear to be gender-neutral but result in discrimination. Assorted laws also forbid "maternity harassment," whereby some women who get pregnant are pressured to leave their job or accept a demotion. Despite these laws, women get the short end of the stick in regard to pay and promotion and many suffer from maternity harassment.

Laws would be fine if they were enforced

The hitch is that the law is mostly honored only in the breach:

- The firm faces no penalties even when a court says it has violated the law, and officials treat the law as guidance rather than as mandatory, even when the words in the law would seem to clearly state that the edict is mandatory;
- Unlike in the US, Japan has no government agency with a mandate to investigate violations and bring violators to court. The bur-

den is put on the victims, including the financial burden of hiring lawyers, vulnerability to retaliation from employers, and years in litigation. Even when victims win, the courts do not necessarily treat the decision as a legally binding precedent. Class-action lawsuits are not available in labor cases.

- In regard to non-regular workers, court decisions have almost always sided with the employer. A labor lawyer who always represents employers told us that judges almost always allow minor and meaningless distinctions to be used to claim that the same job is not really the same job, and therefore non-regulars are not entitled to equal pay. I have personally seen workers at a semiconductor assembly line standing side-by-side doing the same work, with the regulars wearing one uniform and the non-regulars another uniform. The non-regulars were paid less. The lawyer said that, in such a case, the employer would add some obligation, e.g., for overtime, for the regular worker, so it could claim it was not

equal work. After employees won one court case, the companies asked the lawyer how to tweak the job so as to nullify the verdict.

Why does no government agency investigate violations and enforce the law itself just like the Financial Service Agency inspects banks? The lawyer said that, for some reason, there are issues where the government is proactive and other issues where it is not. The labor law is one of the latter. Even when, in response to complaints, a government agency finds that a firm has violated the law, it is given an administrative order to rectify its practice but is not penalized. I asked: doesn't that mean there is therefore no deterrent? That, he replied, is often "the Japanese way of doing things." I thought, but did not say, that perhaps vis-à-vis labor issues, it is the Japanese way of *not* doing things.

Abe defeats attempt at equal pay

Far from raising wages by enforcing existing laws or tightening up laws to correct court interpretations, Abe's party actively watered down an "equal pay for equal work" bill in June.

Abe has proposed a law that would enable greater use of temporary workers sent to firms by dispatching agencies. Dispatched workers are not considered legal employees of the firm where they work and therefore are not eligible even for the unenforced equal pay laws. The opposition Democratic Party of Japan (DPJ) and the Japan Innovation Party (JIP) proposed an addition that would require firms to pay these dispatched workers the same wages as regular employees for equal work. However, reports the *Japan Times*, the equal pay bill "was effectively watered down after the JIP reached a



deal with the ruling camp. The JIP, the Liberal Democratic Party (LDP) and... Komeito changed the wording in the section of the bill that calls for what the sponsors call the principle of 'equal job, equal pay' and made it more ambiguous."

So, given the chance to do something that would be truly effective in raising wages, the Abe team took the opposite tack and actively defeated the effort.

Unequal pay for equal work

Increasing employer flexibility to upsize and downsize their payrolls was the official reason for allowing non-regular workers to grow to 37% of all non-managerial employees. That by itself would be a necessary reform. In reality, a 2006 government survey reported that 71% of firms said they hired part-time workers mainly to reduce labor costs. 58% of firms pointed to cutting wage costs as the prime reason for hiring temporaries and dispatch workers.

And cut wages is exactly what firms do. In 2012, according to the Ministry of Labor, Health and Welfare (MLHW), the average hourly wage for regular employees was ¥1,804, but that of part-time workers was 40% less at just ¥1,026.

In 2014, the typical 20-24 year-old non-regular worker with a high school diploma was paid 25% less per month than his regular counterpart of the same age and education. Wages typically rise with age and peak in the 50-54 age group. By that age, the non-

regular worker with a high school diploma was earning just ¥216,000 (\$1,800) per month, less than half as much as a regular employee (¥451,000 or \$3,760). At no point in his/her career will a non-regular worker make even as much as a 20-24 year-old regular worker (see top chart).

According to Keio Professor Kotaro Tsuru, in a report for METI's Research Institute of Economy Trade and Industry (RIETI), 30% of part-timers have worked for the same firm for more than ten years, but are still paid less. Moreover, adds Tsuru: approximately 30%-40% of the wage gap between part-time and full-time workers cannot be explained by worker attributes and other justifiable factors; discriminatory factors continue to exist.

Imagine the increase in real wages if the

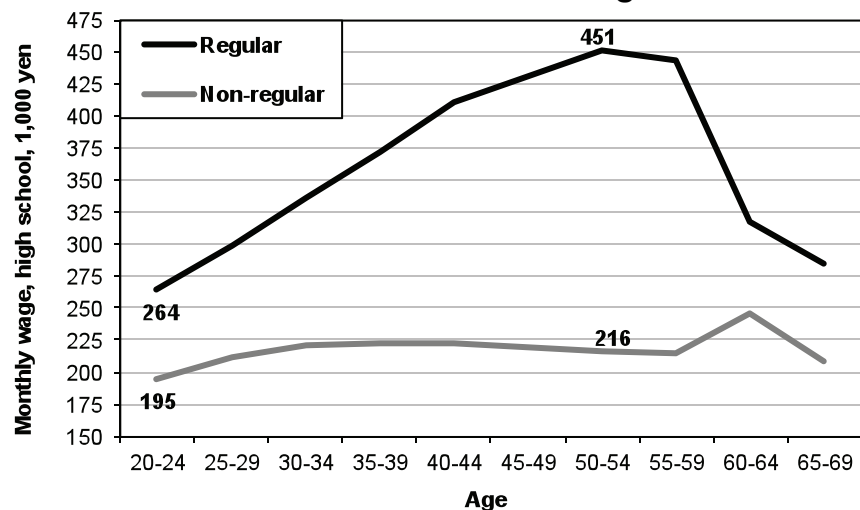
Abe administration simply enforced the laws against pay discrimination. But the firms whose support he needs would not like this.

Discrimination against women

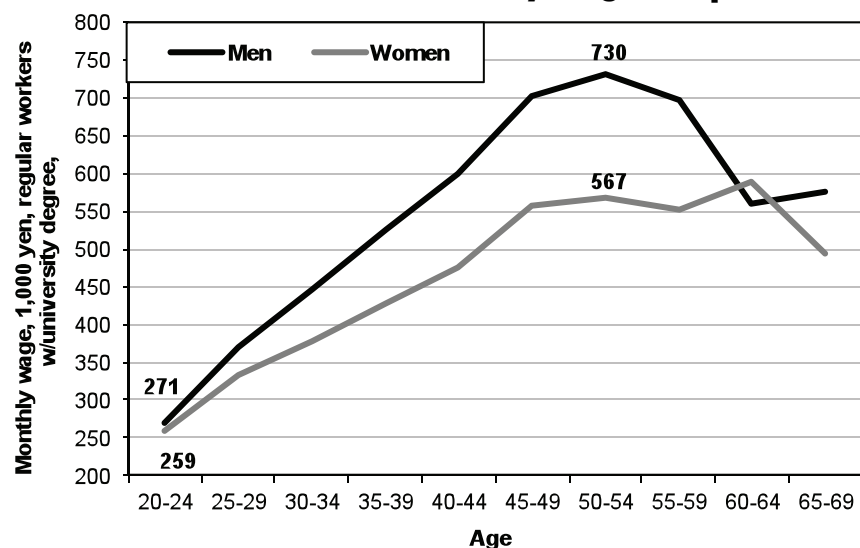
Women face double-discrimination: as non-regulars and as women. 57% of women employees are non-regulars, compared to 21% of men. As a result, women comprise 68% of all non-regulars. So, naturally, the majority of women workers get lower wages, even when doing the same job.

But even full-time regular female workers are typically paid less than their male counterparts. According to the International Labor Organization: the average salary level for women in Japan in 2008 was 68% that of men. That compares to 80% in the U.S. in 2008, 80% in Britain in 2006 and 88% in

Even with same education, non-regulars do worse



Even women with university degrees paid less



Source: Ministry of Labor, Health and Welfare, 2014 data

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REPORT

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France in 2006.

Undoubtedly, some of the wage differential is due to differences in educational attainment and skill levels. However, if we compare the salaries of full-time regular workers with university degrees among men and women, we still see a huge differential (see bottom chart on pg. 2). Men and women start off at around the same pay at age 20-24. By the time the university-educated male becomes 50-54, his pay has almost tripled to ¥730,000 (\$6,083). By contrast, a woman's income has only doubled to ¥567,000 (\$4,725). The result? Her wage is 22% below that of her male colleague.

The Rice Paper Ceiling

We suspected much of this pay difference resulted from men and women being tracked into different occupations. We were wrong.

The MLHW tracks wages in 134 occupations with 7 million workers. We divided them into three groups: male-dominated (women less than 10% of workers), female-dominated (women more than 20% of workers) and those in the middle. It turns out that the median monthly income for women (not counting bonuses) is around ¥200,000 (\$1,666), regardless of which of the three groups they are in. Males earn more in the male-dominated and medium occupations, about ¥309,000 (\$2,575) per month, but less in the female-dominated occupations, about ¥252,000 (\$2,100) per month (see top figure). So, women get lower wages even when they are in the same occupation as men.

Here's why. In reaction to the 1986 promulgation of the Equal Employment Opportunity Law (EEOL), which forbid discrimination between men and women, firms created two separate tracks: *ippan shoku* (clerical or general track) dominated by women and *sogo shoku* (managerial track) dominated by men. Not all those on the managerial track get to become managers—since only 14% of all employees aged 50-64 are managers—but they do have the opportunity to compete for those slots.

Moreover, those on the managerial track enjoy far bigger wage hikes as the years go by, even if they never rise to the position of manager. At age 45, a person on the management track will earn nearly 2.5 times as much as his counterpart on the general track (see bottom figure).

