



# EXAMINING JAPAN'S LOST DECADES

Edited by Yoichi Funabashi and Barak Kushner

# Examining Japan's Lost Decades

This book examines five features of Japan's "lost decades": the speed of the economic decline in Japan compared to Japan's earlier global prowess, a rapidly declining population, considerable political instability and failed reform attempts, shifting balances of power in the region and changing relations with Asian neighboring nations, and the lingering legacy of World War II. Addressing the question of why the decades were lost, this book offers 15 new perspectives ranging from economics to ideology and beyond. Investigating problems such as the risk-averse behavior of Japan's bureaucracy and the absence of strong political leadership, the authors analyze how the delay of "loss-cutting policies" led to the 1997 financial crisis and a state of political gridlock, in which policymakers could not decide on firm strategies that would benefit national interests.

To discuss the rebuilding of Japan, the authors argue that it is first essential to critically examine Japan's lost decades, and this book offers a comprehensive overview of Japan's recent twenty years of crisis. The book reveals that the problem of the lost decades is not an issue unique to the Japanese context but has global relevance, and its study can provide important insights into challenges being faced in other mature economies. With chapters written by some of the world's leading Japan specialists and focusing on a variety of disciplines, this book will be of interest to students and scholars in the areas of Japan studies, politics, international relations, security studies, government policy, and history.

**Yoichi Funabashi** is Chairman of the Rebuild Japan Initiative Foundation and a former editor-in-chief for the *Asahi Shimbun*.

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The world is still trying to understand what went on in Japan's "Lost Decades", a topic that has become all the more relevant as much of the west succumbs to Japan-style problems of deflation and low growth. This collection of essays by experts in their field will help the reader pick through this important subject. For readers seeking to understand Japan and for ones wondering whether "Japanization" is coming to a country near them, this should prove a fascinating read.

**David Pilling**, *Financial Times*

This book contains a superb and timely collection of essays on the troubles Japan has been having, economically and politically, since the 1990s. The period coincides with the ending of the Cold War and the acceleration of economic globalization. The studies show how a nation that seemed to fare so well during the Cold War has stagnated in a globalizing world. As the editors note, Japan's example could be followed by other countries and deserves serious attention.

**Akira Iriye**, *Harvard University, USA*

# **Examining Japan's Lost Decades**

**Edited by Yoichi Funabashi  
and Barak Kushner**

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# Preface

The Rebuild Japan Initiative Foundation (RJIF) is an independent think tank that was established in September 2011. On March 11 of the same year, Japan confronted a major national crisis caused by the earthquake and tsunami in the north-east region of the country. These natural disasters led to a further catastrophe with the Fukushima nuclear power plant accident and meltdown. Back then I strongly felt that Japan's "lost decades," which plagued the country since the 1990s, had bottomed out. I believed that Japan's institutional culture and its social systems harbored serious problems across many sectors – including risk management, governance, and leadership.

I opted to christen the think tank with the word "Rebuild" because Japan suffered a major loss due to its lumbering efforts to respond to the accident. Japan was, in a sense, beset by both the natural causes and social structures that, in part, led to the accident. At that moment, I understood Japan as nothing less, consequently, than a defeated country. The only way to start afresh was to rebuild.

The think tank's first task was to probe the causes of the Fukushima nuclear accident, to investigate the social and structural causes that were responsible for the accident, and to examine the state of Japan's crisis management plans in light of how it responded to the situation. On the basis of these analyses, we carved out lessons and offered proposals concerning new safety regulations. We were able to quickly publish our results in February 2012, first in Japanese and later in English in 2014, as *The Fukushima Daiichi Nuclear Power Station Disaster: Investigating the Myth and Reality*. Upon completing the final report of our Independent Investigation Commission on the Fukushima Nuclear Accident, I strongly felt the necessity for a thorough study of Japan's lost decades. This need arose because the more we explored the causes and background behind the Fukushima nuclear accident, the more they seemed to overlap – seemingly from their very genesis to their conclusion – with the underlying causes of Japan's lost decades.

The lost decades project began in the spring of 2013. I imposed several important conditions upon setting up the research team and framing the investigation and surveys. First, I opted for authors who are considered prominent specialists in their respective fields. Second, I included both Japanese and non-Japanese authors. Third, with a global audience in mind, I thought that results had to be published in English first. Fourth, I also asked a top-class English-language editor to assist in the production. Fifth and finally, I set up a working group made up of leading

young researchers, who assisted the authors in organizing their arguments, gathering research material, and conducting interviews. I was pleased that the project proceeded along the goals I set and satisfied my ambition. All of the authors are incredibly busy and as many as three of them also work as university deans. I would like to express my sincere appreciation to everyone for their participation while they simultaneously grappled with their own strenuous work schedules.

Having Dr. Barak Kushner, a historian specializing in the history of modern Japan and a senior lecturer at the University of Cambridge, was a piece of unexpected good fortune. As the project's deputy editor, Dr. Kushner repeatedly flew to Japan in 2013 to assist. He not only assisted in running our May 2013 international conference with the authors, but also during the duration of the project kept up a continual exchange of ideas with the authors and the working group members concerning the content and scope of the project, striving to arrive at a shared consensus over the issues at hand. This book would have not been possible without Dr. Kushner's selfless contribution and for this I would like to offer my deepest thanks.

Members of the working group debated the issues at hand for so many hours at RJIF headquarters that it became like a second home. They also submitted detailed reports and were in constant contact with the Foundation. I gratefully acknowledge their labor and participation. The members of the working group are: Dr. Aizawa Nobuhiro, Dr. Ken Hijino, Horio Kenta, Igata Akira, Dr. Murai Tetsuya, Nikkuni Shinichi, Dr. Shimoda Hiraku, Uchiyama Hiroyuki, and Jan Zelezny. In addition, journalist Nishizaki Kaoru, Senior Global Correspondent at the *Asahi Newspaper*, served as an advisor to the working group and deftly added to our debates and discussion. I offer my heartfelt thanks for his support.

The lost decades project's staff director, RJIF fellow Kitazawa Kay, also headed our project on the Fukushima nuclear accident. Her professional attitude, as one who always kept her poise in the midst of whatever hardship, has once again seamlessly brought the work to completion. Researcher Takezawa Rie skillfully assisted the English manuscripts and gave much of her time.

