

# Japan Analysis

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## FOREWORD

Japan is changing, and Japan Analysis is changing with it. Following the trend in the major Western democracies, including the developed and partly post-modern ones of Europe, Japan is undergoing a certain shift in its discussions of social issues and domestic policies, around the prospect of its decline - exacerbated, of course, by the rise of China.

There is no doubt that Japanese parliamentary democracy is going through a difficult phase as it faces governmental instability, which has lasted nearly five years, and the problems of coalition governments. These go beyond the traditional political horse-trading, and they arise from genuine concerns over identity in both camps. The public sees Japan's diplomacy losing influence - even while the country takes a clear-cut and occasionally bold stance: one need only mention the choice made after the award of the Nobel Peace Prize to a Chinese dissident in 2010. But its economic prospects weigh heavily on the country, while it remains nevertheless essential to any resolution of global economic imbalances, and a force for international development. These latter

considerations are now being played down or completely overlooked in public perceptions in Europe or the West in general.

That is why Japan Analysis is changing its contents without changing its overall aims. These will continue along the lines established by Dr Guibourg Delamotte, who founded the review in 2004, and to whom we wish to express our warmest gratitude for her untiring efforts and abilities. The goal will remain to provide objective reporting of the debates in Japan, and of the positions taken within them, with "complete transparency". By this we mean the elimination, to the best of our ability, of interpretations imposed from our own point of view. Foreigners' perceptions of the players, observers, and intellectuals on the Japanese scene are skewed by the barriers of language, not by ideology or culture. Our modest intention is that Japan Analysis will throw light on some of these participants without entering into their debates.

By expanding the team we will be able to cover additional areas which have been neglected up until now. The current issue includes geopolitical analyses which are exciting great interest, such as Ishiba Shigeru's view of the Senkaku islands crisis, and an analysis published by the leading journal *Sekai* on the splits in China over foreign policy questions. We will continue to cover domestic policy issues, but we will also turn our attention towards economic and social matters, which have become decisive for Japan's future development.

For this reason Japan Analysis gratefully welcomes other collaborators to work with Guibourg Delamotte, who will remain in overall charge. In addition to Sophie Buhnik, who will become chief editor, we would like to welcome Adrien Carbonnet, Amélie Corbel, Arnaud Grivaud, Akira Hattori, Yuko Kawato, Paul Noeueglise, Alexandre Roy, Adrienne Sala, and Raphaël Languillon-Aussel. The reader is invited to consult the box at the end of each issue to find out about the authors. We hope that readers of Japan Analysis will welcome their participation.

**François Godement**

## CLOSE UP ON THE NEWS

### **1. The consumer credit market in Japan: analysing the reform of the Moneylenders Law's regulation since June 2010.** **- Adrienne Sala, PhD candidate at EHESS.**

Many articles published in Japan, in both the regular newspapers and specialist financial publications, headline the new regulation on the consumer credit market which have been in force since June 2010, and they focus especially on the effects of the reform of the Moneylenders Law's regulation on the non-banking sector<sup>1</sup> (*kashikingyôhô*). This reform was first initiated in 2006 in order to hold down the rising rates of indebtedness affecting Japanese households, which had become an alarming social problem since the 1990s. It is hardly surprising that it took four years for the new regulations to come into effect in view of the fact that, since the earliest times of human civilisation, consumer credit

1 Report on the meeting of the government advisory group held on April 26th 2006 (*kashikinseido nado nikansuru kondankai*).

and controls over interest rates in particular have always been objects of intense debate, whether theological, ideological, political, economic, or social, according to the time and place of their occurrence.<sup>2</sup> The case of Japan is particularly significant, because it straddles an intersection of contradictory interests. On the one hand, there is the supply of personal loans provided by credit companies (*sarakin*) to a lightly regulated non-banking market, reminiscent of the US market in the 1920s which was notorious for its extortionate rates and unscrupulous practices. On the other hand there are the personal loans provided by banking sector, which is highly regulated to the point of preventing its development, along the lines of the Italian model in the 1990s. So the Japanese consumer credit market may well seem somewhat archaic in comparison with the other advanced capitalist countries, if one considers that the implementation of the new regulations intended to control the non-banking sector and to increase supply from the banking sector, only dates back to 2010.

