The choice of being prepared to bear the fiscal burden and pull out of deflation in order to promote structural reform

Interview with TAKAHASHI Susumu, Chief Economist, Japan Research Institute

View of the general economy

Iio: First of all, what is your view of the current Japanese economy in general?

Takahashi: When we talk about the Japanese economy, we must look at the short term economic cycle as well as the overall trend. As for the short term cycle, this extremely short-lived economic recovery is over. Looking into fiscal 2003, while much will depend on the performance of exports, I think there will be a return to somewhere around zero percent growth. As for the long term trend, I have a feeling it will be difficult for Japan to escape from this downward current. The state of the Japanese economy has worsened in the past ten years, and will likely continue to do so in the future.

To put it another way, the economy will worsen while the nation suffers without a solution for pulling itself out of deflation. As a result of this climate, various problems will arise, which will become concentrated on the weakest areas. The weakening of the economic structure is continuing apace, while in the financial system in particular, the effects of plummeting stock prices are appearing extensively.

But the Japanese economy manages to hold up because of past savings. Past savings refer to individual savings as well as those of the society as a whole. This is affecting consumption, the flow of which is stagnating very seriously. But consumption based on stock that is supported by accrued savings is relatively stable. So we often talk about weak consumption, but it's actually not that bad. In other words, we still have some stock so the Japanese economy won’t weaken too extensively. But I think the current situation is one where other areas are picking up the tabs.

Iio: What are your thoughts on the economic policies of the Koizumi government?

Takahashi: The Koizumi Cabinet is advocating structural reform in order to bring about a fundamental change of the current situation. What it means by structural reform is changing the current system and way of doing things.

From this perspective, I think the direction that the Koizumi Cabinet is taking is correct, but I feel it is underestimating the cost of such change. There is currently about 100 trillion yen in bad assets, and as the economic climate worsens, potential bad assets will start to emerge as bad loans. In order to avoid that, we have to get rid of this 100 trillion yen.

The current policy is to have the banks take up the slack and ultimately use public funds to clear up the mess, but I think the government is underestimating the total amount of public funds it believes it will have to use. Even in terms of macroeconomic policies, the government is trying to conduct reform while keeping the fiscal burden as low as possible. The Koizumi government's idea seems to be to carry out structural change using the least amount of money.

If the economy was strong, it might be possible to achieve structural reform that way. But with the Japanese economy as bad as it is, I worry that ultimately it will end up being more costly. Even if the bent toward structural reform is correct, if one miscalculates the necessary cost the economy will slump in the short term, which in turn will trigger a deflationary spiral. Furthermore, it will be the general public which ultimately ends up bearing the large cost.

In order to avoid falling into such traps of deflation, I think it's necessary to spend a substantial amount of money over a span of several years. But I think people are caught up in the belief that the current fiscal state does not allow for that.

In order to pull out of deflation in the next few years, we must change our stance to one of allowing for spending if it's truly necessary. Bad loan disposal is part of the structural reform, but at the same time we must take antideflationary measures or else we'll just end up going around in circles. A policy to enhance bad loan disposal will increase deflationary pressure, so it becomes necessary to take a comprehensive policy that includes an increase in fiscal spending.

The most ideal way to resolve this problem is to take drastic measures and end the pain fast, but given the current economic state, even if one took fairly serious steps, the situation would not turn for the better so easily. Even if we conducted structural reform, the results wouldn’t show immediately. The economy will continue to perform weakly for a while, and we must be ready for fiscal spending to offset the losses.

The bottom line is that we must avoid falling into a deflationary spiral as reforms are carried out. Being bold is fine, but there's a risk of falling into a deflationary spiral if we try to conduct reform within only a short time. The ideal would be to proceed with reform while increasing fiscal spending without making the economy fall into this spiral. In other words, we must accelerate reform and be prepared for extra fiscal spending, while protecting ourselves from falling into a deflationary spiral.

Bad loan issue

Iio: What are your thoughts on the bad loan issue?