RJIF's financial support is entirely dependent on private companies and I would like to once again express my deep gratitude to the companies that support us. We have also twice received generous grants from the U.S.-Japan Foundation to whom we need to offer thanks.

In conclusion, on September 26, 2014, I was sadly informed that one of our authors, Dr. Kitazawa Koichi, President of Tokyo Metropolitan University, had unfortunately passed away. Dr. Kitazawa had taken the reigns of our civilian research team committee, which examined the causes behind the Fukushima nuclear power plant accident. The fact that our final investigative report on the accident became known throughout the world was due to Dr. Kitazawa's unrelenting efforts. It fills me with a great sadness that I will no longer be able to see his warm and almost fatherly reflection. I would like to use this opportunity to express my deepest condolences.

Funabashi Yoichi  
October 1, 2014  
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# Introduction

The start of Japan's lost decades coincided almost exactly with the death of Emperor Hirohito in 1989 – and thus the dawn of a new era, that of his son, Emperor Akihito. This is perhaps one of the great ironies of history. Hirohito's long reign, marked by Japan's Fifteen Years War (1931–1945) and its complicated legacy, had finally ended. A new emperor, appropriate for the new Constitution of Japan, had ascended the throne. Moreover, the Cold War was just coming to an end. Throughout the world, people eagerly anticipated a new world order that would pay a “peace dividend.” Who would have thought that Hirohito's death would actually be followed by an era pregnant with both economic stagnation and political instability?

Needless to say, Japan did not plunge directly into a deep economic recession at the end of the 1980s, nor did the bursting of its economic “bubble” mean that recession was inevitable. As Kuttner, Iwaisako, and Posen underscore in Chapter 2, Japan's Great Recession of 1990–2003 and the subsequent fifteen years of deflation since 1998 were avoidable. Looking at the lost decades shows us that few of the turn of events that occurred during the post-bubble era were preordained by fate, though they may seem so in retrospect. In fact, at various times a multitude of policy options were available that could have led to a variety of different outcomes.

Sadly, the first lost decade in the 1990s was followed by yet another lost decade in the twenty-first century. On the heels of this long downturn, the March 11, 2011, disaster occurred. A powerful earthquake in northeastern Japan, followed by a massive tsunami, which caused a meltdown at the Fukushima nuclear power plant, plunged Japan into its worst crisis since the end of World War II. China's rise to great power status and its aggressive diplomatic posture, along with the territorial disputes over the Senkaku Islands in 2010 and 2012, also shook Japan. The situation appeared dire just when the Japanese people had become keenly aware that they seemed to be drifting without any sense of direction. Many feared that this situation might continue forever. To some, the disasters and the tense political environment only sharpened their sense of the urgent need to bring Japan's lost decades to an end. For others, the events aggravated an even deeper sense of resignation.

How should Japanese policymakers have reacted – have they made any significant efforts to revitalize Japan or have they just accepted a gentle national

decline? The inauguration of Prime Minister Abe Shinzo's second administration in December 2012 and the adoption of the economic measures known collectively as "Abenomics" were the result of a general sense that Japan had arrived at a critical juncture in its history. The campaign slogan for the Liberal Democratic Party (LDP) in the general elections of 2012 was "Take Back Japan!" and voters gave the LDP a landslide victory. This slogan was used during the Upper House election in July 2013, and again the LDP won a large number of seats. But what was it that was to be "taken back"? Was it nostalgia for the "good old years" of the postwar period, when the Japanese economy had been expanding, leading the country toward prosperity? Or was it traditional Japanese culture and customs, which had supposedly disappeared during the postwar decades? Or was it, in fact, Japan's power and national pride, which had been restrained during Japan's long postwar era? The aim and content of the slogan remained ambiguous, but it resounded throughout Abe's campaign, an appeal that unmistakably epitomized Japan's lost decades. As is now clear, the Abe administration immediately got to grips with the ramifications of the lost decades, implementing antideflationary policies and adopting a strong posture toward Japan's neighbors, including China and South Korea. Abe's policies may succeed in bringing Japan's "losses" or "lost decades" to an end. At this time, however, it is not clear how these policies will affect the status quo, and Japan's lost decades do not appear to have concluded.

### **The lost decades: Truth or illusion?**

When visiting Japan, many foreigners are puzzled: despite all the stories, the economy seems on an even keel. Visitors scratch their heads in surprise: is the narrative of the lost decades true? The relative calmness and apparent social stability in Japan, even after such a long recession, is indeed remarkable. Japanese society is resilient. Asia correspondent for the *Financial Times*, David Pilling, recently wrote a book on Japan's lost decades with a rather upbeat title: *Bending Adversity – Japan and the Art of Survival*. The author quotes Japanese novelist Murakami Haruki: "We are lost and we don't know which way we should go. But this is a very natural thing, a very healthy thing."<sup>1</sup> In other words, the postwar Japanese social model was an old, dysfunctional model, and so it was only natural that such a model should be lost. Such loss should, in Murakami's view, be welcomed.

However, during the 1990s and 2000s no one was the wiser that Japan's models might be old and outdated and such thinking had no part in political thinking in Japan. If it had, such ideas might have served as a wellspring for possible alternatives for policy choices. Why were alternative models not given more serious consideration, and why did they not ripen into practical plans? Such questions go to the very heart of Japan's lost decades. In Chapter 8, Machidori Satoshi looks on the political side at some of these reforms and what happened. The essays in this book were all written in an effort to put the concept of the lost decades under a critical microscope and to try to elucidate answers to these questions. The Japanese people already perceive the term "lost decades" as the best way to describe

these past two decades in Japanese history, as vividly demonstrated by a 2009 *Asahi Newspaper* public opinion poll. When asked about their images of prewar, postwar, and present (post-1989) Japan, respondents stated that they had the most positive view of the postwar period (1945–1989) until Emperor Hirohito’s death, which was regarded as “vibrant” and “progressive.” By contrast, the images they had of the prewar period (1926–1945) were “conservative” and “dark.” Most remarkably, the “stagnant” and “dark” images that respondents associated with post-1989 Japan (Japan after Emperor Hirohito died) surpassed those of prewar era. In other words, life in contemporary Japan is perceived as harsher than that of the prewar period, characterized as it was by fascism and a military ideology.<sup>2</sup>