Due to the widespread complaints tracking provoked, the Diet revised the EEOL in 2006-07 to supposedly eliminate

such indirect methods of discrimination. But, as of 2011—four years after the revision of the law—about half of firms with at least 1,000 employees still acknowledged using this two-track system. At those firms, women comprised less than 6% of those on the management track.

As of 2012, only 11% of assistant managers at firms were women, up from 5% twenty years earlier. In 2009, only 5% were section managers, up from 2% twenty years earlier. And a tiny 3% were general managers, up from 1% twenty years earlier. Japan's performance on this scale is far below that of other countries, e.g., France at 39% and the US at 43%.

Abe's law to promote women

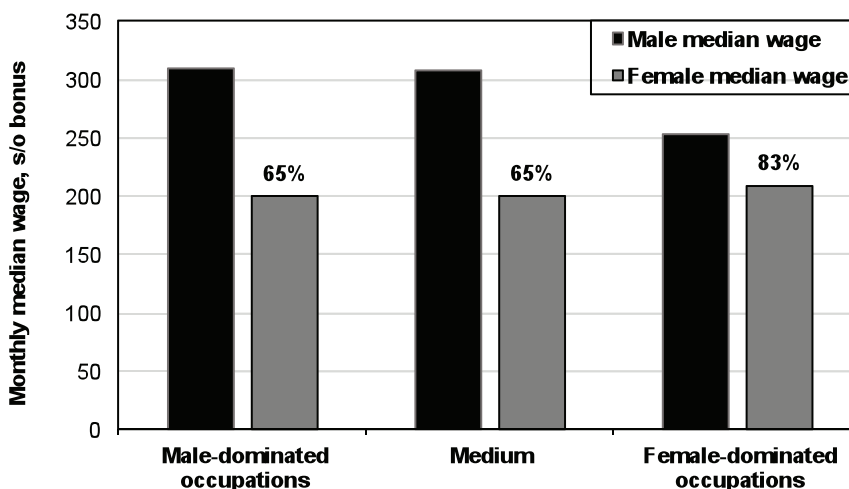
The Abe administration has touted “wome-

nomics.” But, once again, the Prime Minister has enunciated a nice-sounding goal with no strategy to turn that goal into reality.

Abe boasts that, under his tenure, more women are working. True enough. But that's nothing new. The percentage of women joining the labor force has been steadily increasing for decades: from 54% in 1972 to 74% now (see figure on pg. 4). Most of the increase, however, has been in non-regular jobs. Whereas 32% of women workers had non-regular jobs in 1988, now it's 57%.

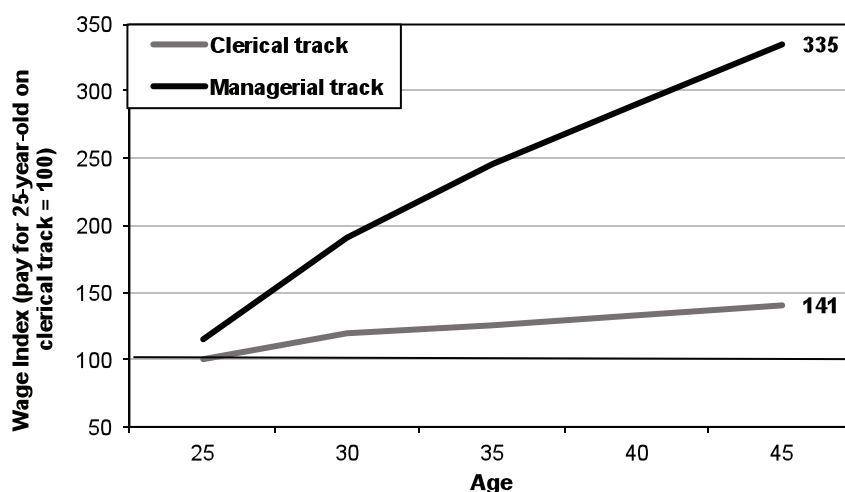
Nor is Abe the first Prime Minister to claim he is promoting gender equality. As scholar Joyce Gelb documented in her chapter of a new book called *The SAGE Handbook of Modern Japanese Studies*, back in 1994, a Headquarters for the Promotion of Gender Equality was set up

Women's paid less in same occupation as men



Source: MHLW Note: Percentage number is the median women's wage as a percentage of the median male wage

Two-track system evades anti-discrimination law



Source: International Labor Organization Note: See text for explanation

within the Cabinet, with the Prime Minister at the head. Two years later, the government declared it would “achieve a 20% participation rate [of women in policy-making]...before the end of fiscal 2000.” Two decades later, women occupy a mere 1.7% of senior government management positions.

Abe’s single concrete initiative is a law just passed by the Diet in late August that is aimed at promoting more women to managerial roles. Firms with more than 300 employees and large public sector employers are required to set and publicize targets for women’s share of management slots. Smaller firms are “urged” to set targets.

Abe has said that women should comprise 30% of company managers, up from 11% today, by 2020, just five years from now. Even under the best conditions, Japan is not going to have that big a change in that short a time.

We have no reason to doubt Abe’s sincerity regarding equal opportunities for women. He has gotten Ministries to hire more women and put them on the elite career track (*sogo shoku*) that can lead to top positions. The Ministry of Economy, Trade and Industry (METI) hired 22 women for the elite track this year, 30% of all new elite track hires. What we doubt is his willingness to spend his limited capital to fight with business about this. He has not picked fights on other matters of economic reform.

While Abe has called for a 30% target, his law does not set this target or any other target. Rather, firms are required to set their own target, as well as their plan to achieve it, and to make their goals and plans public. There appears to be no requirement that they publish their progress in achieving, or failing to achieve, their goal. The government says that it will give preference in public procurement to firms that make “substantial efforts.” Depending on how many firms sell to the government, it would seem that this would be helpful it is strongly enforced.

Mari Miura, a professor of gender and politics at Sophia University, told the Japan Times: “The law may be a little step, but quite an important one.” She contended that the required disclosure of plans meant failure could damage a company’s public image. But Joyce Gelb, author of *Gender Politics in Japan and the US* (2003), commented to us that this approach had been used in the past and failed, e.g., 1986 EEOL, which called on firms to “endeavor” to promote equality. She

doubted Abe’s new law would do any better.

One woman, currently an executive at a small firm she helped found, told us that she was asked by a giant firm to work for it so that it could increase the number of women managers. “I haven’t decided yet,” she told us. “I think it would start as just a symbolic job without real power. But, after five years, as firms get used to women managers, I think it could turn into something real.”

Maternity harassment

While the new law urges firms to change their behavior, it does nothing to address the lack of enforcement of existing laws. Nor does the law address one of the biggest obstacles to female advancement on the promotion ladder. During 1985-2009, about 60% of women left the workforce after giving birth to their first child due to a shortage of day care and lack of support for men taking child-care leave, among other issues. When these women try to return to work, they find it hard to get back onto the managerial track, even if they were on it earlier. Many can only get non-regular jobs.

Nor does the new law, or any other action by Abe, address “maternity harassment” (*matahara*), even though the EEOL prohibits it. Many women face dismissal and/or demotion upon becoming pregnant or after having a child. In fact, reports Gelb, “According to 2006 data, 90.8% of disputes related to retirement and dismissal under the EEOL [the Equal Employment Opportunity Law that purports to promote women’s equality in the workplace] pertained to pregnancy and childbirth.”

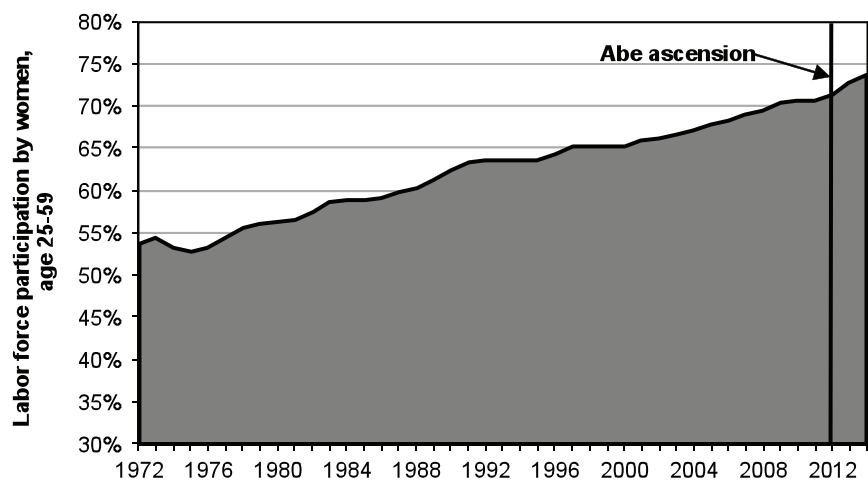
Sayaka Osakabe, a non-regular contract worker on the editorial staff of a magazine, took her case to court, and finally won in 2014. After a first miscarriage, she asked her boss for help to cut back her workload. He replied that she should “put off pregnancy for two to three years and focus on work.” While she was taking bed rest during her second pregnancy, her boss visited her at home and encouraged her to resign, saying her absence “caused trouble.” Determined to stay, she returned to work, only to suffer another miscarriage. According to Osakabe, it was after her second recovery that her boss asked whether she and her husband were having sex. “My boss told me to come over, and asked if I was menstruating again and if we re-started baby-making.”

Finally, in 2014, the Supreme Court overturned a lower court ruling in another maternity harassment case and ruled that forced demotion did violate the EEOL. But the long overdue ruling does not change the fact that each victim still has to pursue her own litigation.