Takahashi: In the case of Japan, the collapse of the bubble economy was the start of bad loans. Every developed nation has similar experiences. But in the case of other countries, the scale of bad loans was small, making it possible to deal with the problem swiftly. It was also easier to make a decision on what to do with them.

By contrast in Japan the scale of bad loans was large, and we were late in addressing the issue, so the problem of bad loans was carried over into the 1990s. As a result, the remaining bad loans caused the economy to worsen and, combined with various other factors, the Japanese economy itself weakened. This was the situation in the late 1990s.

Another factor contributing to the weakening of the Japanese economy is the change in the global competition environment and the delay in structural reform. As a result, the amount of bad loans increased. This kind of bad loan was not caused by the bursting of the bubble economy, but by the increased occurrence of bad loans due to battered corporations and industries. In other words, the current bad loans are the legacy of the delay in dealing with previous bad loans and reflect the worsened state of the Japanese economy.

When we take a look at the disposal of large bad loans conducted by banks, one can see that it took place in 1995, 1997-98 and 2001; all times when the economy was in a parlous state. In other words, we can see that bad loans increase when the economy is in a downturn, meaning that worsening of the economy and bad loans are not one-way issues.

As for the corporate sector, it restructured the excess in debt, facility and employees following the collapse of the bubble economy. Aside from the distribution, real estate and construction sectors, large corporations have completed getting rid of excess debt and have returned to a state similar to that before the bubble economy. But one reason why the problem of bad loans remains unresolved is because of the delay in dealing with the excess debt of the distribution, real estate and construction sectors.

On the other hand, the amount of bad loans caused by the deterioration of small and midsized firms is increasing fairly rapidly. When we analyze the debt based on the size of the firm, the state of small and midsized firms is turning very bad. Not only is the problem of excess debt weighing on such firms, it's the worsening of the Japanese economy in general that is creating these bad debts. So when the banks say bad loans are increasing, it refers not only to outstanding loans of firms suffering from excess debt, but also largely to the fact that small and midsized firms are suffering. The bad loan issue is exacerbated by the worsening state of the economy.

What we mean here by the worsening state of the economy is the erosion of profitability. Large corporations are recovering their profitability, but the profitability and balance sheets of small and midsized firms continue to deteriorate. Furthermore, the banks are picking up the tab.

Amid this environment, the current plan to dispose of bad loans aims at restructuring banks and improving their profitability. The first step is to eliminate the banks' shortage in reserves. To achieve this, the banking sector must improve its profitability, and to improve profitability, the banks are required to change their governance and take risks which measure up to the return. In other words, cut costs and increase the price. But for banks to increase the price means increasing the interest collected from corporations. However if the profitability of firms and industry is weak, it is impossible to improve banks' profitability.

The Bank of Japan (BOJ) and the government both acknowledge that the current deflation is making the bad loan issue worse. The most recent report on bad loans by the BOJ clearly states the correlation between the two. The government is also starting to acknowledge, in its white paper, the relationship between progress in deflation and worsening of the bad loan issue.

In this paper, the government demands that banks either build their reserves, or improve their profitability. Even if the banks claim they can't, the government is adamant in its belief that if profitability improves by changing the governance, then consequently the entire industry will be streamlined and efficacy will improve. But when we consider the real economy, there is a risk that if such changes are conducted while the industry lacks profitability, the economy will fall into a negative spiral.

Iio: So you are saying that while the industry itself lacks profitability, it is impossible to raise the profitability of banks no matter how strongly they are urged?

Takahashi: Yes. If the banks force themselves to increase profitability, they will have to resort to imposing a credit crunch or credit withdrawals. If the corporations are healthy enough, they might accept interest hikes, but those which are not would likely refuse to accept it. Hence banks cannot improve their profitability as they cannot increase lending, which is their prime source of income. Furthermore, if profitability cannot be improved the only option is to halt lending itself.

Iio: But it seems that if there is fair competition, innovators will emerge from the banking sector and there may be firms which will lend at lower rates and return higher interests to depositors.

Takahashi: With the profitability of the entire economy as low as it is, no matter what approach you take I think it would be difficult to turn up high profit. A while back, it may have been possible to provide high returns through foreign currency and securities. But the risk of currency fluctuation is high. Furthermore, overseas interest has fallen, and with stock prices also starting to sag, it is difficult to provide satisfactory returns.