As Japan’s recession has continued, other countries have become increasingly conscious that Japan had lost its way. Since the second half of the 1990s, perhaps as successive Japanese governments proved themselves unable to deal with nonperforming loans (NPLs) and as deflation became ever more severe, interest in Japan’s lost decades has deepened. In April 2002, on the eve of Prime Minister Koizumi Junichiro’s state visit to China, Chinese Premier Zhu Rongji was reported to have said: “Whoever manages to put the Japanese economy back on track, will certainly win the Nobel Prize.”<sup>3</sup> Under Koizumi, Japan finally dealt with its NPLs and resumed economic growth. Unfortunately, Koizumi’s reforms did not take root. The Koizumi years were characterized by an increase in the number of nonregular workers and layoffs, as summarized by some who defined its economy as “growth without employment.” As a consequence, the Japanese people were unable to feel the benefits of economic growth. Kobayashi Keiichiro examines such issues on the macroeconomic level in Chapter 3, while Toyama Kazuhiko analyzes the situation at the micro level in Chapter 4.

In the United States and Europe, especially after the Lehman Shock, the expression “turning Japanese” was used with increasing frequency, and in a cautionary sense – as something that Western countries should avoid. That is to say, they had to avoid following in the footsteps of Japan and letting their economies plunge into decades of stagnation. In October 2008, after the collapse of Lehmann Brothers, a meeting of the Federal Reserve’s Federal Open Market Committee (FOMC) was convened and president and CEO of the Federal Reserve Bank of San Francisco, Janet Yellen, called for a more aggressive policy of monetary relaxation: “Historical precedents,” she said, “such as the case of Japan, teach us that it is a mistake to act cautiously as the economy unravels.”<sup>4</sup> In 2010, economist Paul Krugman wrote in the *New York Times*, in a column with the title “Lost Decade Looming?”: “Despite a chorus of voices claiming otherwise, we (i.e., the developed economies) aren’t Greece. We are, however, looking more and more like Japan.”<sup>5</sup> A July 2011 issue of the *Economist* also produced a special issue that carried representations of U.S. President Barack Obama and German Chancellor Angela Merkel wearing traditional Japanese clothes on its cover, followed by the title: “Turning Japanese.”<sup>6</sup> Prime Minister Noda Yoshihiko would later recall how shocked he had been by that title.<sup>7</sup> Similarly, Fareed Zakaria has expressed the following caution over the

deepening crisis in Western democracies, which face the challenges of “budgetary pressures, political paralysis, and demographic stress.”

There once was an advanced industrial democracy that could not reform. It went from dominating the world economy to growing for two decades at the anemic average rate of just 0.8 percent. Many members of its aging, well-educated population continued to live pleasant lives, but they left an increasingly barren legacy for future generations. Its debt burden is now staggering, and its per capita income has dropped to 24th in the world and is falling. If the Americans and the Europeans fail to get their acts together, their future will be easy to see. All they have to do is look at Japan.<sup>8</sup>

As these examples suggest, “turning Japanese” described the situation of countries that were in their own turn starting to face the very same issues that had plagued Japan – including an ageing population, NPLs, rising public debt and deflation, an inability to deal with the impact of globalization on employment, income gaps, and a growing share of public debt placed on the shoulders of younger generations. As China’s high-growth era shows signs of reaching an impasse, there are fears that it too might suffer lost decades similar to Japan, and some have now also begun to issue cautions to China about “turning Japanese.” Reuters columnist, Andy Mukherjee, in a column titled “The Lessons for China from Japan’s Lost Decade,” described China’s situation as follows: “[The Chinese] economy today has three big similarities with Japan in the late 1980s: High and rising debt, diminishing export competitiveness and an ageing society. China can avoid slipping into Japan’s deflationary hole, but only if it learns from Tokyo’s failure to cleanse its banking system.”<sup>9</sup> Japan’s fate now appears to be held up as a negative role model for a number of other countries.

A great many attempts were taken to analyze the many facets of Japan’s lost decades and to offer policy remedies. This period in fact saw a succession of reforms. Nonetheless, no real effort was made to understand Japan’s lost decades holistically, not only from the perspective of demographics, fiscal and monetary policies, and management, but from all sides, including politics, foreign policy and security, ideas, and ideology. In Japan, reviews of government and legislators’ public policy failures by committees made up of third party specialists, and attempts to extract lessons, tend to be unsatisfactory. This is partly due to weak government oversight functions held by the Diet.

The Fukushima nuclear accident in March 2011 changed all this. Following the accident, three investigative commissions were set up by the Cabinet, by the Diet, and by an independent body. All three commissions attempted to analyze and shed light on the underlying and structural causes that led to the accident. Among the three, the Diet investigation commission holds investigative powers and it is in fact the first time the Diet’s government oversight function has been exercised in this fashion. Ahead of the Diet commission was the independent investigation commission, which was managed by the Rebuild Japan Initiative

Foundation (RJIF).<sup>10</sup> We are proud that the commission's independent investigation contributed to an increased interest concerning the need to probe Japan's public policies. RJIF's project on Japan's lost decades is similarly centered on public policy evaluation.

During the lost decades, the governments of Japan changed at a bewildering speed. It was not rare for newly installed administrations to resign before they even had a chance to implement the new policy plans they had formulated. Neither the government nor the Diet confronted the effects, or lack thereof, of the various policies taken under different administrations. No progress was made in policy research either. Such failures represent the breakdown of policy think tanks as well. In addition to providing information on Japan's case, and offering examples to other countries around the globe, many of whom are now going through a version of their own lost decades, concerning what to avoid, we wanted to make sure to analyze the issues in their original context. We wanted to ask ourselves what were the issues that Japan was grappling with during this period, perhaps for the first time in its history. What did not work? And why? What should we call into question?