Abe’s Womenomics

Even if Abe’s law was fully effective, it would help few women. Only 30% of employees work at the large companies affected by the law. Only 14% of all employees aged 50-64 are managers. 14% of 30% equals 6%. What about the other 94%? Osakabe comment, “Rather than focusing on a small portion of elite women who are top managers, I’d like them to start by dealing with problems affecting women like us at the bottom.” (RK)

Rising female labor participation is nothing new



Source: Statistics Bureau

TOKYO INSIDELINE

by Takao Toshikawa

PRC financial typhoon creates worries for Abe

For now, Abe polls bounce

The Shinzo Abe government has tried to maintain its political momentum by inducing high share prices on the Tokyo Stock Exchange, which has become increasingly derided as a government-controlled market. However, Japan's stock market has been struck by a major typhoon originating in China (see interview on pg. 12).

There must be some very pale faces in the Kantei (Prime Minister's Office), as they face the prospect of plunging share prices in Japan triggering an even bigger drop in the already declining Cabinet support rate. On August 24, as world markets grew chaotic, Abe administration leaders were eager to erase anxiety. At his regular press conference, Chief Cabinet Secretary Yoshihide Suga merely read the statement prepared by his staff: "Corporate performance is at the highest level ever. The Japanese economy is in a gentle recovery."

Although the terseness was intended not to create anxiety, it actually exposed the Kantei's worries. At a press conference the following day, Suga said, "We will take necessary measures in cooperation with the Group of Seven countries," indicating a willingness to consider stimulus measures.

In the Upper House Budget Committee on the 24th, Minister for Economic and Fiscal Policy Akira Amari said, "The Chinese economy will calm down," dismissing the prospect of a further decline. On the 25th, when the People's Bank of China announced additional monetary stimulus, the Japanese stock market bounced back for a while, but then returned to volatility. At a press conference on the night of the 24th, Liberal Democratic Party (LDP) Secretary General Sadakazu Tanigaki, a former Finance Minister, said, "The economy is greatly affected by human psychology. Anxiety is becoming widespread. I think we need to take steps to keep it from spreading further." He thus raised a call for stimulus.

Worries about GPIF

Many institutional investors are saying that

the ¥130 trillion (\$1.1 trillion) Government Pension Investment Fund (GPIF), which invests more than 20% of its portfolio in domestic stocks, could suffer a similar loss. Prices have risen on the Tokyo Stock Exchange in part because GPIF has propped them up. Deputy Chief Cabinet Secretary Hiroshige Seko declared, "Maintaining share prices is the Abe government's lifeline" and removed professional stockbrokers from management of the GPIF portfolio. In January, the government appointed former private equity executive Hiromichi Mizuno of the London-based private-equity firm Collier Capital to the newly-created post of Chief Investment Officer at GPIF.

During the April-to-June quarter of this year, GPIF made more than ¥2.6 trillion (\$22 billion) in investment profits. There is no doubt, however, that the 10% fall in share prices since July 1 has generated a significant loss on paper. If GPIF takes a large loss, it will sound to the public like "my pension will decrease." The Abe Kantei won't be able to just stay calm and act as if this were just a "fire on the other side of the river."

Abe approval rate recovers for now

The Abe Cabinet's support rate has been falling, but some believe it has hit bottom. According to an opinion poll taken by the *Nikkei* on August 29-30, Abe's support rate rose by 8 points from July to 46%, while non-support fell by 10 points to 40%. The Prime Minister's statement on the 70th anniversary of the end of World War II, which included the words "sorry" and "invasion," was well-received (see pg. 7), and contributed to the bounce. In the *Nikkei* poll, 42% of respondents approved and 33% disapproved. Still, the 46% approval rate is second only to July's result as the lowest since Abe returned to power.

No one contests Abe LDP reelection

The campaign period for the LDP presidency election begins on September 8, with voting on the 20th. In the last issue, I reported

that former LDP General Council Chairwoman Seiko Noda desired to run. She is now recognizing that it could be difficult to collect the endorsement of 20 Diet members required to become a candidate. Minister of Vitalizing Local Economies, Shigeru Ishiba, who had urged Noda to run, has also dropped out. So, Abe's reelection to a third term seems certain, possibly without a vote. All seven factions of the LDP are now supporting Abe's reelection. His second three-year term ends in September 2018; LDP rules do not allow a third term.

Former LDP Secretary General Makoto Koga, who hoped to unite Abe's opponents, was backing Noda. Koga put his hopes of securing supporters on the 34-member Shisuikai faction led by General Council Chairman Toshiro Nikai. Like Koga, Nikai is part of the LDP's "neo-China dove" group. Early on, however, Nikai announced his support for Abe's third election.

An Abe associate appraises Nikai, who has been telling his own party network, "I'm not aiming to be Prime Minister," as "a man who won't need to be put out of the way." In October 2007, Nikai visited Abe in the depths of the latter's despair after resigning the premiership. He brought Abe a baseball signed by Nikai's friend, world home run king Sadaharu Oh (currently Chairman of the Fukuoka SoftBank Hawks). Abe will not forget Nikai's kindness during his time of misfortune. Abe and Nikai have an emotional bond now. Like Nikai, Secretary General Tanigaki has also moved to support Abe's uncontested reelection. The 45-member faction, led by Foreign Minister Fumio Kishida, announced its support for Abe on August 27.

Noda's miscalculations encouraged Ishiba to consider running, but he lacks backbone. No doubt it occurred to him that if he were to raise the flag of rebellion in the presidency election and be utterly defeated, it would spell the effective end of his political career. Under the old multiple-seat district Lower House election system, LDP factions were "parties within the party," and it was natural for different factions to run candidates for the party presidency. Under today's single-member district system though, power concentrates in the hands of a party's President and Secretary General, who control official party election endorsements. Raising the flag of rebellion can lead to being cast out as a traitor. It would take more than one hand to count those who disappeared from politics after being failed

rebels. The debate over the legislation that would permit the exercise of the right to collective self-defense has lowered Abe's support rate with the public, but no one within the LDP is willing to challenge his reelection on those grounds. His position as "sole power" in the LDP is unshaken.

Health rumors

Recently, Abe's uncertain health has become a topic of rumors. He has long suffered from chronic ulcerative colitis. Weekly magazines, never the most reliable of sources, have been in an uproar over purported signs of a change in his condition. They tell the following stories: On a visit to an art museum in Ueno, Tokyo, Abe became ill and rushed straight back to the Kantei without stopping, instructing all traffic lights to be turned green along the way. While on his way to Hiroshima to attend the Atomic Bomb Victims Memorial ceremony and the Peace Memorial ceremony, he felt sick on his plane and, upon landing, went straight to his hotel for a rest before attending the ceremonies. Finally, at a meal with economic leaders at a hotel at Tokyo Station, he felt unwell and began coughing up blood in the restroom, and his doctor was rushed to his side by police car. To top it all off, an LDP executive said that in order to pass the security-related legislation, there is no choice but for Abe to stick out his neck. And that adds to Abe's stress.

When asked about these reports, Abe ally, Deputy Chief Cabinet Secretary Seko, laughed it off, saying, "There is always negative campaigning before something like a party presidency election, or the endgame surrounding the security legislation."

Here is the real story resulting from our careful checking. While it is true that Abe felt ill on the way back from the art museum and went nonstop to the Kantei, everything else can indeed be seen as negative campaigning. An NHK executive told me that he was at Abe's side for two and a half hours on August 14 for the speech commemorating the 70th anniversary of the end of the war, the press conference afterwards, and an interview, and the Prime Minister never once had to leave to use the restroom. Chief Cabinet Secretary Suga is furious at the weeklies for their "recklessness."

China visit postponed

Abe's planned visit to China in early September has been postponed. National

Security Director Shotaro Yachi had been working on the matter behind the scenes, including a trip to Beijing.

The way the Kantei tells the story, it was the Abe side that decided to postpone. The desire to prioritize Upper House debate on the security legislation as it approaches its climax won out over an early Japan-China summit meeting. Inside the Foreign Ministry, there was much opposition to an early China trip by the Prime Minister. Vice Foreign Minister Akitaka Saiki and Administrative Senior Adviser to the Cabinet Secretary Nobukatsu Kanehara were the main figures in this opposition. The reason for the opposition is that, with China in the middle of landfilling in the Spratly Islands, the international community could view a meeting now with President Xi Jinping as Japan's de facto acceptance of China "changing the status quo by force."

However, there is some evidence that Abe may not have been able to get the invitation he wanted. In early August, Chinese Foreign Minister Wang Yi told state broadcaster, CCTV, that, "I've never heard of this matter of Abe visiting China in September. This matter is not on the agenda."

There is, however, talk of a trilateral summit in Seoul among Xi, Abe and South Korean President Park Geun-hye sometime in late October or early November.

Meanwhile, a surprise foreign policy initiative with North Korea now seems to be moving beneath the surface, via the "Mongolian factor" discussed in the previous issue. Abe's highly trusted Secretary to the Prime Minister (Political Affairs) Takaya Imai is the primary string-puller in this. A clear signal may emerge in late September.

Upper House to vote on CSD

The Upper House debate on the security legislation will climax in a vote in mid-September. Abe is determined to force a vote sometime between Sept. 11 and Sept. 16. Given his coalition's majority in the Upper House, he is unlikely to need the Constitution's "60-day rule." (If a bill is sent from the Lower House to the Upper House and no action has been taken within 60 days, it can be considered rejected. The Lower House can then pass the bill into law with a two-thirds majority vote, and the LDP has control of two-thirds in the Lower House.) September 14 will mark 60 days. If the 60-day rule is used, the Upper House will not have a chance to pass the legislation, and

once again there may be debate over the Upper House's usefulness and whether a unicameral legislature would be better.

Komeito Chief Representative Natsuo Yamaguchi said at an August press conference, "Reaching a decision within 60 days is what the Upper House should do." The LDP and Komeito both aim for a vote and passage in the Upper House plenary session on September 11. However, debate in the Upper House Special Committee on Peace and Security Legislation is taking longer than first expected, and so voting may occur after September 14. The debate in the Special Committee reached 57 hours as of August 25. In light of the fact that there were 116 hours of debate in the Lower House, many are saying that the Upper House needs to have at least 100 hours. It could reach 100 hours in mid-September.