The pension fund is a good example. The pension fund offers various investment opportunities, but all of their choices are suffering from a decline in profitability. The drop by more than 10% can be said to be abnormal.

After all, if the profitability of an industry or business is high, then banks can offer high interest rates to depositors by lending to such profitable enterprises. Profitability will improve if banks lend where the return measures up to the risk. But there are few such businesses to lend to.

Iio: If banks can provide high interest rates, then it seems to me that depositors will shift from saving to consuming.

Takahashi: As I mentioned before, it's not that consumption has completely halted; rather it is being polarized. Spending by those who have financial assets from the past is fairly steady. In case of company employees, their income flow is decreasing, and lacking financial assets, they lack the power to spend.

Furthermore, both the aging population and the younger generation are worried about their future. Hence they tend to save, in preparation for the insecure future, making it difficult for them to spend. With asset deflation ongoing, households need to maintain cash flow, and repayment of debt is a priority. As a result, people continue to save despite the knowledge that interest rates are low, and consumption remains restrained.

Iio: Do you expect people to continue saving even if there are negative interest rates?

Takahashi: The economic theory is that savings will decrease when there are negative interest rates, and coupled with a sense of insecurity about the future, they will merely change into cash.

Iio: Another point I would like to ask you about on the bad loan problem is that while the weakening of profitability of the overall economy causes bad loans, the fall in the value of the collateral is also causing it; but if the banks had offered loans by properly weighing the risk and return, would such a problem have occurred? In other words, doesn’t the fact that banks take collateral for loans make the problem worse?

Takahashi: Putting aside the question of whether collateral is good or bad, it's true that the bad loan problem gets worse because the value of collateral falls. The fall in the value of collateral is due to asset deflation. The reason why asset deflation doesn't stop boils down to the problem of the profitability of the economy in general being low.

In the case of banks and financial institutions, assets will decrease while they hold the collateral, but they cannot change the portfolio; despite the fact that it's desirable for the industry to invest in new areas. Given this context, when we look at what banks are doing these days, there are quite a few cases where they aggressively offer loans (of about 30 million to 50 million yen) to firms without demanding collateral. Banks are finally starting to properly weigh the people, product and money when offering loans.

In that sense, bank lending is gradually shifting away from its emphasis on physical things; and some banks are doing so successfully. But overall, it’s hard to see an increase of loans which do not demand collateral.

When we consider why it doesn't increase: if the chances of the new firms or new areas with promising growth are high, then it would be possible to invest there, but with the economy shrinking in general, you want to try and cover loss and thus seek collateral.

I believe banks want to create new business models, but there are still limitations, and while they are making the effort, there is still a strong risk that some efforts may turn into new bad loans after 2 or 3 years. I guess banks are now faced with that dilemma.

From the standpoint of the government, if banks change their business model, their function as financial mediators will return, and resource allocation will become more effective. The theory is that this will lead to the revitalization of new industries and the economy. But in reality it is not that easy. Even if that took place, it would take a lot of time. Rather, the trend may be toward restraining revitalization in the short term.

Direct financing and indirect financing

Iio: Is it impossible to conduct business without borrowing from banks?

Takahashi: Japan went through its financial Big Bang and tried to open the channel for direct financing, but nothing has been successful thus far. There are two reasons; one is that it takes time to establish the channel for direct financing. People must change their tendency to avoid risks, but this takes time. The other is that people who bought shares with their savings continue to suffer large losses as the economy continues to worsen. So there are only a handful of cases where people have succeeded through direct investment, and that tends to encourage people to avoid direct financing. Hence the tendency for the individual to avoid risks gets stronger. If the economic situation improves, the channel for direct financing may expand relatively fast.

Iio: One aspect to banks enduring the strain of the bad loan issue is that the banks are shouldering all the risks. Yet, isn't it true that the securitization and liquidation of debt, which would help disperse the risk, is delayed here compared to other nations?