On the basis of these sorts of queries, in 2012 the Rebuild Japan Initiative Foundation assembled a team of researchers from around the world and conducted long discussions that resulted in this book. Japan's lost decades coincided with the end of the Cold War and the start of the "post-Cold War era" and "post-Cold War world." In December 1990, the value of shares on the Tokyo Stock Exchange plunged, and this marked the beginning of the collapse of the bubble economy. In Japan, these years closely overlapped with the beginning of Japan after the death of Emperor Hirohito, but most Japanese people did not notice that this new era differed in nature from the postwar era. In fact, the Japanese people probably began to feel that the "long postwar" had undergone radical changes only by the fiftieth anniversary of the end of World War II, in 1995. In the same year Japan was hit by the Kobe earthquake and the Tokyo subway sarin gas terrorist attack; on both occasions the government was extremely slow to respond. In the January 1995 Kobe earthquake, it was reported that the first group to distribute water, food, and blankets were the *yakuza*, or organized crime syndicates (sometimes dubbed the "Japanese mafia"), and there is a general sense that volunteer efforts far surpassed those of the government. The earthquake exposed the complete lack of crisis management capabilities – the negligence – on the part of Japanese authorities. In 1995 the term "lost decade" had yet to be coined, but these events radically shook trust in the government. The March 1995 Aum Shinrikyo sarin gas attack deepened the nation's mistrust of feckless political leaders unable to defend the people, bringing the degraded state of the nation and of society to the forefront of people's consciousness and tearing down Japan's myth of domestic safety. The fanatical behavior of Aum Shinrikyo believers exposed the fact that some people despise the world so much they feel impelled to destroy it. The sarin gas attack offered a glimpse of the social and psychological dislocation of some of Japan's younger generation. And as Robert Jay Lifton notes, people's "diffuse Aum-related anxiety now became part of a larger constellation of fears about earthquakes, economic recession or depression, weakening family ties, and increasing domestic and social violence."<sup>11</sup>

The next major watershed moment came around 1998, when the financial crisis grew more severe. In the years following 1998, deflation in Japan turned chronic – in other words, deflation became structural. Despite some years during the Koizumi administration when there was economic recovery, economic stagnation basically continued for more than twenty years. As pointed out by Kuttner, Iwaisako, and Posen in Chapter 2, macroeconomic policy failures from 1999 to 2012 resulted from fundamental governance problems in Japan. Another key moment came in 2011 with the earthquake in northeastern Japan, the tsunami, and the resulting Fukushima nuclear power plant disasters. The latter in particular exposed the myth of absolute nuclear safety that had been advanced by Japan’s “nuclear village,” a cozy collection of politicians, bureaucrats, businessmen, and scholars who advocated nuclear energy. The Fukushima nuclear disaster revealed the deficiencies of Japanese institutions in risk preparedness and the problems in governance and overall leadership, as well as the closed-minded and insular institutional culture prevalent in Japan, often referred to as the “Galapagos syndrome.” It became clear to everyone that the “Japanese model” lacked the capacity to deal with national emergencies, because Japan had never directly confronted them in the postwar period. As Shirai Satoshi noted, decades after the end of the war, the tragic state of things in 2011 gave people a feeling of desperation, which we have to say is epitomized by the word “defeat.”<sup>12</sup>

To summarize: The seeds of the lost decades were sown in 1989 and 1990, just after the death of Emperor Hirohito and just before the collapse of the bubble economy. The loss of confidence began with the shock to the national psyche following the 1995 Kobe earthquake and the Tokyo subway sarin gas attack, intensified during the 1997–98 financial crisis, and became absolutely entrenched after the 2011 earthquake and the ensuing Fukushima nuclear accident. In the end, all these events led people to seriously question whether Japan could ever break away from the morass of its lost decades – or whether it would simply sink even deeper. The often-heard definition of Abenomics as Japan’s “last chance” reflects the expectations and insecurities stemming from this feeling that Japan has almost completely lost its way.

When discussing the lost decades, we need to define what was “lost.” First, we can say that substance was lost. There are two kinds of such losses: absolute losses, or numerical and quantitative losses in absolute terms; and relative loss, or decline, due to the rise of the rest of the world while Japan stagnated. A classic example of loss in absolute terms is the drop in birthrate and Japan’s overall population decline, as Seike Atsushi describes in Chapter 1. The fertility rate continued to decrease throughout the 1990s and has dropped to the 1.2 level. The working-age population started to decline after peaking in 1995 (87.17 million people). Japan’s total population also started to decline after peaking in 2008 (128.08 million people). One could say that the clearest indicator and also, perhaps, perpetrator, of the lost decades was demographic decline. Along with demographic decline, there was the loss of economic growth. The loss of the value of stocks and property following the collapse of the bubble was as high as 2.9 times Japan’s gross domestic product (GDP), a loss in asset value that was greater than during America’s Great Depression that followed “Black Thursday”

in 1929.<sup>13</sup> During this period, Japan suffered long-term deflation that had no previous equivalent in the world. The average yearly economic growth from 1992 to 2001 in Japan amounted to just 0.8 percent. By the end of October 1997, the yield to maturity on five-year interest bonds dropped to 1.11 percent, breaking the all-time global record low.

On February 12, 1999, following eight full hours of discussion over a Monetary Policy Meeting, the Bank of Japan (BoJ) decided to adopt a zero interest-rate policy (ZIRP), the first such decision by a central bank. However, loans to Japanese firms did not increase as intended, and for ten years since 1995 the total value of bank loans dropped to 30 percent. Banks hoarded government bonds rather than making loans, and during this period the ratio of loans to deposits in so-called city banks – Japan’s large commercial banks – dropped from roughly 80 percent during the pre-2000 years, to 60 percent in 2010.<sup>14</sup> The government implemented numerous fiscal stimulus packages but gained limited results. In the meantime, social security spending increased, adding to government deficits and the public debt. The public debt to GDP ratio leaped from 71 percent in 1992 to 230 percent in 2011, a threefold increase. Nonetheless, the government continued issuing bonds. During this period, and for over ten years, the Japanese government was able to float bonds that had interest rates lower than 1 percent. According to financial analyst Peter Tasker, Japan’s prolonged public financing at such low interest rates was the first case since ancient Babylonia.<sup>15</sup> The collapse of Japan’s economic bubble generated a massive amount of nonperforming loans (NPLs) that weighed down the Japanese economy. Yet, from 1992 to 1997 the disposal of NPLs continued to be postponed and only the failure of major financial institutions in 1997 and 1998 forced a change. From the end of the 1990s, deflation had turned into chronic deflation. From 1999 to 2012, consumer prices fell by 0.3 percent every year.

