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In Search of New Economic Path of Japan in the Post-Global Financial Crisis

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Since the global financial crisis, the Japanese economy once again dipped into an economic downturn. The Abe administration, which was inaugurated in December 2012, pursued Abenomics in an effort to get the economy out of deflation. However, it is still uncertain whether such efforts will produce noticeable results. This paper examines Japan's economic policies in the following five areas, namely, (1) enhancement of international competitiveness in manufacturing; (2) fostering of new industries for strengthening domestic demand; (3) securing sustainability for governmental finances and social security; (4) proactive liberalization of trade and

investment; and (5) establishing new energy strategy for building new energy supply structure. Based on such examination, this paper discusses the policy implications for Korea.

1. The International Competitiveness of Japanese Manufacturing

The trade specialization index, an index used to evaluate international competitiveness and trade conditions, shows that the international competitiveness of Japanese manufacturing has steadily declined.

It appears that today, the competitive edge of Japanese manufacturing lies in precision machinery, general machinery, transport machinery, chemicals, electric machinery, steel, electronic parts, and telecommunication, in order. Japanese corporations are speeding up the restructuring and entry into overseas markets, led by companies whose competitiveness has suffered. In particular, since the Great East Japan Earthquake, there have been changes in the investment and procurement activities of Japanese corporations from the perspective of rebuilding supply chain. The changes in Japanese corporations' investment and management strategy also have substantial effect on Korea. One of the representative examples is the drastic increase in Japanese corporations' investment in Korea since 2011. In addition, structural changes are starting to appear gradually in the Korea-Japan trade structure.

The future Korea-Japan cooperation plan should include: (1) proactively utilizing the buying power of the Korean conglomerates in the IT and automobile sectors to promote Japanese firms' investments in Korea; (2) the Korean firms utilizing their own manufacturing capability and the Japanese firms' technology to reinforce mutual cooperation; (3) promoting the Korean parts and materials sector's entry into the Japanese market by proactively responding to Japan's expansion of overseas procurement; (4) Korean government's efforts to attract small and medium-sized Japanese companies; (5) the Korean companies proactively working towards increasing market share in the Japanese market; and lastly, (6) proactively putting out information about the growth potential of the Korean market to convince Japanese firms that they can do business in the long term in Korea with stability.

2. Japan's Policy for Fostering New Industries

It is well known that the Japanese economy has been experiencing severe downturn in domestic demand in the last 20 years. In order to overcome these problems, the Japanese government has set productivity enhancement as its priority policy agenda based on innovation and creation of new demand and jobs. For example, the "Japan Revival Strategy" announced in July of 2012 suggested the "Green" (energy and environment) and "Life" (medicine and welfare) sectors for creating new demand. The green growth strategy pursues core projects such as parts and materials, products (next generation automobiles, storage battery, and marine development), and system (next generation energy control system), whereas life growth strategy pursues strategy for enhancing the competitiveness in pharmaceuticals and medical equipment industries.

Under the current global recession, there are convincing arguments that the new growth strategy must be based on domestic demand instead of exports since the export-led growth in Japan involved many risk factors so far. According to that argument, domestic demand expanding policy is the most important. The main elements in the strategy are expansion of fiscal spending and monetary easing policy. The policy emphasizes that employment should be protected while wages are encouraged to increase and social security is strengthened thereby encouraging expansion in consumption. The Abenomics is based on such understandings.

However, this strategy is based on somewhat distorted understanding of reality. There is a limit to artificially expanding Japan's domestic demand because Japan already is a society with decreasing population, with low-birth and

aging growing ever more severe. The Japanese government expects a low possibility of debt crisis occurring in Japan for Japan's debt situation is fundamentally different from that of the European countries inflicted with debt crisis. However, such optimism needs to be backed by high domestic savings rate and continued trade surplus. Seen from mid to long term perspective, Japan's current account has been gradually shrinking and there is high likelihood that domestic savings will shrink as well due to the aging of its population. The idea of expanding domestic demand by raising wages and strengthening social security, thereby increasing the people's purchasing power is misleading, at least to a certain degree. Wage increase is something that grows out of companies' ability to create added value, not something that could be compelled by fiat of policy.