Mass protests

Separate from the bargaining in the Diet, an opposition movement is flourishing outside the Diet. Reflecting the Internet society, university and high school students, scholars, the religious, the old, and the middle-aged are using email and social networks to organize themselves by occupation and generation in an opposition movement. Oddly, teachers and junior high and high school alumni at Abe's alma mater, Seikei Gakuen, have formed groups and raised the opposition flag. On August 30, a huge demonstration surrounded the Diet building. Sponsors said 120,000 people participated, while the police said it was 30,000. The pros and cons of the security legislation are points of debate in the Sept. 13 mayoral election in Yamagata City.

Cabinet reshuffle

Deputy Chief Cabinet Secretary Seko told me that a Cabinet reshuffle and the LDP leadership changes will occur in October. Core Cabinet Members Deputy Prime Minister/Finance Minister Taro Aso, Foreign Minister Kishida, Chief Cabinet Secretary Suga, and Minister of State for Economic and Fiscal Policy Amari will be retained. On the party side, Secretary General Tanigaki and General Council Chairman Nikai will also stay put. Unclear is the course that will be taken by Policy Research Council Chairwoman Tomomi Inada, considered a possible successor to Abe. Becoming the Cabinet as Minister of Economy, Trade and Industry is a strong possibility.

Abe opens door with statement on war

by Daniel Sneider

Daniel Sneider is Associate Director at the Shorenstein Asia-Pacific Research Center at Stanford University. This is excerpted with permission from APARC. For full text, and comments by others, see <http://tinyurl.com/ok5svra>

Prime Minister Shinzo Abe's August 14 statement should be judged against two criteria: whether it shows a genuine effort to reflect upon and draw lessons from Japan's wartime past; and whether it contributes to the improvement of ties in Northeast Asia and creates opportunities for reconciliation between Japan and China and Korea. The statement advances both goals, certainly beyond the worst expectations, though with some significant caveats.

Abe offers a long rendition of the events leading up to the war. He portrays Japan as responding to the challenges of Western imperialism, as a champion of liberation from colonial rule. He sees Japan emerging from World War I as part of the international system, only to fall victim to the Great Depression and Western protectionism, deepening its isolation and undermining its political system. Up to this point, Abe's version of events can be read as a justification for Japan's own imperialism (which he neglects to mention began in the late 1800s with the seizure of Taiwan) and a denial of historical responsibility. But he goes on to acknowledge Japan's own decisions that led to war: "With the Manchurian Incident, followed by the withdrawal from the League of Nations, Japan gradually transformed itself into a challenger to the new international order that the international community sought to establish after tremendous sacrifices. Japan took the wrong course and advanced along the road to war."

This version of history will not satisfy many people, including many historians, but it is a step away from the view held by Japanese revisionists, including Abe himself, that Japan waged a war of self-defense and not of aggression, or even more provocatively, that it was engaged in the noble cause of liberating Asia from colonial rule.

Willing to apologize, but only to an extent

The Prime Minister's statement goes on to express condolences, "deep remorse and heartfelt apology" and responsibility for the suffering that ensued as a result of Japan's decision to go to war. He uses the key words that were first uttered in the 50th anniversary statement of Prime Minister Tomiichi Murayama, acknowledging "aggression" as well as "colonial rule," though in both cases in a more indirect fashion than Murayama did.

The statement enumerates those who were Japan's victims—China, Southeast Asia, Taiwan, and Korea, the innocent victims as well as the soldiers from both Japan and their foes who fell on the battlefield. And he speaks of the "women behind the battlefields whose honor and dignity were severely injured," a reference to the so-called "comfort women" coercively recruited to work in the brothels serving the Imperial Army, though again his reference is indirect and without assignment of responsibility. He also pays homage to the expressions of toleration for Japan from former POWs and Chinese who gave a home to Japanese children left behind.

The Prime Minister stated more clearly than in the past that the previous statements issued by Prime Ministers Murayama and Junichiro Koizumi "will remain unshakeable into the future." But Abe expresses his long-held belief that apologies must come to an end, that future generations cannot be held accountable for the past. That is not a view universally shared—including by myself. And it is

already drawing the ire of people within and outside Japan.

But Abe did temper that insistence with this significant admonition: "Still, even so, we Japanese, across generations, must squarely face the history of the past. We have the responsibility to inherit the past, in all humbleness, and pass it on to the future."

In some ways, this reflection on the past is an internal dialogue between Abe as an individual, one who has long held revisionist views of the wartime past, and Abe as the Prime Minister. One can see him still struggling to justify Japan's wartime past as equivalent in some sense to the actions of other imperial powers of the time. But Prime Minister Abe has faced powerful reminders in recent months of the limits of his ability to impose his personal views on the nation.

Abe has been under growing pressure from conservative realists in Japan's establishment who warned against any attempt to deny Japan's past aggression, which they fear would worsen relations with its neighbors. Abe's failure to convince the nation of the need to shift its security policy, the tremors that are reaching Japan from a weakening Chinese economy, and the knowledge that its most powerful ally, the US, is urging repair of relations with the Republic of Korea all may have combined to help shape this statement.

The key signs of the internal debate came in the days before Abe's statement. The report of Abe's advisory panel on the history of the twentieth century was unyielding in its condemnation of Japan's aggression, without any of the justifications that Abe weakly attempted. It was followed by an August 7 editorial in the *Yomiuri Shimbun*, a bastion of conservatism, which began: "Prime Minister Shinzo Abe must send a clear message that Japan made a fresh start in the postwar period based on its reflection on the past misguided war." It called on Abe to repeat the key words of the previous statements and cited the example of Germany, "a nation that has squarely reflected on its Nazi-era past" and thus "gained the confidence of France and other nearby countries by using heartfelt expressions, even if they did not use direct words of apology."

Impact on relations in the region

Will this statement contribute to the easing of tensions over history issues between Japan and its Northeast Asian neighbors? Undoubtedly, the contents can be read as a glass half full or a glass half empty. And for Koreans in particular, for whom there are few gestures of contrition (interestingly, fewer than toward the Chinese), it will be tempting to focus on what is missing from this statement as more significant than what it contains. But that would be, in my view, both a strategic and tactical mistake.

Rather, there is reason to see this as the opening of a door, at least by avoiding a severe departure from past apologies in favor of a revisionist agenda. We may see the resumption of dialogue—the convening of a long-delayed trilateral summit of the leaders of China, South Korea, and Japan, perhaps this fall in Seoul, at which the Japanese and Korean leaders can meet separately for the first time in more than three years. Ideally, the two governments could seriously tackle key issues of compensation and apology for the "comfort women" and forced laborers, for which practical solutions are available and urgently needed before the victims pass on.

For progress to take hold, it is crucial that the inner Shinzo Abe remain restrained, that there be no further expressions of denial from senior members of his government and party and that Abe embrace the spirit of his statement in full. The doubts about Abe's sincerity will remain and anything that is done to fuel those doubts could again cause the situation to take a turn for the worse.

by Yoshisuke Iinuma

Hit the right notes, but can you hear any music?

Abe's careful speech

In a speech delivered 70 years after the end of World War II, Prime Minister Shinzo Abe signaled a return to a realist position. By reluctantly acknowledging past Japanese aggression, as well as expressing remorse and apologizing, however indirectly, he avoided falling further into political difficulties in Japan and abroad. Domestically, he needed to avoid further damage to the support rate for his cabinet, which had plummeted in the polls with the strong opposition to the passage of the government's security bills with inadequate debate. Internationally, and to meet US wishes, he also needed to refrain from saying anything that could create any unnecessary provocation, and invite criticism from China and South Korea, further exacerbating the tensions in Japan-China and Japan-South Korea relations. In his speech, Abe somehow managed to achieve these political goals.

However, his speech lacked the candor and sincerity of the one given by Prime Minister Tomiichi Murayama on the 50th anniversary of the end of the war. At the annual memorial service for the dead on August 15, the day after Abe's speech, Emperor Akihito went further than his customary remarks, by expressing "deep remorse over the last war," and adding that he extolled "the ceaseless efforts made by the people of Japan...backed by their earnest desire for continuation of peace." Many felt that the intention of the Emperor, in words he perhaps added himself to the Emperor's Message—usually a formal speech written by officials with a fixed wording—was to address the precarious political situation brought on by the international tension over history issues and the debate over the security bills. These remarks felt different in moral power from Abe's speech.

Japan's rightists disappointed

From the perspective of the right-wing camp that has supported Abe for some time, there was hope that Abe would wipe away what they saw as the negative impact to Japan of

Murayama's speech by avoiding words like "apology." They have long expressed great dissatisfaction with Murayama's message that Japan had taken the wrong path, and that it needed to make deep apologies for its invasion and colonial rule in Asia. Abe's speech did not meet their expectations.

Specifically, Abe stated that from the 1930s on, in defiance of the new international order created after World War I—exemplified by the League of Nations and the General Treaty for Renunciation of War (Pact of Paris)—Japan took the wrong path forward by advancing into war. This denies the historical position of Japan's right-wing, namely that the war waged by Japan was unavoidable in order to safeguard Japan's independence and self-defense, and to break Asia free from its colonization by the Western powers. The historical perspective heard in Abe's remarks seemed to owe much to the "expert panel discussion" that Abe held to aid him in creating the speech.

Fuzzy history

Abe's speech did leave intact some parts of the nationalist view that "Japan was inevitably forced into war." Abe's speech suggests that, while Japan initially followed the path of international politics following World War I, the country felt a deepening sense of isolation from the economic blocs formed by the Western nations and had to break through the diplomatic and political impasse with force.