At the start of the twenty-first century, depopulation and deflation started to draw dividends on Japan’s economic malaise. During this period, Japan’s declining population and deflationary economy had the heaviest impact on the countryside. A strong yen led to manufacturing offshoring, a drop in public works resulted in a sharp decrease in construction projects, and Japan’s shrinking population caused sluggish consumption. All of the above weakened the economic and labor market foundations of Japan’s rural areas. This phenomenon was the flipside to the overconcentration of people in Tokyo that has become especially marked since 2000. Overconcentration in Tokyo is evident from the large number of enterprises listed on the Tokyo Exchange Market, the total amount of bank deposits and loans, sales in information and advertising industries, and the number of university students. There has been a population shift, made up especially of young people, moving from the countryside to big urban centers, Tokyo in particular.

## **What about employment?**

Japanese companies embarked on full-scale restructuring of their businesses in 1998. The aim was to deal with the three excesses of “employment, debt, and

equipment,” with particular emphasis on the reduction of personnel costs through adjustments in the employment system. Regular employment, which supported Japan’s prosperity in the postwar years, was reduced and irregular employment increased. While the irregular-to-regular employment ratio was 20.2 percent (8.81 million people) of the total workforce in 1990, this ratio increased to 35.1 percent (18.11 million people) in 2011.<sup>16</sup> Corporate activities also lost their former momentum as a result of population decline, deflation, market contraction, increasing social security expenses, yen appreciation, and other factors. Japan’s international competitiveness and return on equity also declined. In 1990, Japan was the world leader in international competitiveness. In 2011, Japan had dropped sharply to twenty-sixth place in the world.<sup>17</sup> These losses could also be seen in the field of education, with a decrease in the quality of education and an increase in the significance of economic disparity, as investigated by Kariya Takehiko in Chapter 6. The number of Japanese universities that are considered to rank among the world’s top 400 universities (in results that have been published since the early 2000s), decreased from twenty-seven in 2005 to sixteen in 2010. The rank of the University of Tokyo dropped from sixteenth in 2005 to thirtieth in 2012. Beginning in the early 2000s, there was a noticeable decrease in the number of Japanese students studying overseas: from 83,000 students in 2004 to 58,000 in 2011. The drop was particularly pronounced in the number of Japanese students studying in the United States, from 46,000 students in 2001 to 19,966 students in 2011, a reduction of over 50 percent.

The opportunity gap linked to economic disparity that has emerged is particularly serious. A growing inequality was evident in children’s academic performance, motivation for learning, and learning behavior, respectively. An exceptionally dismal piece of data from the lost decades is the increase in suicides, which rose steeply from 1998 onward. Before 1998, the number of suicides was between 22,000 and 23,000, but that year it suddenly jumped to 32,000. According to the 2013 Cabinet Office’s *White Paper on Suicide Prevention*, there is a strong correlation between the suicide rate and the unemployment rate.<sup>18</sup> During the next fourteen consecutive years, from 1998 to 2011, the annual number of suicides exceeded 30,000. In 2000, author Murakami Ryu wrote his Japanese novel *Exodus from the Land of Hope* and later commented that “This country has everything. You can find whatever you want here. The only thing you can’t find is hope.”<sup>19</sup> These words epitomized a sentiment that became increasingly widespread during Japan’s lost period.

On the other hand, Japan also experienced relative losses, meaning that even if Japan did not decline in some sectors, it stagnated while other nations advanced, and so its decline is relative in that sense. In 2010 China overtook Japan as the world’s second biggest economy, an event which probably sounded like a death knell and reminded Japan of its lost decades woes. However, as highlighted by Shiraishi Takashi in Chapter 11, the other side of Japan’s decline is Asia’s prosperity, the most dramatic example being China’s massive economic growth. In the context of the so-called rise of the rest, apart from Japan, other mature economies are also losing their relative economic standing in several

types of global rankings. We need to understand Japanese losses through this particular prism. During this period, overall Japan's per capita GDP fell from eighth place in 1991 to twenty-fourth place in 2012 in the world rankings. However, this drop is relative because Japan's GDP per capita actually increased from US \$20,465 to US \$36,265 over these two decades. Similarly, in the world's container port ranking, Yokohama and Kobe both fell from thirteenth place and fourth place in 1991 to fortieth place and forty-ninth place in 2012, as a result of the "rise of the rest." With regard to the number of Nobel prizes in the field of natural sciences during the 2000s, Japan rose to second place (9) after the United States (47). According to these figures, the past two decades were not lost decades at all – if anything they were fruitful decades. But if we look at the number of citations from natural science articles produced in Japan, while there was an increase in 2009–11 relative to the 1999–2001 period, Japan's overall world ranking dropped in relative terms due to the rise of contributions in other nations, including China. Japan, in fact, dropped from fourth place to seventh place in the top 10 percent of most cited articles, and from fifth place to eighth place in the top 1 percent of most cited works. By contrast, China rose from thirteenth place to fourth place in both categories.<sup>20</sup>

What about Japan's "lost opportunities"? Following the bursting of the bubble economy, the amount of NPLs began to swell. If the government had opted for capital injections by resolutely using public funds and had responded more adroitly to the situation, the ensuing financial crisis would have not become so grave and deflation would not have become endemic. However, LDP administrations delayed NPL disposal fearing popular opposition, and in the end ten years were needed to resolve this problem. This was the first and biggest lost opportunity of Japan's lost decades. In the end, leaders were timid in their development of new policies. Japan seemed to lack the strength and the focus necessary to forcefully advance international initiatives. The failure of the Japanese proposal for an Asian Monetary Fund (AMF) in 1997–98 to respond to the Asian Financial Crisis is a representative case. In addition, Japan continued to hesitate in its trade liberalization, and this lack of progress in market liberalization further obstructed domestic structural reforms. The fundamental cause behind Japan's botched response to the Asian Financial Crisis lay in a lack of political willingness to link structural reforms with market liberalization. Peter Drysdale and Shiro Armstrong in Chapter 10 highlight Japan's failure in trade policies and economic diplomacy as a means to achieve structural reforms. Shiraishi Takashi, too, speaks of lost opportunities with regard to Japan's role in managing regional cooperation in East Asia. It would have been much more effective to back Japan's trade policy with an economic partnership agreement (EPA), leading to increased imports from Japan.