Takahashi: I think people are finally starting to make efforts now. But looking at the United States, one can see liquidation occurring only after land prices have bottomed out and started to rebound. So the essence of the problem here is that the economic cycle is at its worst state.

U.S. banks have experienced liquidation of loan assets several times. In the 1970s and early 1980s, liquidation occurred when loans to developing nations defaulted. Furthermore, the real estate bubble occurred in the late 1980s and banks were faced with the problem of having to liquidate real estate. The government took the initiative to create a new scheme, and as land prices bottomed out and rebounded, various schemes were created and the liquidation market expanded.

Japan in contrast has not experienced liquidation. Furthermore, the economy is sagging, and with asset deflation continuing, such endeavors cannot take off.

Then again, in terms of expanding the direct financing channel, various attempts to develop new products like REIT (real estate investment trust) are being made, but the return is still very low. This once again returns to the fact that the economy is in a downturn.

Iio: How about investment opportunities overseas? Is that difficult because of currency fluctuation?

Takahashi: Currency has a large impact. The tendency to hold foreign assets has grown considerably in the last five or six years, but the currency risk still poses a problem. Another factor is the weakening growth rate of the United States. The global deflationary trend is hampering overseas investment.

If the Japanese economy is this bad, the currency should weaken likewise. The weak yen should be one way to save the ailing economy. But the weakening of the U.S. economy is ultimately preventing the yen from weakening. A fairly large amount of funds flowed to U.S. financial assets because its profitability was high, but with the profitability of the U.S. economy weakening, the dollar has weakened. Hence it’s difficult for the yen to weaken and that results in currency rates settling in a fairly narrow range. If this situation continues, the yen may stabilize, or worse it may start to strengthen, making it difficult to invest overseas.

In any case, depositors are still very cautious about shifting their savings to other assets. Having suffered losses in domestic assets as well as overseas assets, we need to see more successful cases to accelerate overseas investment. In other words, it's hard to make money now no matter where we turn.

Banks are now receiving requests for a kind of fund where the banks lend to new businesses and sell that fund to depositors. In this process, the system of indirect financing remains, but the method is one of direct financing. The recent trend is one where there is no determining line between direct financing and indirect financing. The banks themselves are trying to disperse the risk which concentrates around them by being a mediator of direct financing. But, the return on the risk remains small and there are still not many investment opportunities.

Deflation

Iio: What are your thoughts on the view that, what with deflation being a global trend, a single nation's policy is not going to help alleviate the problem?

Takahashi: Some say that China's excessive supply capacity is what brings about deflation in

Japan and other developed nations, while others claim the impact of China isn't as much as people think, but rather that deflation is homemade. The government's view is that deflation and economy are two different things. It says that deflation is a state of a continued fall in prices, and how the economy performs is a different matter. The conclusion thus drawn is that the economy can be dealt with by fiscal policy, but the ongoing deflation can only be countered by monetary policy. Hence the argument that it is possible to stop deflation by adopting an expansionary fiscal policy, and that if deflation can be halted, most problems will be resolved, is a predominant theory being touted within the Cabinet and Finance Ministry.

But while it is possible to think of the economy and deflation separately, for the sake of convenience, I believe that both are interrelated. There is an aspect to the situation which sees the worsening of the economic state, amid excessive supply capacity, continuously pushing down prices, and an aspect where deflation is worsening the economic condition. In the midst of this interrelation, deflation is caused by both external and internal forces.

Iio: What domestic elements are accelerating deflation?

Takahashi: There is the demand aspect and the supply aspect. Opinion is divided among economists, with those who emphasize the economy claiming it's the lack of demand, and that it's possible to halt deflation by triggering demand. Meanwhile, those who emphasize supply say it's necessary to strengthen supply. I believe both to be true, and that the current situation is caused by the interaction between supply and demand. While it's true that demand is on a shaky footing, the weakening of the capacity to supply as well as the weakened competitiveness are the major problems. With regards to supply, industries and businesses are slow to respond to new situations in which it needs to cut excessive supply capacity while adopting a new supply capacity. This must be rectified.

