

# Global Economics Update

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## JAPAN AS NUMBER 3

MATTHEW P. GOODMAN

In 1995, a group of Cornell psychologists found that Olympic bronze medalists are typically happier than silver medalists about their position on the podium. The competitor in the number 2 spot cannot help thinking about how close he came to winning gold, while the person in third thinks, "Wow, I got a medal!"

By this standard, Japan—third in the global GDP standings since China overtook it in 2010—should feel good about itself. With nearly \$6 trillion in annual output and many areas of competitive strength, Japan remains a heavyweight in the global economy.

Yet two recent reports from Tokyo raise serious doubts about how long Japan can remain on the GDP medal podium. A research institute affiliated with the Health Ministry projected earlier this year that Japan's population will slip below 100 million by 2048, from a peak of 128 million in 2010. Among other things, this will have severe consequences for Japanese growth in the decades ahead.

Citing similarly dire demographic trends, the research arm of Japan's leading business organization, Keidanren, issued its own report earlier this month projecting that Japan could slip to as low as ninth in the global GDP tables by 2050 without substantial labor market reforms and gains in productivity.

There is no doubt that Japan faces a daunting array of economic challenges. For nearly two decades it has experienced little or no growth and chronic deflation: consumer prices, excluding food and energy, have fallen every year since 1999. Its gross government debt is one of the world's highest at some 225 percent of GDP (though more than two-thirds of this is owed to the government itself).

Demographics, deflation, and debt have been described as Japan's "3D" challenges. To these a fourth has been added since March 11, 2011: "denuclearization." In the wake of the devastating earthquake and tsunami that struck the Fukushima Daiichi plant that day, virtually all of the nation's nuclear energy capacity—which had supplied some 30 percent of Japan's electricity—has been shut down; the last plant will close on May 5. As a result, fossil-fuel imports shot up last year and contributed to Japan's largest-ever trade deficit of more than \$50 billion in the fiscal year to March 2012.

Since coming to office in August 2011, Prime Minister Yoshihiko Noda has been surprisingly bold in seeking to address these challenges. He overcame opposition from within his own party and the country's entrenched agricultural interests to announce in November his intention to explore Japanese entry into the Trans-Pacific Partnership (TPP). In late March, he bucked his party again to get cabinet approval to raise the unpopular consumption tax from the current 5 percent to 10 percent by 2015. And he has publicly supported reopening two nuclear reactors in central Japan despite widespread anxiety about safety in the wake of Fukushima.

## Upcoming Events

- April 26: America's Trade Policy with Rep. Camp (CSIS)
- April 26: Japan's Economic and Political Future (CSIS)
- April 26: The Coming U.S.-Japan Summit with Amb. Fujisaki (CSIS)
- May 9: Mexico's Elections and Prospects for Structural Reform (CSIS)
- May 16: CSIS-JETRO Conference on Asia-Pacific Economic Integration and U.S.-Japan Relations
- May 18: G-8 Camp David Summit

## JAPAN AS NUMBER 3 *(continued)*

As Noda prepares for his first visit to Washington next week, he has apparently decided not to spend political capital trying to advance Japan's bid to join the TPP talks. This decision, while understandable, is unfortunate—for Japan and the United States.

To be sure, since Noda's announcement last November, political sentiment in Japan has swung against TPP. Support within the ruling Democratic Party of Japan, always soft, has weakened in the face of growing resistance from vested interests and a proliferation of sensational books blasting the trade agreement as an American plot to impose “Anglo-Saxon norms” on Japan.

In a serious blow to Japan's near-term TPP prospects, the two leading parties agreed in March on legislation to roll back many of the postal privatization steps that were the hallmark of popular prime minister Junichiro Koizumi (2001–2006). Ensuring a competitive playing field for American insurance companies is one of the “confidence-building measures” the U.S. government has sought from Tokyo before approving the latter's bid for TPP membership.

Restoring growth is a precondition for addressing Japan's economic challenges, including debt and deflation, and should be a higher priority for Japanese policymakers. With a declining workforce, growth depends on greater productivity, which in turn will only be unleashed through the kinds of structural reforms that TPP will require. (A TPP deal is expected to add more than half a percentage point to Japan's GDP.) The prime minister

and a majority of Japanese people seem to understand this, but politics are getting in the way.

President Obama would be wise to remind Prime Minister Noda of the benefits to Japan of joining TPP. This requires no altruism on his part: Japanese participation would bring significant economic and strategic benefits to the United States. It would more than double the size of TPP, since U.S. trade with Japan is greater than that with the eight existing TPP members combined. And it would give Washington a heavyweight strategic partner in shaping the rules of the global trading system: beyond a few important differences, Japan is aligned with the United States on most of the high-standard provisions envisaged for TPP, which will become a model for “next-generation” trade agreements.

At a recent CSIS event, prominent Japanese commentator Yoichi Funabashi noted that even when it crafts good policies, Tokyo has a political “deliverability” problem. As Japan's de facto loyal opposition, Washington can help address this additional “D” challenge and put the world's third-largest economy back on track to strong and sustained growth. ■

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## Simon Says...

Apparently some Anglo-Saxon influences in Japan are sacred. PM Noda drew fire in late March when he publicly likened TPP to the Beatles, Japan to Paul McCartney, and the United States to John Lennon, saying that “without Paul, the Beatles wouldn't be the Beatles.” He was criticized for getting ahead of his party in expressing a clear preference for Japan to join TPP. Or perhaps the real problem was too much deference to America, since everyone knows that John was the brains behind the Fab Four.

The Nikkei newspaper company, which owns Japan's leading stock index, may be trying to make investors feel better about

equity prices that are still languishing around one-quarter of their 1989 peak. In the lobby of its new headquarters building in Tokyo hangs a large electronic board showing the current trading price of the Nikkei average, the yen, and several other financial instruments. Nothing unusual about that—except that price gains are displayed in **red** and losses in **green**. Opinions are split on the reason for this reversal of the traditional color scheme: one source explained simply that red is an auspicious color in Asia; or perhaps “spilling green ink” is soothing to anxious investors, especially in this environmentally conscious era?