Japan also had several lost opportunities regarding the history issue and how the population deals with war memory and responsibility. John Ikenberry, partly in Chapter 15, asks what would have happened if Japan had solved its history problems at the beginning of the 1990s, when both Japan's economy and its international standing were strong and China was in a weaker position. Looking back, he says, the lost opportunity to settle the history issues might have been in the

early 1990s when Japan was at the high tide of its economic growth and international prestige. Somehow, Japanese leaders might have found a way to settle these issues, and would have done so from a position of strength. Today, growing nationalism in Japan coincides with anxiety about Japan's geopolitical decline, and this combination make gestures of historical reconciliation very difficult.

Lastly, Japan seemingly lost its principles and vision of the future, which at one time were highly praised due to the strength of Japan's socioeconomic foundations and its internationalization. This may qualify as a "lost dream." The notion of a society that was once almost completely middle class illustrates this absence. In fact, a substantial middle class, together with a small disparity between rich and poor, constituted the foundation of Japan's postwar growth and stability and formed the core of Japan's success story. In 1979, Ezra Vogel wrote in *Japan as Number One* that the gap between the rich and poor in Japan was "one of the world's narrowest."<sup>21</sup> In the past twenty years, this core value of the postwar model has begun to disappear. The income gap between the wealthiest 10 percent and poorest 10 percent of Japanese society consisted of a eightfold difference, but by 2006 this gap had increased to a twentyfold disparity.<sup>22</sup> Japan's income gap is still small compared to that of the United States, Britain, and many developing nations, and it did not increase as much as many people believed during the lost decades. However, when the notion or myth of Japanese society as almost completely middle class was shaken, the result was palpable. The society that emerged at this time – characterized by a growing number of nonregular employees, gaps in income and education (which were often related), and a widening disparity in wealth amongst the elderly population, as well as a sudden increase of households on public benefits – deeply shocked many. The dramatic increase of nonregular employees meant that a large number of young people became commodities in the labor market and produced a dual labor market with major differences in salary and employment security. The fragility of Japan's employment system became apparent following the 2008 Lehman Shock, with most of the negative outcomes hitting nonregular employees largely made up of young people.<sup>23</sup>

Those who probably lost the most during the lost decades were those who belong to Japan's "lost generation." Such an understanding was reinforced in 2006 when Japan's public television station, NHK, broadcasted a defining two-part documentary titled, "The Working Poor."<sup>24</sup> This documentary delved into the situation of people who work full time but earn less than they would on welfare. The year 2006 was also when the newly coined term "herbivore men" began to appear in the Japanese media. This term is a half-serious reference to young men who lack aspiration, either for a career or in terms of interest in the opposite sex. Numerous polls targeted at young men reveal that a large percentage consider themselves to be "herbivores."<sup>25</sup> At the beginning of 2007, the *Asahi Newspaper* ran a series of articles on the lost generation by adopting a Japanese abbreviation of the phrase (*rosu gene*). This moment was when the term "lost generation" came into the popular lexicon. This new vocabulary reflected the life modes of those aged twenty-five to thirty-five years, who had become adults in the aftermath of the collapse of the economic bubble. The media shed light on a generation of

younger people who are variously described as “freeters” (underemployed part-time workers), NEETs (“Not in Education, Employment, or Training”), and social recluses (*hikikomori*), as well as on a plethora of nonregular, temporary workers who are dispatched from agencies and full-time employed regular workers.

The intensification of globalization and market competition, the effects of long-term economic stagnation and business restructuring, and, finally, a declining, ageing society coupled with seemingly ever-expanding government debt, greatly undermined the long-held popular belief that Japan was a safe and secure country. Yet, the more such difficulties beset Japan the more the government tried to reassure people that Japanese society was as safe as it ever had been. Former Prime Minister Aso Taro asserted as much when he said that the administration policies attempted to maintain a “society which provides peace of mind to its members.”<sup>26</sup>

The Fukushima nuclear disaster further shattered people’s trust in politicians. As Kitazawa Koichi discusses in Chapter 7, this accident represented Japan’s most serious crisis since the end of World War II. Notwithstanding the multiple warnings the International Atomic Energy Agency (IAEA) had issued to Japan about fundamental issues regarding its nuclear safety regulations, Japanese nuclear operators, regulators, government officials, and academics were so completely cocooned in their myth of “nuclear safety” that they continued to ignore the IAEA’s caution and the need for preparedness. This insularity should qualify as a “lost opportunity,” a lost chance to mitigate a potential disaster. The myth of nuclear safety depended on a kind of state paternalism that had always acted as the guarantor of safety and reassurance and dismissed the possibility of the potential of severe accidents such as Fukushima due to the dogmatic believe in Japanese infallibility. Inertia characterized regulatory governance, which was both complex and ambiguous. Those who managed the regulations, that is to say the government, were completely enthralled by their cozy relations to political power and avowed know-how of those who were supposed to be regulated, the electric power companies.

Other areas we need to consider are the effects and side effects of such losses. These are problems that arose from policy failures, or so-called lost policies, and their shape varies depending on the case. Does the trauma resulting from a loss lead to new innovations or developments? For instance, the 1990–91 Gulf War severely shook Japan’s long-held belief of its insular pacifism, which was limited to maintaining peace on its own archipelago. This political shock paved the way for Japan’s later participation in peacekeeping operations (PKO), and it is possible to say that such a change constitutes an example of a loss that Japan successfully transformed into a longer-term lesson concerning how to manage its security policy. In Chapter 9, Michael Green and Igata Akira have described such traumas as “teachable moments” for Japan, in an attempt to be positive and forward looking. In fact, during this period Cold War ideological and partisan cleavages in Japanese foreign and security policy issues grew less pronounced, and a kind of national consensus matured out of, for instance, greater faith in the Japanese Self-Defense Forces and the Japan-U.S. alliance. It is thus not possible to make sweeping statements and dismiss the period as totally lost.

By contrast, in the field of foreign and security policy, no consensus has been found between Japan, the United States, and Okinawa concerning the issue of U.S. military bases in Okinawa. Sheila Smith, in Chapter 12, outlines the inadequacies in the strategic coordination within the U.S.-Japan alliance. Neither country can sufficiently come to grips with scenarios that engage the possibility of the North Korea nuclear threat and the rise of China. Unfortunately, the Japan-China dispute over the Senkaku Islands raised the issue even further. As Smith enunciates, for the first time the two allies confronted the prospect of a direct use of force against Japan. Strategic issues involving the realignment of U.S. military forces stationed in Japan and the composition and capability of such forces continue to go unanswered, while the issue of the bases remains overall unresolved.