This exaggerates the damaging effect that Western bloc economies had on Japan. The biggest factors in sinking the Japanese economy were the failure of domestic economic policy and the global Depression that began in 1929. The economic blocs really began with the formation of the Sterling Bloc in the Ottawa Trade Agreement of 1932, and by that time the Japanese economy was already in recovery after changing to a Keynesian economic policy, and experiencing significant growth in exports.

The political and diplomatic main-

stream in Japan was aiming at international cooperation. It was the reckless behavior of some segments of the military, beginning with the Manchurian Incident of 1931, which caused dysfunction in domestic politics. Further, the Cabinet could not control the military because of the fatal flaws in the governmental structure under the Meiji Constitution (e.g., the Army and Navy could bring down a cabinet just by refusing to let their officers serve in it).

Zinging China, ignoring Korea

While most of the wording in Abe's speech was merely suggestive, he did make some assertive statements about the nations involved. The first target was China. In talking about how Japan "had [in the past] attempted to break impasses by force, but should now resolve any conflicts peacefully and diplomatically, without resorting to force, and with respect for the rule of law," he seemed to imply a substantial criticism of the current challenge to international law presented by China's current actions in the East and South China Seas.

Second was the coolness shown by the scarce mention of Korea. There was no clear mention in the speech of colonial rule in Korea prior to the 1930s. In addition, while gratitude was expressed for the forbearance of former POWs from the US, Britain, the Netherlands, and Australia, as well as that shown by the Chinese, there was no reference at all to South Koreans. The "expert panel discussion" submitted, in the report to Mr. Abe, a critical view holding that "South Korea's policy toward Japan vacillates between reason and sentiment," and that "the South Korean government has continually moved the goalposts in terms of historical recognition issues." Starting from this perspective, the speech tacitly requested South Korea to establish consistent standing for achieving the reconciliation.

It should be noted that, while Abe showed gratitude for the forgiveness of the US and European powers regarding the issue of abuse of POWs by the Japanese military, there was no mention of the imperialistic activities of the major powers leading up to the 1930s. Combined with the absence of any reference to Japan's colonial rule up to that time, this could be seen as a veiled justification of Japan's actions before the 1931 Manchurian Incident, since Japan could be seen as acting much like the Western powers had done before it.

Favorable domestic response

The domestic response to Abe's speech was positive, but not overwhelmingly so. According to a *Kyodo* poll, 44% of respondents were "favorable," while 37% had an "unfavorable" response. Although worded indirectly, the expression of an "apology stemming from deep remorse," was felt to be "appropriate" by 54% of the respondents in an *Asahi* poll. One line in the speech—that "generations of children who had no involvement in the war should not be burdened with the fate of continual apology"—garnered high favor, supported by 63% in the *Asahi* poll.

One point to note is that in the official English translation of the speech this line is rendered as "We must not let our children...who have nothing to do with that war, be predestined to apologize." The original Japanese text lacks the subject "We," resulting in an emphasis on negating future apology, as if saying: 'children should not be made to continue apologizing.' The possibility of this having a binding effect going forward on future statements by the Japanese government cannot be ruled out.

Chinese and Korean reaction

In a poll of people interested in relations between Japan, China, and Korea conducted by the Genron NPO, a think tank, (with 307 Japanese, 337 Chinese, and 157 South Korean respondents), the percentages of those who rated the speech "favorable" were 45.6% of Japanese, 21.4% of Chinese, and 5.7% of South Koreans, while the percentages of those who rated the speech "unfavorable" were 41.7% of Japanese, 56.9% of Chinese, and 83.1% of South Koreans.

However, in China, and especially in South Korea, there has not been strong negative response from the government. Although China's *Xinhua News* characterized the speech as a "product of deception lacking in good faith," there was no protest from the Chinese government. Although South Korean President Park Geun-hye did say that "there are many regrettable portions" of the speech, compared to the strong criticism in the South Korean media, she displayed great restraint, by saying, "it is vital that we act in good faith going forward." These stances suggest an attitude of trying to maintain stability now and seeking future improvement in relations with Japan.

China may be exercising restraint because it hopes business investment from

Japan will help China break through its current economic difficulties. In South Korea, President Park has been exposed to domestic criticism due to the lack of progress in diplomacy with Japan, and on the issue of the "comfort women" (women coerced into providing sex to Japan's soldiers) in particular. But she is in a position where she must make concrete progress with Japan. Under these circumstances, in the near future there should not be a recurrence in the talks of disputes over historical recognition issues. However, immediate changes in the behavior of those around Abe were not apparent, as the day after the Abe speech three cabinet ministers visited the Yasukuni Shrine. So, the difficulties around these issues remain essentially unchanged.

Abe hurts his own cause

Looking at the bigger picture, Abe's "retreat and concession" on history issues has come too late. Issuing remarks that appear to support Japanese militarism in the 1930s-40s, such as "the definition of aggression is not fixed," and further, putting constitutional reform on the political agenda, has raised awareness among the public about the Constitution, and particularly about protecting Article 9 (the so-called "pacifist clause" of the Constitution).

According to an annual NHK poll the numbers on constitutional revision have changed significantly: in 2013, 42% of respondents said that it was "necessary," and 16% said that it was "not necessary." In 2014, the figures were 28% and 26%, and in 2015, they were 28% and 25%. On the question of amending Article 9, in 2013, 33% said it was "necessary" and 30% "not necessary," but this question swung significantly towards those who opposed changes, to 23% "for" and 38% "against" in 2014; and 22% and 38% in 2015. So, it appears that Abe has hindered the achievement of his objectives through his own words and actions, and the current difficulties with the security bills are part of this trend.

What will the bill really change?

Although there is a strong possibility that the collective self-defense bills will be passed by a steamroller vote in the Upper House this month, as a practical matter, the current political situation will put great constraints on the government in actually using these laws. A major reason for this is that the administration has not deepened public

understanding by frankly explaining the true aims of the bills.

In addition, the opposition, the DPJ in particular, is avoiding a serious debate on the extent of the real danger in the East Asian security environment. Instead, they are focusing on the unconstitutionality of the bills and other issues such as increasing dangers to the Self Defense Force troops. The traditional secretive mindset of the government as well as the DPJ's intra-party split on the security issue is revealed here.

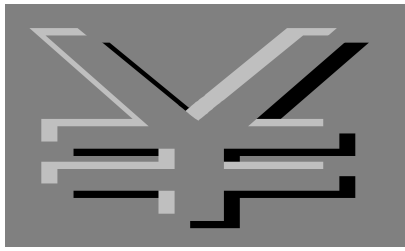
The ultimate reason that led the Abe government to push these security bills was to create an expansion of Japanese military capabilities in an effort to firm up a US commitment to defend the Senkaku Islands vis-à-vis China. The US ultimately hopes to establish reliable coordination of strategy and operations with Japan in the event of an emergency situation with North Korea, and to completely remove any unpredictability in implementing strategy.

On the Japanese side, particularly in the Ministry of Foreign Affairs, there is also a desire to ease practical constraints on peace-keeping operations (PKOs) overseas to allow more active participation, while on the US side, there is the additional aim of involving Japan in reconnaissance patrols in the South China Sea.

But discussion of such practical strategic matters hardly ever takes place in the Diet. Consequently, the Japanese public knows nearly nothing about the operational realities of the US-Japan Security Treaty. Unable to just stand by, twelve leading international political scientists advised the Diet of the need, while considering the security bills, to also carry out a wider debate on the US-Japan security guarantee itself. Such debates have not been held.

Constraints on implementation

After moving on to the debate of the bills in the Upper House, the administration has only emphasized the increasingly challenging security environment in East Asia, such as the aggressive advances of the Chinese navy. No compelling long-term strategies or broad perspectives are offered. As soon as bills are passed, several constitutional scholars and lawyers are preparing to file lawsuits challenging their constitutionality. People would likely keep a negative stance on implementation of what is prescribed. The actions that Japan can actually take will still be quite constrained.



Economy Watch

Amari: TPP could halt

Economic and Fiscal Policy Minister Akira Amari told *Kyodo* that negotiations for the Trans-Pacific Partnership (TPP) pact may be halted if the 12 participating countries cannot strike a broad deal in the weeks before Canada's October 19 national elections. "After election campaigning starts in Canada [in early October], it will be difficult," to continue the talks. The TPP has become an issue in the very tight race.

Having failed to set a meeting for Trade Ministers in August, following the failure of the July meeting in Maui to seal the deal, the ministers have so far been unable to set a date for their hoped-for meeting in September. It is still uncertain whether such a meeting will take place.

It is now legally impossible for the US Congress to vote on ratification before 2016. Some countries will be less willing to make concessions in order to reach a deal that the US Congress may be unable to even vote on in an election year. A clued-in source in Japan said that governments will put less energy into the TPP if they think it will be put off until the next President. Presumptive Democratic nominee Hillary Clinton has refused to state her position on TPP until the text is released.

GDP plops down again

No sooner does the Japanese economy get its head off the mat than it seems to plop down again. In April-June, according to preliminary figures, GDP fell at an annualized pace of 1.6%, following a 4.5% rebound in January-March. When the revised figures come out on September 8, the decline is expected to be revised downward to something like 2.0%.