But Japan was unable to strengthen supply capacity, and to some extent demand must keep up to strengthen the flow. The present situation in Japan is one of a weakening demand making it difficult for supply to improve, while a weak supply is failing to trigger demand.

The prescription for economic and macroeconomic policies: measures need to be taken on both the demand and the supply side.

The government can take two definite steps to trigger demand. One is a matter of scaling public works, and the other is about whether or not to implement tax cuts. While there is also the problem of what kind of public works should be made available, and the need to shrink the scale of them amid limitations in state finances, I believe the government needs to take a stance where it maintains the current scale, at least nominally, in order to respond to the current demand shortage. Private demand will pick up naturally when expected growth rate increase and investment demand is triggered. That will erase a sense of insecurity about the future and consumer demand will rise. It would probably be difficult to trigger demand by tax cuts alone.

It is also necessary to combine structural reform with this in supporting the supply side. In other words, it is important to conduct a policy that addresses supply and demand. For example, tax cuts for investment in research and development and IT should be effective in strengthening the industry's competitiveness.

In pursuing this, it is consistent with macroeconomic policy to take measures even if the volume of fiscal spending expands, by viewing it as a necessary cost.

With regards to monetary policy, theoretically you can say monetary easing may or may not work on the economy. You won't know until you try it. Unless there are strong obstacles, it would be good to experiment with monetary policy in combination with other policies. If fiscal policy is changing through structural reform of microeconomic policy, then it should be all right to change one's stance on monetary policy.

Monetary easing is ultimately about setting an inflation target, and while there is the problem of whether or not that is an effective policy, lower rates will strengthen demand for overseas investment. If that consequently leads to a weak yen, it may help boost Japan and that’s worth a try. There is a risk of walking into a deflation trap as a result of drastic monetary easing, but I don't think this is such a problem for the time being. If the fiscal stance remains firm, there is no major problem in easing monetary policy.

Iio: The ultimate method of quantitative easing is buying government bonds, and if the government continues to issue JGBs saying its necessary to increase spending in order to conduct structural reform, deflation may stop but real interest rates will rise. Furthermore, I believe that capital fleeing overseas is actually the result of rising interest rates, but is it possible to seek some kind of balance between the two?

Takahashi: When looking at the workings of the market, I am a little worried that the rates won’t rise that easily. When there are limited investment opportunities interest rates will not rise unless people fight over funds. With the expected growth rate low and demand for investment weak, there is no competition for funds, and consequently we do not see the rates rise.

Iio: Won't JGB rates rise first?

Takahashi: I just mentioned increasing government spending, but if we do away with the target of reaching a primary balance in the next ten years, then the interest rates of JGBs may rise.

But there is no logical reason as to why this target must be the year 2010. I've tried several calculations and see no major damage occurring if this target is moved from 2010 to 2013. I don’t think rates would rise even if the government announced that it will spend in areas where it thought necessary to fight the current deflationary pressure, while maintaining the target of trying to reach a primary balance in the next ten or so years.

Financial administration

Iio: Next I would like to ask about financial administration. The Japanese government has already issued massive amounts of government bonds. For the last ten years, the government has been conducting an administration where tax revenue cannot repay the spending. If not, then won't it be difficult to recover primary balance?

Takahashi: The plan for the Koizumi Cabinet proposed by the Council of Economic and Fiscal Policy demands that primary balance be reached somewhere around the year 2010. The premise of this is that the economy stabilizes and expands from the year 2004. With real growth at 1.5% and nominal growth somewhere between 2.5 and 3%, it is possible to reach primary balance in ten years. This means that pulling out of deflation is a prerequisite. But on the other hand, just like Mr. Takenaka described it as a narrow path, this is the only picture that the council could come up with.

Fiscal restructuring is impossible when there is deflation. So the economy must first be stimulated and efforts made to put fiscal restructuring back on track. I'm very concerned that such restructuring may not be possible even in 2004 or 2005 if things remain the way they are. But then the solution is not just increasing fiscal spending, as it boils down to the problem of maintaining a balance. Short term fiscal spending will only boost the economy in the short term and recovery would not be maintained. Hence the only solution is to allow for fiscal spending to some extent, while steadily conducting structural reform and waiting for the results to show.