In 1995, under the Murayama administration, Japan moved toward acknowledging aspects of its war responsibility and expressed contrition. The Prime Ministerial address, known as the Murayama Statement, was an attempt to come to terms with and overcome the issue of Japan's history in Asia following the end of the Cold War. However, the statement then provoked a backlash from revisionist forces within the LDP. This would later lead to visits by Prime Ministers Koizumi Junichiro and Abe Shinzo to the Yasukuni Shrine and to a deleterious diplomatic environment that Togo Kazuhiko describes in Chapter 13. The history issue continues to create friction with neighboring Asian countries and the United States. As Akiyama Nobumasa suggests in Chapter 14, the Koizumi government's 2005 campaign to secure a permanent seat on the UN Security Council ended in failure. China, which holds a permanent seat with veto power, opposed Japan's bid and pressured other countries, especially in Asia, not to support Japan's efforts. In the end, Japan was able to secure only three votes from Asian countries. A former diplomat, who was involved in Japan's campaign for a seat, recalls proposing a review in the Ministry of Foreign Affairs "to look into the causes behind Japan's failure, in order to extrapolate lessons." The proposal however, was ignored.<sup>27</sup> With such failures in mind, it is imperative that we coolly and calmly analyze what was "lost" within diplomatic, security, and crisis management circles.

Prolonged deflation, increases in irregular employment, stagnant wages, and uncertain future prospects could very well discourage people's aspirations; stifle their optimism, energy, and willingness to take risks; crush entrepreneurship; dull the luster of marriage; limit the desire to go abroad to study or work; and drive society toward narrow-minded nationalism. Despite these examples, it is difficult to say with pinpoint accuracy what Japan lost and what the country gained. Losses for some may also be gains for others. The optimal solution for one community can often be a suboptimal solution for the group as a whole. In employment, for instance, the flexibility longed for by employers is usually understood by employees as insecurity.

As Andrew Gordon writes in Chapter 5, there are many instances where one's solution is another's problem. The only way to judge whether something is actually a problem is to determine whether the result was positive or negative with respect to the general long-term interests of the nation as a whole. It can be deemed "lost" if it has a negative effect on the overall and long-term interests of

the nation. Assessing the full value of the reforms that were designed to address the fundamental causes of the lost decades remains a very difficult proposition and is one of the key aims of this book.

Japan's lost decades were not simply the result of the government's inaction. Countless plans for reform were proposed and some specific ones actually drawn up, as Machidori Satoshi makes clear in Chapter 8. Some plans became policies and some materialized in new regulations, including the lifting and relaxation of previous controls. Nevertheless, these reforms were mostly ineffective. Partial effects notwithstanding, the overall impact was negative. At the same time, however, it is too simple to dismiss the reforms as lost. We can go further and analyze why these reforms did not perform as intended, question what the essence of failure was, and ask if policymakers have learned any lessons from their failures. It is only by taking stock of the situation now that we will be able to say whether or not the decades were truly lost and how extensive the losses were. The problems that have beset Japan's lost decades are challenges that other countries too are facing. It is true that the assets, opportunities, and perceptions that Japan lost during this time are rooted in the structural factors stemming from Japan's institutional culture. However, such losses are not actually cultural phenomena unique to Japan.

In the 1990s many economists, including Ben Bernanke, former head of the U.S. Federal Reserve, criticized the Bank of Japan's monetary policy – its timid quantitative easing, for example. Much of the criticism was appropriate. In the stagnation that affected their countries in the wake of the 2008 credit crunch, however, many of these economists experienced the same problems that economists had encountered in Japan – political opposition to the disposal of NPLs and wariness of long-term risk that came with bold quantitative easing. Bernanke later let it be known that privately “he regret[ted] the tone of those attacks (directed toward Japan),” suggesting that his direct experience now gave him a different perspective.<sup>28</sup> In this sense, Adam Posen has suggested that we should stop thinking of “turning Japanese” in the context of the lost decades “as a syndrome specific to Japan.” “While our economies in Europe and the United States may not ever ‘turn Japanese,’” Posen continues, “we all share some risks and problems in common with Japan circa 1995 . . . Japan's economic experience is similarly of universal relevance, offering parallels to today, but not some alternative state of the world.”<sup>29</sup>

The thrust of this book is to present an intellectual framework that shows how Japan during the lost decades performed precisely as Posen suggests and that offers parallels to present-day issues that other countries now face.

## Notes

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# 1 Japan's demographic collapse

*Seike Atsushi*

Japan's population is ageing at an unprecedented rate, both in terms of scale and speed. Around 25 percent of the population is made up of those who are sixty-five years or older, meaning that a staggering one in four are of retirement age. When we consider that in the early 1990s this figure was only one in ten, the nature of this issue comes sharply into focus. The change in demographics is perhaps best appreciated in the remarkable swiftness of the transition. The proportion rose from 7 percent of the population in 1970 to a total of 14 percent in 1994, an increase of 7 percent in just twenty-four years. This is a fraction of the time of comparable transformations in countries such as France, which experienced a similar leap over a period of more than one hundred years. The proportion of elderly people has continued to rise in Japan, from 14 percent in 1994 to 21 percent in 2007 – a further rise of 7 percent but even more quickly, in less than thirteen years. The graying of Japan's population looks as if it knows no limits.

One major factor behind this phenomenon is the remarkable improvement in life expectancy. Simply put, many more people are living longer. At the end of World War II the average life expectancy in Japan was fifty years for men and fifty-four for women. In a few short decades Japan's average life expectancy has risen to rank among the highest in the world, eighty and eighty-six years for men and women respectively. This rise of course stems from the combination of better nutrition, better health care, and a safer and for most people less physically demanding working life. These developments are due in no small part to Japan's remarkable postwar economic progress, and more particularly the increase in per capita gross domestic product (GDP).