Disappointing figures in July for consumption, jobs, exports, and industrial production have led economists to revise downward their forecasts for July-September. Only a few weeks ago, the consensus expect-

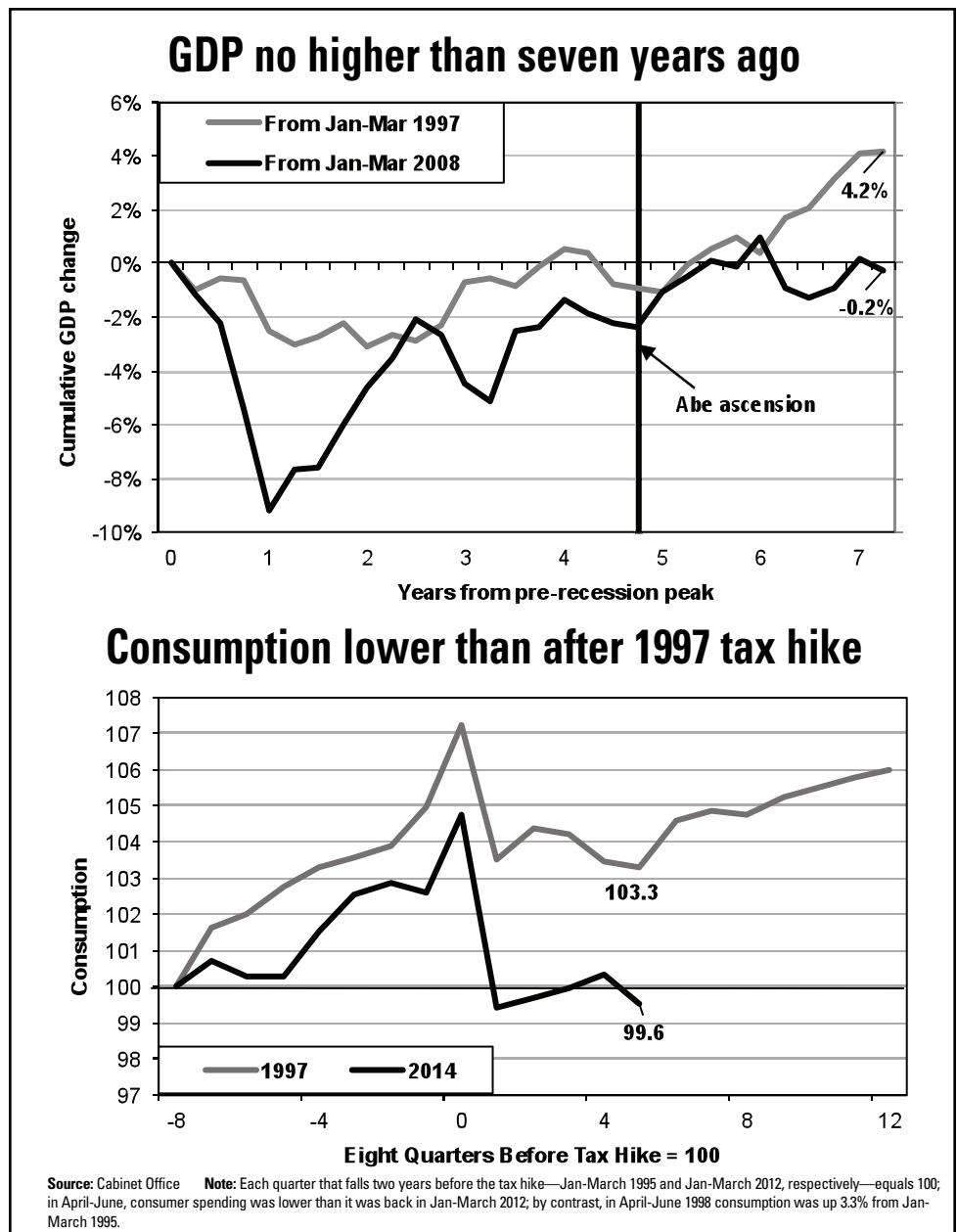
ed a 2.5% rebound. Without even waiting for August and September data, the usually bullish Morgan Stanley is now saying the GDP bounce for July-September may only be 0.5%. Moreover, it has halved its forecast for all of calendar 2015 from 1% growth to just 0.5%. Consumption in July rebounded only

0.6% month-on-month from June, when it had unexpectedly tumbled 3.0%. Jobs fell by 130,000 from June. Real exports were down 0.6% from the year before. And manufacturing output fell 0.7% from June.

To counter the stagnation, Abe is widely expected to come up with a supplementary budget of ¥3-4 trillion (equivalent to 0.6-0.8% of GDP).

GDP today is no higher than it was more than seven years before just before the global recession, an even worse performance than that following the 1997 tax hike and banking crisis (see top figure).

This poses a puzzle. Market economies "want" to grow, just like corks in a bathtub "want" to rise to the surface of the water. If you stop pushing the cork down below the



surface, it will bounce back up. If a postwar market economy goes into a deep recession, it will typically show a strong recovery—assuming that policymakers don't keep pushing the cork downward as they are doing in the EU. The remarkable thing about Japan is how hard it has been for it to crawl back from the lashing it took during the 2007-2008 global financial crisis.

Unlike in Europe, policymakers are not imposing austerity. Monetary largesse by the Bank of Japan (BOJ) is unprecedented. The yen has weakened 34% from its 2012 level. And government spending is up 10% from its pre-recession level; half of that growth in government spending came during the tenure of Prime Minister Shinzo Abe. To be sure, Abe did raise the consumption tax from 5% to 8% in April of 2014. But a resilient economy should not still be suffering from such a small tax hike, which is why both the Ministry of Finance (MOF) and BOJ had incorrectly assured Abe that Japan would not suffer another recession as it had in 1997. They were wrong because Japan's economy is not resilient.

Consumer spending is on a far worse trajectory than it was following the 1997 tax hike, mostly because real wages keep falling (see bottom figure). Once again, the BOJ and MOF assured Abe that this could not happen. In April-June, consumer spending fell at an annual rate of 3% and was the biggest reason for the fall in GDP, followed closely by a drop in exports.

Imagine the situation today if Abe had not postponed the second tax hike (from 8% to 10%) originally scheduled for this October 1, but now set for April 2017. In the August *Reuters* Corporate Survey of 516 big and medium-sized firms, more than 80% said the economy would not be ready for the second tax hike even in 2017.

Asked what should be the government's biggest priority, 63% said ending deflation and promoting economic growth. That is twice as many as those who chose reducing Japan's government debt.

Companies dis CSD bill

In the same *Reuters* poll cited above, 62% of companies opposed enacting Abe's collective self-defense (CSD) bills during the current Diet session, with many respondents saying that there had not been enough debate to gain the understanding of the people. Some also said it would be a violation of

Japan's pacifist constitution.

Others worried that, "Forcing the bills through the current parliamentary session could sow the seeds of trouble for the future, impeding the smooth enactment of economic measures, which are expected to come later," as a manager at one electronics firm put it.

Tourism boosts GDP

While the yen's huge depreciation has done little for exports, it has lured in millions of tourists. Purchases of goods and services by tourists boosted April-June GDP by 0.2 percentage points.

Back in 1996, spending by Japanese going abroad offset income from foreign tourists coming to Japan to the tune of about ¥4 trillion per year, thereby reducing Japan's current account surplus. That is the broadest measure of Japan's trade balance in goods and services and income. But now, Japan takes in more than it sends out and, in April-June, tourism added ¥1.3 trillion to Japan's current account surplus.

M&A vs. capex

Instead of investing at home, Japan's biggest firms are using the cash horde to buy overseas firms.

Corporations have been raking in profits by the truckload. In fact, current profits (known as recurring profits in the US) are up to a record 14% of GDP (see figure). Much of this profits growth is due to the depreciation of the yen. For example, a dollar earned

by a US subsidiary turns into 50% more yen than it did when the currency rate was ¥80 per dollar just three years ago.

But, with domestic demand so sluggish, these firms see no reason to plow the increased profits back into Japan. So, investment by these corporations in April-June was just 7.6% of GDP, the same ratio as in 2012 (see figure again). In price-adjusted terms in the GDP tables, business investment in April-June was still almost 7% below the pre-recession peak reached seven years ago in Jan-March 2008.

As of mid-August, purchases of overseas firms totaled ¥7.16 trillion (\$60 billion), about 1.4% of GDP. That's up 77% over the first eight months of 2014, according to *Thomson Reuters*. Moreover, the total already exceeds the full-year record of ¥7.13 trillion. The average deal amounted to ¥17 billion (\$141 million). Japan's cross-border M&A equaled about 6% of all global cross-border M&A.

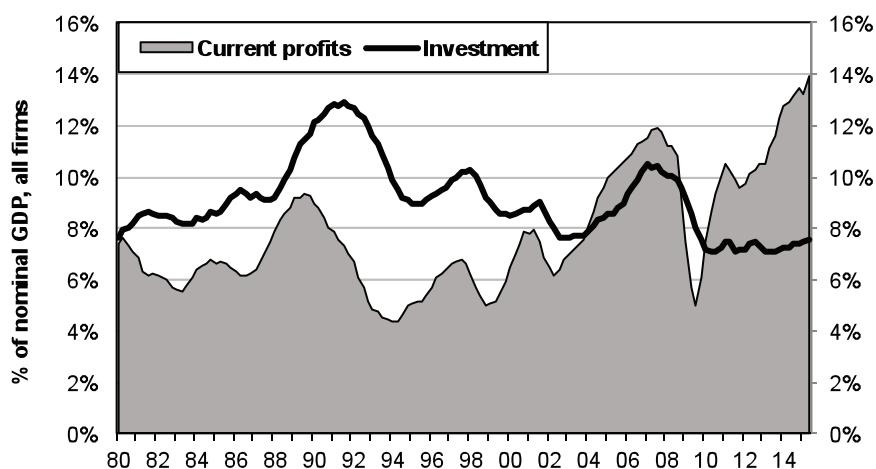
Importing housekeepers

As an experiment, a year from now, Japan will lift a ban on housekeeping service companies importing foreign housekeepers in two strategic economic zones: Osaka and Kanagawa prefectures. The purpose is to help remedy a shortage of labor in housekeeping field.

The new regulations will mandate that housekeeping service companies employing foreign workers do so directly and on a full-time basis, and that they pay wages equal to,

(Please turn to page 14)

Lots of profits, but not invested back into Japan



Source: Ministry of Finance

INTERVIEW

Nicholas Lardy:

PRC stocks “just a correction”

Nicholas Lardy is a Senior Fellow at the Peterson Institute for International Economics. His most recent book on China (2014) is: *Markets over Mao: The Rise of Private Business in China*.

