Japan's economy contracts as Koizumi announces restructuring plans

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Japan's gross domestic product fell by 0.2 percent in the first quarter of this year and appears certain to officially enter a recession, defined as two successive quarters of negative growth.

The deterioration of the economy came in the wake of the release by the Koizumi government of a draft economic plan aimed at trying to revive the world's second largest economy which has experienced a decade-long stagnation since the collapse of the share market bubble in the early 1990s.

Prior to the release of the GDP figures, Economic and Fiscal Policy Minister, Heizo Takenaka indicated last week that the government would again downgrade its assessment of the economy for the fifth straight month in its report for June, changing its outlook for the economy from "further weakening" to "deteriorating".

"The economy is facing a bit of a tough situation, and we will have to change our view from the previous month," Takenaka told reporters.

The downgrade came in the wake of worse than expected economic data. Industrial production fell 1.7 percent in April, following a 2.1 percent decline in March. Falling exports to Japan's key markets in Europe and the United States, due to slow economic growth, and a decline in the level of domestic consumption are said to be the main reasons for the slump in industrial production.

Exports fell 2.5 percent in April, whilst inventories rose 2.1 percent, an indication that industrial production will likely to be cut further in the coming months.

Unemployment rose to 4.8 percent from 4.7 percent in March, just short of the post war record high of 4.9 percent recorded in January this year. Unemployment among men rose to 5 percent with total unemployment rising to 3.48 million, up 20,000 from a year ago.

Among the sectors with the worst job losses were the automobile and construction industries. Tens of thousands of jobs are to be cut in the vehicle industry. Late last month Isuzu Motors announced that it will cut up to 10,000 employees, more than one quarter of its total workforce of 38,000 by 2003 as part of a restructuring plan. Isuzu will close its large truck manufacturing plant in Kawasaki.

Nissan plans to cut its workforce by 21,000 or 14 percent. Mitsubishi Motors announced earlier in the year plans to axe 9,500 jobs, representing 14 percent of its staff, whilst Mazda is restructuring its operations and shedding 2,300 jobs.

Eight major construction contractors have announced combined job cuts of almost 3,000 as part of their rehabilitation programs imposed by their bankers. The largest, Kumagi Gumi, will cut 2,000 jobs over the next three years in an attempt to cut 8.8 billion-yen in labour costs.

Alongside news of the continuing job destruction, came a report that wages for salaried households dropped 0.5 percent from a year ago, representing five straight months of decline. Consumer spending, which accounts for 60 percent of GDP in Japan, fell 4.4 percent in April. The fall was the largest recorded since December 1999 when spending fell 4.7 percent.

The Japanese Cabinet Offices' business diffusion index fell below 50 for the fourth consecutive month, coming in at 28.6. A figure above 50 is an indicator of economic expansion and a figure below 50 indicates a contraction of the economy.

Corporate profits registered zero growth in the first quarter compared with profit growth of 31.9 percent in the October-December quarter last year.

According to Jesper Koll, chief economist at Merrill Lynch Japan, the figures indicate that "Japan's economic downturn is accelerating." "Merrill Lynch expects zero growth, with gross domestic product contracting for two consecutive quarters from April (the definition of a recession)."

It was against this background that the Koizumi government released its first proposals for "reviving" the economy. The reform plan was compiled by the newly created Council on Economic and Fiscal Policy. Headed by Prime Minister Junichiro Koizumi, the council includes Economics Minister Takenaka plus three other government ministers, the Governor of the Bank of Japan, Masaru

Hayami, and four big business representatives.

While no specific plans have been outlined, the blueprint includes a commitment to press ahead with the removal of bad debt from the banking sector within 2-3 years, sweeping privatisation of public enterprises, an overhaul of the social security system and taxation and major cuts to public spending. The council is scheduled to meet later this month to provide more concrete details.

The main targets of privatisation include the Narita and Haneda airports, the Japan Highway Public Corp, Japan Oil Corp, the Urban Development Corp, the Housing Loan Corp (which at present controls the majority of mortgage loans) along with state run universities and postal services. The latter is a major target as it is said to control the world's largest pool of savings.

Tax changes include the provision of tax breaks to business and stock market investors. Employers are also set to benefit through plans to make job related training expenses tax deductible.

The draft plan also calls for the privatisation of Japan's employee pension scheme. This news will be particularly pleasing to foreign and domestic fund managers as the pension scheme, currently run by the government and backed by Japanese banks, is said to hold one of the biggest pool of pension assets in the world, according to a recent report in the *Financial Times.* In the words of one US fund manager cited in the report: “What companies are competing for is probably the biggest honey pot in the world.”

The draft plan also calls for the cutting of subsidies to local government which provide infrastructure and social services and the reallocation of tax revenues collected from automobile weight taxes, road tolls and petrol excises. These taxes will be used in general spending and not solely on road construction. This measure will bring furious opposition from construction companies, many of which have close connections to the ruling Liberal Democratic Party and have reaped large profits from construction programs.

The moves for restructuring of the banking system, the privatisation of the public sector, economic deregulation and cuts to government spending have drawn praise from the representatives of international capital. However, they are also stepping up the pressure to ensure that Koizumi's words are matched by deeds.

US Federal Reserve Board chairman Alan Greenspan has insisted that “the disposal of bad loans is indispensable for the reconstruction of the Japanese economy.”

International Monetary Fund managing director Horst Koehler who visited Japan last month to have discussions with the government, praised Koizumi's efforts to rehabilitate Japan's economy through structural reforms and emphasised likewise that resolving the bad debt problem in the banking sector was the Japanese government's number one priority.

While drawing praise from international financial circles, the draft plan, if implemented, will mean an economic and social catastrophe for millions of Japanese people.

According to research carried out by the Nippon Life Insurance and Dai-Ichi Mutual Life Insurance companies if the banking sector is forced to write off the almost 13 trillion yen ($US109 billion) in bad debts it could throw as many as 1.1 million people out of work. This figure does not include the tens of thousands of jobs that would be destroyed as a result of corporate restructuring (the auto industry is an indicator of the extent of job losses that could take place), privatisation of the public sector and those jobs that would be destroyed as a result of government spending cuts.

The draft economic plan calls for the creation of five million new jobs but gives no specifics. The figure of five million is more than anything else an estimate of the number of jobs that the Council on Economic and Fiscal Policy thinks will be destroyed.

The economic research firm Teikoku Databank believes that rather than fixing the economy, Koizumi's reforms will worsen economic conditions. Its recently released report entitled “Bad timing for painful reform” stated: “Prime Minister Koizumi's ‘No Pain, No Gain' approach to mending the economy will accomplish little more than a surge in bankruptcies and unemployment”.

“The pledge to go through with final disposal of banks' bad loans (within two to three years) has the very worst timing... when the economy is headed for a downturn and at the same time that financial and fiscal policies can do little to help recovery.”

It warned that small to medium companies, which employ the largest proportion of the Japanese workforce, would be the most likely to suffer. “Acute conflict of interest between banks and their borrowers will interrupt efforts to put weak firms back on their feet and increase the possibility of large scale bankruptcies,” it said. These warnings have been underscored by the latest GDP figures which point to further contraction of the economy in the coming months.