The other factor supporting the graying of Japan's population is the decline in the birthrate. A country's birthrate decreases when it transitions from being a developing nation, which usually means that it has a high poverty rate and high infant mortality and birth rates, to being a developed nation with low infant mortality, birth, and overall mortality rates. The decline is usually associated with economic growth. This was precisely the course that Japan followed. Immediately after World War II, Japan's fertility rate, previously at 4.5 births per woman, declined rapidly. In the 1960s and 1970s, after a period of unprecedented high growth, Japan joined the ranks of developed nations and the birth rate fell to just above two births per woman. This level is known as the replacement rate, which is needed to maintain population equilibrium.

The problem was that this trend went too far – the fertility rate did not stop decreasing. From the mid-1970s onward, when Japan’s economy was entering its phase of greatest expansion, the fertility rate decreased to below two births per woman, which meant that Japan’s population was on track to decrease with each succeeding generation. This downturn in the fertility rate has been put down to the fact that while wages grew in line with the nation’s economic growth, the financial burden on families of having and raising children – even though the Japanese economy was on the rise – was just too great, particularly in the cities. At the end of the 1980s, Japan’s fertility rate dropped to a low of 1.57 births per woman, a figure that dipped below the sharp and temporary drop to 1.58 in 1966, a year which according to traditional beliefs and the Chinese zodiac was the “Year of the Fiery Horse.”<sup>1</sup> This decrease in the fertility rate continued with the collapse of the bubble economy in the early 1990s. After reaching an astounding nadir of 1.26 births per woman in 2005, it has since recovered slightly. Japan’s Ministry of Health, Labor and Welfare has reported that the rate for 2013 was at 1.43, up from 1.41 in 2012.<sup>2</sup>

Japan’s rapidly aging population is a phenomenon that is unmatched in other countries in the world and the birth rate has reached an all-time low. How could this have been allowed to happen? A nation’s population is its most fundamental base and the possibility of its collapse should be a key focus of concern for politicians and other leaders of society. When Japan’s fertility rate first dipped below two births per woman in the mid-1970s and clear predictions were made that the

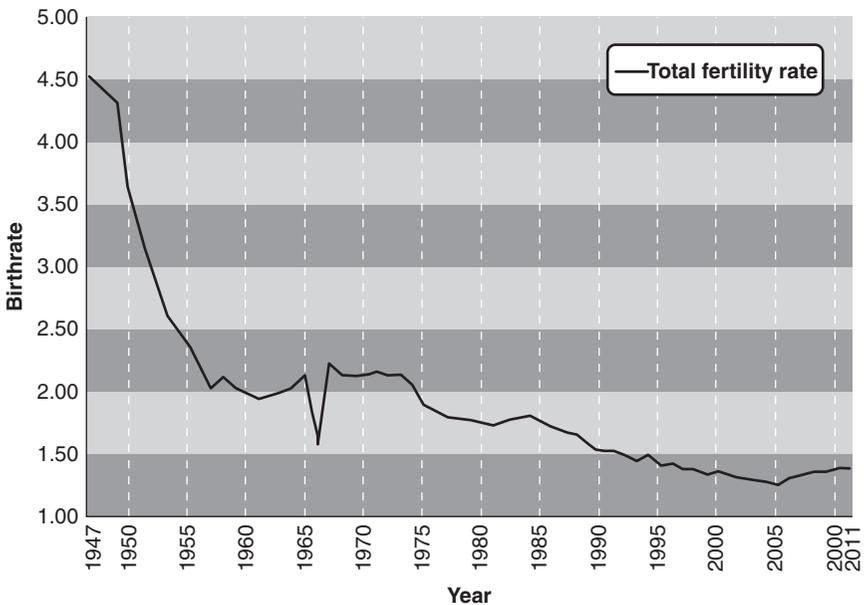


Figure 1.1 Trends in the fertility (birth) rate in postwar Japan (1947–2011)

Source: Based on data from the *Demographic Statistics Data Book* (2013), National Institute of Population and Social Security Research.

population would start to decline in one generation's time, plans to counter this trend ought to have been at the forefront of social and political discussion. However, as I show below, no sense of urgency seemed to ignite political concern, with the consequence that countermeasures, when they came, were addressing a situation that had already occurred.

Many people in Japan now fear that the downward trend in the population and the seemingly unstoppable overall ageing of the population will have deep and costly negative effects on the economy. It will cause a shrunken labor force that will limit production and will produce a smaller consumer market less able to stimulate demand. Of course, if per capita productivity and the consumption rate grow sufficiently to compensate for the population decline, the effects on the economy might not be so damaging. There is no guarantee, however, that such a scenario will be possible. A decline in population not only affects the economy but also leads to a decrease in the human resources that sustain society, such as public services and education. In short, the consequences could be considerable.

### **The shape of provincial Japan in the future: The Masuda Report**

What shape will Japan be in demographically in thirty – or fifty – years' time? In recent years, as the population decline has finally begun to become a matter of public debate, this is a question that increasingly preoccupies a number of population specialists, politicians, and business leaders.

The December 2013 issue of *Chuo Koron*, a special edition on “Disappearing Regional Cities,” carried an essay by the demography researcher Masuda Hiroya entitled “Regional Cities Will Disappear by 2040: A Polarized Society Will Emerge.”<sup>3</sup> The author, a former governor of Iwate Prefecture for twelve years, writes with concern about the demographic crisis now confronting Japan, and particularly on how the decline of the population will affect Japan's provincial areas. Based on his experiences of dealing with depopulation in Iwate Prefecture, in northeastern Japan, Masuda argues that Japan now faces the prospect of more and more marginalized settlements all over the country, with myriads of villages and hamlets suffering depopulation and becoming “hollowed out.”<sup>4</sup>

Masuda bases his analyses on reports and statistics compiled by the National Institute of Population and Social Security Research (NIPSSR), Japan's Ministry of Health, Labor and Welfare think tank. NIPSSR publishes a report every five years, entitled *Population Projection for Japan*. It also publishes a more detailed report entitled *Regional Population Projections for Japan*, which tabulates statistics and trends for towns and villages outside the larger cities.

The *Regional Population Projections for Japan: 2010–2040*, compiled in March 2013, calculates that if the current situation prevails, Japan's population of roughly 128 million in 2010 will fall to around 107 million in 2040.<sup>5</sup> Long-range estimates tabulated in January 2012 project a further decline to 86 million in 2060, and roughly 42 million in 2110. The proportion of the elderly population (aged sixty-five and above) will be 36.1 percent in 2040, and 39.9 percent in 2060.<sup>6</sup>