TOE: There are four theories about the recent financial turmoil in China. Which one do you think Chinese leadership believes?

- 1) This is just a simple and necessary correction in overvalued stock and real estate prices, with no broader implications for economic growth.
- 2) This is the result of a conspiracy by foreign speculators, either to make money or to damage China for some reason.
- 3) China is going through something equivalent to the popping of the stock/property bubble in late 1980s Japan. As in Japan, this popping will lead to a sizeable and permanent deceleration of China's growth.
- 4) China is in the midst of a complex transition: from an economy dominated by exports, investment and manufacturing to one with a greater role for consumer spending, services, and smaller trade surpluses (as a % of GDP). These transitions are always bumpy, and the financial turmoil is part of that bumpiness. China's leadership will successfully manage this transition as they have previous ones.

Lardy: I honestly don't know what the leadership really thinks. In public, they are certainly putting a lot of emphasis on foreign conspiracies because it's convenient to blame foreigners when things go wrong. But it's not very plausible. For one thing, foreigners own just 3% of the total value of Chinese stocks.

TOE: Which theory do you believe?

Lardy: I believe it's a simple market correction. On June 12, when the Shanghai Composite Index peaked, its value was two-and-a-half times as high as it was a year earlier. This was despite the fact that economic growth had slowed from 7.4% to about 7.0%, and the reported growth of corporate profits had slowed dramatically.

Secondly, lots of people were buying stocks “on margin,” i.e., borrowing money in order to buy stocks. When prices started to go down, lots of people were forced to sell immediately in order to cover their margin debt. Once a huge amount of margin sales got going, the downturn was both big and abrupt. Prices dropped 30% within a matter of days.

TOE: Does that apply to property prices?

Lardy: No. That's because people don't have any leverage in real estate to speak of. Moreover, percentage-wise, real estate prices fell only in the single digits. Over the last 4-5 months, the number of cities where prices are falling has declined quite sharply and the number of cities where real estate prices are going up a little bit every month is rising. It looks like we're at a positive turning point on real estate.

TOE: If there is not that much borrowing to finance real estate purchases, then the fall in property prices should not pose the danger of a debt crisis in bank loans, right?

Lardy: Right.

TOE: How confident are you that this is just a correction?

Lardy: I'd say 80%.

TOE: Should the government simply let stock prices fall until they hit their bottom, or should they stabilize prices? It looks as if they've gone back and forth on this. On August 25, the Chinese policy took into custody a reporter for *Caijing* business magazine just for reporting that the government was reconsidering its intervention.

Lardy: The correction took them by surprise. Once they got organized, they intervened on a scale that we haven't seen before.

In late August, it looked as if they may have given up that intervention. But the situation is not very transparent. We don't really know when they're buying nor how much.

In my opinion, the government should avoid a situation in which the investing public thinks it has any influence over stock prices. The stock market is definitely a case in which you have to let the organic demand work itself out. It's a market where overshooting is commonplace. Investors should understand that before they get into the market. China needs more people in the market on a longer-term basis rather than day traders. 80% of the trades are retail trade, with many of them being day traders. There are no institutional investors, like pension or insurance funds, to speak of.

These retail investors are very uninformed. They buy stocks based on things like the number of eights in a stock's digit code, since eight is a lucky number in China. As Chinese economist Wu Jinglian put it, the stock market in China is a casino. It will remain so until there is a bigger role for asset managers, pension funds, insurance companies, etc.

TOE: In terms of the broader economy, President Xi Jinping talks about trying to hit a “new normal” of 6-7% growth. Can he succeed, or, in the attempt to achieve it, will Chinese growth decelerate more? You hear some talk of a “middle income trap,” where some Newly Industrializing Countries hit a certain per capita level of GDP, which is below the level of rich countries, and then suffer a big slowdown in growth.

Lardy: That depends on how much reform Xi undertakes. If he doesn't do anything more, the growth rate will likely go significantly lower and maybe the “middle income trap” would become a good explanation. If he pushes ahead on the reforms that they've supposedly adopted, there's significant potential for strong growth—7-8% per year—over the medium term.

TOE: The last time we interviewed you (see December 2013 *TOE*) you were pretty upbeat on the prospects for reform.

Lardy: I'm less optimistic than I was then. I had thought that they would have made more progress by now, particularly regarding reform of state-owned enterprises. They've moved ahead pretty well on financial reform, licensing private banks, almost completely liberalizing deposit interest rates (the lend-

ing rates were liberalized a couple years ago), and a gradual further opening of the capital account [international money transfers]. Outside of the financial sector, progress has been more limited.

TOE: The Chinese themselves talk about the need to move away from an economy dominated by manufacturing, investment, and exports to one where personal consumption and services play a stronger role. How do you assess progress on that transition?

Lardy: A transition is underway. This is the fifth consecutive year in which the private consumption share of GDP is going up. It's gone up from 36% of GDP to 38% since 2010. It will be up a bit more this year.

That is a small number, but it's a huge reversal of the trend of the previous decade when the consumption share of GDP kept going down from 50% in 1990 to a low of 36% in 2010. The change in trend looks significant. The size of the increase from the bottom is not so impressive.

One of the big reasons for China's shift away from over-dependence on manufacturing and investment is that its currency [the renminbi, aka the RMB] is no longer undervalued. Keep in mind that about 90% of China's exports are manufactured goods. The RMB has appreciated by 50% since 2005.

The degree of financial repression [below-market interest rates] has diminished somewhat in recent years with the advent of wealth management products, money market funds and other things that have offered a higher return to fixed income savers. That has helped the growth of personal income, and to a reduction in the excessive savings of households that had existed in the last decade. [Below-market rates helped feed China's excessive investment—*TOE*].

A third big positive factor is that energy is not as underpriced, compared to global prices, as in the past. Cheap energy had been a subsidy to the industrial sector, since 80% of electricity in China is used in industry.

TOE: Some people contend that the economy is in worse shape than it appears to be, and that the GDP numbers are unreliable, perhaps even faked. They point to things like low growth in electricity consumption.

Lardy: Trying to figure out what's going on in China's economy by looking at electricity consumption is like trying to drive a car by looking in the rearview mirror.

In the 2000s, if GDP grew 10%, then electricity demand grew about 12%. People used to that relationship saw that electricity consumption was growing at a rate of less than 1% this year and so they cannot believe that GDP is growing 7%.

But they haven't taken into account the fact that the service sector is now generating most of China's growth. The service sector's share of GDP has gone up by about 3-4 percentage points since 2012. That may sound small but, these things change glacially. That is actually a big structural shift.

Now, it takes six times as many kilowatt hours of electricity to produce a unit of GDP in manufacturing as in services. Moreover, most of the energy use in industry is in heavy industry, like steel and cement. And it is heavy industry that is in decline. Light industry, mostly consumer goods, is still growing fairly rapidly. So, the relationship between electricity production and GDP growth has completely changed.

TOE: There's been a lot of frenzy in the press and the financial markets and some Republican Presidential candidates regarding the 2% depreciation of the RMB in mid-August. To me, 2% does not seem like a big deal, especially compared to the big move in the Japanese yen.

Lardy: The view that this was an attempt to stimulate the economy is completely wrong. If Beijing were reacting to weak export growth, they should have had a big devaluation in 2014 when China's exports grew a measly 0.9%. A 2-3% depreciation today is too small to boost export growth.

The depreciation move on August 11 was exactly one week after the International Monetary Fund (IMF) issued its report on whether or not the RMB should be included among the reserve currencies, a Chinese ambition. One of the IMF's criteria is whether the RMB rate is market-determined. For the past seven months until mid-August, every day the government intervened in the market to keep the RMB from depreciating below the 2% trading band it had set, and every day they set the central "parity" for the 2% band at the same rate as the day before [the opposite of what they would do if they were trying to cheapen the RMB to promote exports—*TOE*]. So, they were not allowing the market to operate.

All they said on August 11 was they were going to begin taking into account the previous day's close when they set the cen-

tral parity for the 2% band [e.g., if it closes at the bottom of the band, or the top of the band, that will change the central rate for the next day—*TOE*]. That will make the rate more market-determined.

People somehow think that China is reverting to its practice in the last decade to intervene in the currency markets to keep the RMB cheap. During that time, it intervened so much that its foreign exchange reserves rose by almost \$4 trillion. And its current account (trade) surplus rose to 10.1% of GDP, three times as high as Japan's ever did. By contrast, last year, the current account surplus was down to 2.1%. This year it will be about 3% because the prices of commodities that it imports are going down.

When they made that announcement on August 11, people who misread it panicked and a lot of them said, "Oh, my god, this is the beginning of a big decline in the value of RMB." So, everybody rushed to try to sell the RMB before it went down even more. I think the government probably had to intervene quite a bit to keep it from declining quite dramatically. But they didn't change the peg very much. Its value is within 4% of where it started on August 11.

TOE: If the government let the RMB be determined by the market, would it move much, either up or down?

Lardy: That depends a lot on how much they liberalize the capital account [transfers of money for financial or investment purposes], and I can't anticipate what will happen. Foreign ownership of equity is just 3% of the market's total value, and the share in bonds is even lower. Chinese households still have savings deposits bottled up in RMB that are equal to something close to 100% of GDP. Now if they throw open the doors to capital flows—which I don't think they will do without a few limitations—I don't know whether outflows or inflows are going to dominate. If outflows dominate, the RMB could depreciate quite a bit. If inflows dominate, the RMB could appreciate. We're potentially moving into an environment where the exchange rates are going to be determined a lot more by capital funds than by goods and services.