If the government continues its efforts for structural reform while taking measures to avoid the deflationary spiral, then we should be approaching the aforementioned scenario in the next few years.

Iio: Can we expect economic growth while the population is decreasing?

Takahashi: The population growth rate is extremely low compared to the past, but economic growth is still possible as the decrease in labor power can be compensated for by technological advancement. Even without that, it's possible to cut back the negative growth by incorporating the female and elderly, as well as overseas workers, into the domestic labor force. By securing a work force through such means and increasing productivity through structural reform, it's possible to maintain a growth rate of about 2%.

Iio: You mentioned the need for fiscal spending in the short term and the need to reach a balance in the long term, but many say that the areas in which fiscal spending is made is inefficient and that there should be a more effective way to spend government money.

Takahashi: Changing the content of the fiscal spending is also one kind of structural reform. The ideal is to decrease fiscal spending while seeking an efficient way of distributing it so that the impact of the spending multiplies. It is necessary to at least make efforts to do so. But it's difficult to see such positive results immediately, so we should avoid trying to drop the nominal target of fiscal spending in the short term.

Iio: Given the experience of the past ten years, I think we are undergoing a vicious circle, similar to a substance-addiction, where fiscal spending is made since the economy is weak, but because the spending is made where there is not much impact, it becomes necessary to spend more. How can we escape from this kind of situation?

Takahashi: For example, when a supplementary budget is drawn up, the spending should not concentrate on short-term stimulative measures but should focus on new areas such as city renovation or areas where the demand from the population is high. It must also continue efforts to reform the system in order to realize these changes.

While one must work to decrease public works spending, when considering the potential increase in deflationary pressure as bad loans continue to be processed, there is a risk that the balance from the macroeconomic point of view may tilt if spending is cut back too drastically. While avoiding further spending, I think the realistic solution is to maintain the current level, or maybe a little less, but change the way in which the money is being spent.

Iio: What areas will enjoy this multiplier effect?

Takahashi: I would say areas where you can expect to bring in new investment from corporations. If one takes conventional views, areas such as IT and biology and the so-called new social infrastructure would be candidates for such spending, as popular demand in them is high. They are also areas where corporations expect market growth. So if system reform takes place while government money is being invested in such areas, then the market will expand and corporations will be willing to invest; and then we will see the multiplier effect.

Iio: But is the reason why corporate investment doesn't take place in such areas of growth is because of some human-caused factor such as restrictions or policies which must be removed?

Takahashi: If we take a broad view, then the reason is because of the low expected growth rate, but the corporations have this mentality that new areas for growth do not actually grow; and one cause of such a view is the system. The system comes up with obstacles for those who make an effort.

In view of this, the current idea of setting up special zones will help change the corporate mentality, as it will remove some of the restrictions. It would then be possible to call in new investment, at least within these special zones. Of course the best solution is for the entire country to uniformly take such deregulatory measures.

Iio: But when you set up such zones, leeway is created which could hinder deregulation. I believe that if attempts at such special zones are to succeed, they also need rules, and need to be implemented on a nationwide scale.

Takahashi: To address that, it is also important to ensure something like a founder's profit or a pioneer benefit. Then efforts would be made to implement the endeavor throughout the nation. This pioneer benefit would likely fall into the hands of such people without having to guarantee it by law. The impact of showing what is possible is enormous, and it can change not only the thinking of firms, but also that of local governments.

Structural reform

Iio: Structural reform is basically about increasing productivity, but on the other hand, there is fear that structural reform increases deflationary pressure. How should we deal with this?

Takahashi: If we don't pursue structural reform now, the economy will fall into an endless balanced contraction. When we look at it from a global perspective, if Japan postpones reform, it will be left behind other nations. For example, China is now steadily increasing its competitiveness. While Japan's supply stagnates, global demand for Japanese products will wane and the Japanese economy will shrink.