Korea is also predicted to gradually face the problem of low growth and weak domestic demand. The strategy the Korean government should pursue at such time is more proactive cultivation of overseas markets, expansion of overseas investments, through which innovations are created, and fostering global firms and human resources that can realize such innovations. The unintended side-effects, such as widened gap in income, must be resolved through additional policy measures, not by denying proactive global strategy and competitiveness enhancement strategy.

3. Integrated Reform in Tax and Social Security System

Japan's national debt has recorded 200% of the nation's GDP as of 2010 due to decline in revenues and rise in social security benefits. More than half of general spending out of the government's general accounting is being

spent on social securities related expenditures, centered on pension and medical insurance. Despite the spending, the public pension and national health insurance are fraught with problems of non-enrollment and non-payment as a result of wide-spread non-regular employments, while fiscal balance is mired in debt. This is why many people have voiced concern over the social safety role served by Japan's social insurance and the sustainability of social security system.

The centerpiece of DPJ's integrated reform in tax and social security is tax rate increases. It is somewhat unclear whether the proposed amendment to consumption tax law, which passed the Parliament in August 2012, will be actually implemented as it is conditioned upon the so-called economy resilience provision. The current five percentage consumption tax will increase to eight percentage starting in April 2014, and then to 10 percentage starting in October 2015. The Japanese government hopes that, with each one percentage increase in the consumption tax, the revenue will increase by 2.7 trillion yen per year, which will be used towards social security.

However, the effect of the integrated reform is expected to be smaller than originally expected. According to the simulation results from the Japanese cabinets, it is hard to attain the fiscal management strategy goal, which aims to convert primary balance into surplus by the year 2020. Some even say that the current five percentage consumption tax must be raised up to 30 percentages in order to attain the finances stabilization goals by relying on consumption tax alone. Considering the assertions in debates surrounding consumption tax increases - for instance, the argument that priorities should be placed in cutting annual expenditures or administrative reforms for stabilizing finances; that tax increase during a deflation will pull the Japanese economy into a

deflationary spiral; and that problem of reverse progression which is innate in Japan's consumption tax system must be resolved - it is easy to see that the increase in consumption tax is merely a "first step" towards stabilizing the governmental finances.

In the future, the role of Korea's finances should shift from economy adjusting function or social capital formation to social security. Japan's experience shows this very clearly. Japan's annual social security expenditure has already exceeded 100 trillion yen. This is almost equal to Japanese central government's annual budget. Of the central government's budget, social security related expenditure easily exceeds 30 trillion yen. Social security already takes up a significant portion in Japan's finances. When Korea strengthens its social security in the future, similar phenomenon will occur. In order to manage both the finances and social security soundly, it is necessary to design and manage the two systems in an integrated manner, and to form a corresponding government body. We have now entered an era in which it is very important to maintain the integrity of finances well in order to secure a safe funding source for social security, and the importance is expected to increase considerably in the future.

4. Japan's Trade and Investment Policy and Korea's Response

Japan has been trying to proactively pursue trade and investment liberalization policy. It is promoting FTA negotiation with major countries in the Asia-Pacific region. TPP negotiation is a representative example. It has also commenced FTA negotiations with the EU. To facilitate the negotiations, it has set pursuing structural reform in agriculture and do-

mestic regulations reform as an important policy direction. It is also implementing "Asia-Pacific Economic Strategy" in order to utilize the energy of the overseas newly emerging markets centered in Asia. However, such strategies have yet to produce any concrete results. In particular, there are still many things to resolve in relation to creating domestic atmosphere necessary for actively pursuing liberalization.