TOE: What is the impact of China's economic slowdown on other countries? For example, China's purchases had driven prices up in commodities markets because China was growing so fast and importing so

many raw materials to feed heavy industry. With China engaged in this transition, you see some of these commodity prices falling. **Lardy:** Those prices have been falling for 2-3 years because China has been changing for a while. This is not some sudden new event linked to the stock market turmoil. In 2010, when the growth of investment in property was at an all-time high of 33%, China's imports of minerals, metals, mineral fuels, etc. more than doubled. But property construction has been slowing for a while; growth is down to 5% in the first half of this year. Growth decelerated from 33% in 2010 to 28% (2011), 23% (2012), 18% (2013), 10% (2014), and now 5%.

As that happened, growth in China's commodity imports also slowed: from 100% in 2010, to 80% (2011), 35% (2012), single-digits in 2013 and just about zero growth in 2014. So far this year, commodity imports are down 30%.

At some point this deceleration will bottom out. But I'm not foreseeing a return to anything remotely similar to what we saw in the first part of the decade.

TOE: What about industrialized countries like Japan or the Asian tigers that export to China?

Lardy: That brings us back to our expectations for GDP growth. I'm not in the camp that sees Chinese growth dropping to the low single-digits for years to come.

TOE: Japan's exports to China are much more correlated with China's own exports to the US and Europe than they are to China's internal growth. That's also true of other countries in East Asia. So, if a higher RMB and other factors reduce China's export growth, what does that mean for Japan and other Asian exporters?

Lardy: Japan and Southeast Asian countries

and Korea are still supplying a lot of the components that go into China's exports. So, Japanese exports and Southeast Asian exports to China boom when China's exports to the US and Europe boom.

TOE: So as China becomes less export-oriented and it goes through this transition, does that have a negative impact for export growth by Japan and East Asia?

Lardy: I would think that export growth would be less robust, for two reasons. The recovery, especially in Europe, is still weak. Secondly, a lot of the supply chains have moved to China. In the past, Apple products made in China had a gigantic import content. Now, some of the firms from Japan and other countries that supply these components have relocated to China. The import content of China's exports has declined significantly over the last ten years, from about 50% of the value of exports to just 35%.

(Continued from page 11)

or higher than, those received by Japanese employees. However, other laws mandating equal pay for Japanese part-timers and women have not been enforced (see pg. 1), so we wonder about the enforcement of this law. Each foreign worker can work in Japan for no more than three years. Live-in service will be forbidden, and employers will be responsible for securing housing for their employees.

Duskin, Japan's leading housekeeping service provider, already employs foreign students and other short-term residents on a part-time basis. Foreign full-time workers will be employed to perform a variety of services, including child care and shopping, in addition to usual housekeeping duties.

It is not clear how many workers this will entail. The Tokyo-based housekeeping firm Bears told *Nikkei* that it will take on about ten workers from the Philippines and other nations to start, as it expands in Osaka and Kanagawa. Bears will also set up a Philippine subsidiary within the year to handle recruitment and training. Pasona Lifecare will take on around 50 employees who have been trained by a Philippines human resources company, Magsaysay Global Services.

The government figures expect the market for housekeeping services to expand to

¥600 billion (\$5 billion), six times its size in 2012. Yet, many current housekeepers are elderly and work only part-time, forcing a search for new sources of labor.

If these latest measures are a success, bans will likely be lifted in Tokyo and other high-demand areas. The policies could eventually be applied nationwide.

It may also help more women take on full-time jobs if they have housekeeping services at home.

Clean house at Toshiba

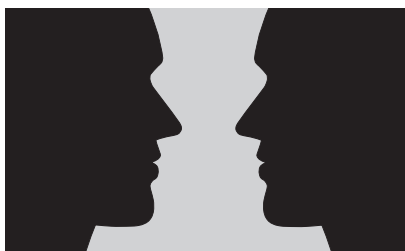
Maybe some of these housekeepers could be sent to Toshiba. New claims of previously undisclosed financial improprieties have forced the company to postpone for a second time the release of its fiscal 2014 financial results.

Two weeks ago, Toshiba gave a preview of its fiscal 2014 results as well as a restatement of past earnings that had been artificially inflated by accounting illegalities. Just as it was finalizing the numbers, *Nikkei* reported, ten new cases of improper or suspect accounting were brought to management's attention by whistleblowers within the firm. Such reports from within the firm have increased since an independent investigative panel began probing accounting improprieties in May.

The fact that these whistleblower reports are so numerous raises some questions in our mind. How widespread was knowledge of accounting fraud within the firm? Is senior management trying to clean house by soliciting these reports? Masashi Muromachi, the Board chairman who took on the post of President in July, told a news conference that, "There is a newfound awareness among employees that whistleblowing helps improve our corporate culture. I believe it is important to come to terms with this in order to regain shareholders' trust."

But *Nikkei* had a less upbeat take on the situation: "Though Muromachi tried to put a positive spin on the situation, the rash of whistleblower reports paints an unfavorable picture. Toshiba set up an internal investigative committee in April, before the independent panel got down to work. It also carried out a separate, parallel audit of 584 subsidiaries. But this triple probe apparently failed to get to the bottom of the rot within the organization. The independent panel's own credibility now appears likely to be called into question. Muromachi acknowledged that the investigation had its flaws.

Toshiba has been given an extension until September 7. Says *Nikkei*, "Should Toshiba need even more time, it may lose investor confidence."



by Regis Arnaud

Small Talk

Tech power

TOE sat down with Tokyo University assistant professor Matthew Brummer, an expert on innovation, to understand Japan's status as a "tech power."

TOE: Is Japan still a leader in innovation?

Brummer: We can measure innovation in three ways: first by listing the number of patent applications by nationality and, vis-à-vis each patent, the nationality of patents cited in each application. Each patent application must mention the research that preceded it. A second method is to count the number of scientific articles by nationality. The third method measures high-tech exports as a share of total exports. In each case, the US clearly stands out in the lead, followed by Germany and Japan, roughly at the same level. There are of course differences among industries.

Japan's challenge is to maintain technological prominence as it shifts to a service economy. Services are based on many characteristics not common in Japan, starting with the use of English.

TOE: How do you explain Japan's endless pursuit of innovation?

Brummer: Let's start by asking: how is it that a country like France, which was a technological leader for centuries, could be surpassed by Japan in just fifty years?

Attitudes toward innovation relate to two different types of instability. Internal instability (strikes, demonstrations against new technologies that devalue existing technologies) often forces a government to compromise and slow down innovation. For example: in France, taxi drivers protested against Uber [which actually started when Uber's founder got upset by the appalling level of service of taxis in...Paris!], their views were taken into account, forcing Uber to back down. Innovation is by definition "creative destruction." It replaces the old with the new and dislodges the elite and

dominant players of the time. This is why the elite often finds common cause with segments of the population threatened by innovation. It is wrong to believe that all people want to innovate.

Japan does not suffer from this sort of internal instability. However, it suffers increasingly from external instability, with very different consequences. It cannot accurately assess the magnitude of the challenge to its high-tech firms from the Newly Industrializing Countries. It cannot accurately predict China's advances, including advances within the military sphere. Japan also questions whether the US will fulfill its promises to aid Japan in case of a military conflict. Fears about China are increasing. This risk calls for a national strategic response to keep Japan vibrant, and part of that response is technological innovation.

Therefore, it seems to me that the global slowdown in innovation is a consequence of peace. France and other European countries are dropping from the top ranks of innovative countries because they are no longer faced with an external challenge, but just the internal reaction against creative destruction. Japan and Taiwan continue to innovate as they have maintained a siege mentality.

TOE: Is Japan alone in this position?

Brummer: No. It is very close to the situation in South Korea and Taiwan: these three countries feel under siege but enjoy the protection of the United States.

Remember the crisis over rare earth minerals in 2010? China had drastically reduced its exports of these to favor its own industry. [It reduced its exports to Japan even more due to the tension over the Senkakus when a Chinese fishing boat rammed a Japanese coast guard vessel and Japan arrested the Chinese captain—*TOE*]. Rare earth minerals were indispensable to Japanese manufacturing. Japan very quickly developed a long-term response. It approached Russia, Vietnam, and Brazil as new sources

of supply, which reduced its dependence on China, while simultaneously finding substitute materials.

The same applies to the US. While it is certainly not threatened by its closest neighbors, it and its interests abroad are exposed to lots of external threats.

A wrong pass for Japan

Will Japan be deprived of its current status as scheduled host of the 2019 World Cup tournament in rugby? "There is today a 50% chance of this happening," a senior official of the Japan Rugby Union told *TOE*. The reason: the cancellation of Japan's new national stadium has put in disarray the economic model on which the rugby World Cup was founded. The official explained, "It is very hard to execute a successful World Cup tournament. You need big stadiums that gather big crowds and create big TV audiences. World Rugby [the international federation that assigned the tournament to Japan] is very sensitive to the profitability of the Cup games. That is not because they are greedy, but because this is the only tournament that makes money in the rugby world. If they don't have profits there, they don't have any profits at all." World Rugby is also particularly incensed with the fact that Japan has done nothing to make rugby more popular since it was assigned the tournament four years ago.

The professional rugby tournaments are held in almost total indifference in Japan. World Rugby has given Japan until the end of September to demonstrate that it can successfully hold the tournament. If Japan cannot do so, South Africa seems next in line. What's more, the context is bad for Japan: World Rugby Chairman Bernard Lapasset is running for reelection, and he probably needs votes from the Anglo-American world more than he needs Japan's support. As an astute political player, Lapasset may not have much sympathy for Japan if it cannot provide sufficient assurance about the success of the Cup tournament.

Were Japan to be deprived of these games, that would be a terrible blow to its image after the cancellation of the national stadium for the 2020 Olympics. It would also be personally crushing to former Prime Minister Yoshiro Mori, the current chairman of the Japan Rugby Football Union. For him, organizing a rugby World Cup in Japan has always been a major goal.