If we think of it in this way, Japan cannot stay the way it is, and it is mandatory to redistribute resources to increase productivity, which is the goal of structural reform. It would be ideal if structural adaptation were to occur naturally, but society does not work that way, and we must go forth with reform. The textbook explanation is that such trends should naturally take their course through the mechanism of the market. But there remain the issues of restrictions and structure; and Japan is very slow at addressing them. The problem of shortage in demand became serious before these problems were addressed. But since structural reform takes time, as I mentioned earlier, we must proceed while trying to support the economy. If not, the cost of structural reform will only increase.

Iio: Is there the choice of triggering a depression?

Takahashi: The measures being taken now are those which are trying to avoid depression. They are policies which try to avoid what happened in Argentina from occurring in Japan. We're still not yet like Argentina, but we could be if the current situation continues for the next ten years. Should that happen, there will be no way of changing it.

So to take appropriate measures, as soon as we realize that we are heading in that direction, will help cut costs and increase the chance of revitalizing the economy.

Iio: The opinion of experts on structural reform does not appear to be unified. My view is that structural reform is not explicitly dealt with using a macroeconomic model, and from a microeconomic perspective, the issue is not dealt with in the overall context of increasing the country's productivity.

Takahashi: In traditional macroeconomics, the talk tends to be about fiscal and monetary policy within the given framework, and there is not much discussion regarding the reforming of this system or that market. There is no economics of structural reform.

But when we take a look at what Britain and the United States went through, the outcome was the result of adopting policies which changed the market structure, and combining fiscal with monetary policies. If Japan only looks at fiscal and monetary policies when talking about the macroeconomy, then something is wrong. What's crucial is to think about how changing the workings of the microeconomy would affect productivity and to combine that with macroeconomic policies.

When Reagan took office, there was talk about the Laffer Curve. We don't know if that was effective or not, but it contributed to society in that it changed the economic society. For example, policies such as deregulation of the aviation industry were adopted for the purpose of revitalization. Japan is now talking a lot about industrial revival, but the United States went all out to achieve that in the 1980s. These various efforts helped improve the economic situation. Macroeconomic policy swayed pretty much during those years, but the reason why it was able to attain sustainable growth in the 1990 is because both the government and the private sector worked hand in hand to conduct reforms.

Remember how the United States was afraid of Japan from the mid-1970s through to the early 1980s? Japan now possesses the same fear towards China, but if Japan takes the necessary measures, there is still hope.

There is this big wave, the peak of which was reached when “Japan as number one” was the common cry, but now it is steadily declining. However, if we adopt the beneficial parts of reform measures taken in the United States and revise the healthy parts of the Japanese system, then there is a great possibility of drawing out Japan's potential.

Japan is now facing an aging society, but this is a new phase which other Asian nations have yet to experience. If we are clever enough, we may be able to create products and offer services which China and other developing nations cannot come up with. That is what a maturing society is about – the shift of people from material wealth to spiritual wealth.

An aging society is one where the needs appear in different places, and it is these people who have the need that also have the money. If new areas can be cultivated from here, they will become a source of future exports. What's important now is the actualization of these new areas in order to stimulate investment and increase the expected growth rate of corporations.

What I'm interested in now from this standpoint are activities such as eco-money and NPOs. They are moves which bridge the gap between self-responsibility and public aid. They respond to needs which cannot be answered by the government, corporations or an individual, and so will develop into an area of new added value. They may not be high added value, but are nevertheless an important one for society.

If we can nurture this field and create a new social system which allows for such activities, then we may be able to export them. So I believe it's important to take measures which will enable such endeavors to proceed on a sound footing.

I also believe there is still room for development in the field of manufacturing. Japan is good at nanotechnology. Nanotechnology is an area where Japan does not have to suffer too much technological discontinuity and a lot can be expected from it.

Even in other fields, the hardware part – which is the manufacturing – can be combined with the software part – or Japanese culture – to create new products. If that is possible then the Japanese industry can continue to create products with high added value.

But the problem at the moment is that we still can't see such possibilities yet. Only an increase in successful cases will help break the deadlock. However, we still don't have the answer. We don't have a good answer as to how to change people's thinking and how to nurture new fields of interest.
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