The Japanese firms are increasingly investing overseas owing to the strong yen, rebuilding of supply chain, limitations on energy supply, and etc. The Japanese government is also supporting the Japanese firms' overseas expansion, acknowledging the possibility of a virtuous cycle created by overseas investment, domestic job, and industry creation, as well as the need for the small and medium sized firms to enter the overseas markets. Also, it is offering a variety of incentives to draw foreign investments. Despite these efforts, Japan's trade and investment policies are very weak when compared with its domestic economic policies in terms of budget, organization and human resources. In order to promote the globalization of Japan's economy and society, the reinforcement of policy in the areas of trade and investment is needed.

Some argue that East Asia should also form a regional bloc just like the EU or NAFTA, but, judging by the experience thus far, there is a limit to building an economic bloc with just the East Asian countries. Based on these observations, the following three should become the core of Korea's trade strategy.

First, Korea needs to support the strategy of the U.S. to engage in Asia. This is because the U.S.'s enhanced engagement in Asia will prove effective in the liberalization of each of the East Asian countries and maturation of the market economy systems. TPP is the U.S.'s

economic means of engagement in Asia. Korea needs to work on measures to make strategic use of the TPP negotiations. Because TPP is based on the idea of wholesale liberalization, it could be used as a means of promoting the development and advancement of China and other later emerging East Asian countries.

Second, cooperation with Japan is essential for the advancement of East Asia's economic system. In this sense, it is desirable to recommence the Korea-Japan FTA negotiations. In particular, Japan is viewing Korea's leaning towards China, prompted by the commencement of Korea-China FTA negotiations, with a watchful eye. If Korea-Japan FTA negotiations are delayed much further, it could have negative effects on the Korea-Japan cooperation.

Third, it is necessary for Korea to reinforce alliance with the developed countries, including the U.S. and Japan, while also making efforts to qualitatively enhance the cooperation with China. That is to say, if Korea leans towards the U.S. and Japan at the exclusion of other countries, the Korea-China relationship could suffer. Accordingly, there is a need to proactively participate in the Korea-China FTA and Korea-China-Japan FTA negotiations, while also continuously exploring agendas that could reinforce the cooperative relationship between Korea and China.

5. Japan's New Energy Strategy

Since the Great East Japan Earthquake, the following three areas have gained importance for Japan's energy strategy. First, there is the discourse regarding optimal energy-mix. The most central issue here is how to deal with dependence on nuclear power. The Japanese

government has proposed an innovative energy/environmental strategy whose goal is to "eliminate nuclear power dependency by the year 2030." However, this strategy is becoming more and more likely to undergo change since the Abe administration took power. Second is an issue related to renewable energy. While those who agree with supplying renewable energy and those oppose to it are locked in a debate, system and policy are being established to expand renewable energy. Third is the issue regarding structural reform of the electric power industry. Japan's power industry is characterized by regional monopolies and comprehensive management system. As such power industry structure has recently come under criticism, there have been reforms including complete liberalization of retail sale of power, and reforms in method of managing power distribution network.

Japan's experience as described in the foregoing offers us the following policy lessons: First, Korea needs to re-examine its nuclear policy. In particular, right now - when the country is undergoing change of generations of technology workforce and facilities have become aged - is the most dangerous time when accidents could occur. From this perspective, more than anything else, Korea at this time needs a large-scale check-up to reinforce the authorities of regulating bodies for the purpose of raising nuclear management capability and safety. Second, this is the time to invest in the development of alternative energy rather than increase dependency on nuclear energy. Through this, new industries must be fostered. Third, the Korean government must also think seriously about power industry structure reform as well. In particular, in order to develop power generation industries that use small scale renewable energy sources such as solar power and wind power, free access to power distribution network and low cost is required more than anything else.

If Korea pursues supplying renewable energy, it will be inevitable to build power distribution network based on public goods management system. Liberalization of power user charge is another important issue. The Japanese government has decided that it will liberalize power user charges when it is believed to have the function of controlling demand. Korea's power charges are set too low as a result of government regulations. Because of this, the power charge's demand controlling feature has not been operating adequately. Korea's power user charges are very low even when compared to the international standards. [KIEP](#)