2 See Gelpi and La Bruyère (1994), *Histoire de crédit à la consommation*, La Découverte.

But that would be to pass over the instalment sales companies (*shinpan*). These date back to the inter-war period, and they dominated the market in terms of credit exposure at least until the mid-1990s. It must be recognised that these companies are far less mediated than the *yen shops* to be found in all the popular quarters of major Japanese cities.

Although the effects of reforming the Moneylenders Law apply to the whole of the consumer credit market, and therefore to all of its participants including the *shinpan* companies, the credit card companies, and the banks, the law was initially intended to regulate the supply of funds from the *sarakin*. The three main stipulations of this law are:

- capping the interest rate at 20%;
- limiting borrowing to a third of the borrower's disposable annual income;
- requiring production of a proof of income.

These three measures are significant because they radically alter Japan's supply of credit from the non-banking sector.<sup>3</sup> Let us now consider more closely the effects of these new regulations on the consumer credit market in Japan.

There is little doubt that one of the major changes lies in the disappearance of the notorious "grey zone". Lenders used to enjoy room for legal manoeuvring: they were indeed able to impose interest rates somewhere between the ceiling rate fixed by the civil code at 20% and the rate fixed by the penal code, which was originally at 109.5%. But from the early 1980s growing numbers of suicide caused by the resulting over-indebtedness sounded an alarm bell for the authorities. From that time on, gradual revisions of the ceiling rate of interest were enacted in order to eliminate the grey zone, but only leading to its

<sup>3</sup> Government report, *The essence of the law on credit* (2006) (*kashikingyōseido nado no kaikaku ni kansuru kihontekina kangaekata*).

complete disappearance in 2010, thirty years later!

This legal grey zone owed its existence to article 43 of the Moneylenders Law passed in 1983, which was the first law for regulating the market, whose ambiguity aroused a great deal of polemic.

According to article 43, the rate of interest falling within the grey zone is legally valid if the two parties were in agreement at the time of signing the loan contract. This amounts to saying that the law was weighted in favour of the lenders' interests at the expense of protecting those of the borrowers. So the elimination of this grey zone represents a step forward in setting the direction towards improved consumer protection. Indeed the case of Japan conforms to the terms of the classical debate between the credit establishments and the borrowers over the following question: who is responsible for a default, and in broader terms, what are the factors leading to excessive indebtedness, the over-easy availability of credit or the irresponsibility of the borrowers? By attributing responsibility to the consumer, article 43 echoed the principle of self-reliance (*jikosekinin*) promulgated by the neo-liberal trends of the 1980s. In fact, the authorities invoked that very principle in their response to the initiatives of the consumer associations fighting for greater protection of their rights. These associations' efforts led to poor results, as was summed up by the expression used to name the whole decade of the 1980s: *fuyu no jidai* (the winter season).

Nevertheless, tempting it is to draw an analogy with the history of consumer protection in Japan, it is not an entirely satisfactory explanation for the weakness of the legal protection extended to borrowers by the 1983 law, and it is still less satisfactory as a justification for the very existence of a non-banking sector. For a better explanation, it is necessary to

take into account the convergence of several different factors, like the internationalisation of the financial market since the mid-1970s, the savings surplus, the long process of banking sector's deregulation from the 1980s through to the mid-1990s, and the influence of lobbies acting for the associated financial consumer credit companies (*shohishakinyûkyôkai*). Nevertheless, the implementation of the regulation on consumer credit since June 2010 has seemingly put a radical end to the dual structure in the supply of credit.

However the law has not merely stopped at abolishing the grey zone by imposing a ceiling of 20% on interest rates, thus making article 43 superfluous. The Supreme Court has also obliged lenders who charged more than 20% interest to pay back all the money received above that amount, if the borrower goes through the necessary legal procedures. It seems that it has therefore been decided to hold the credit companies responsible for the problem of excessive indebtedness. This Supreme Court decision gave a fatal blow to the non-banking credit market, and it is bankrupting many small lenders who, without the support of a bank, are finding it difficult to overcome the problems caused by their lack of funds.

But this law on regulation is not only weakening the small lenders. The consumer credit market, of which over 70% is in the hands of four leading institutions (Takefuji, Promise, Aiful and Acom), was already experiencing a constant decline in business going back to the early 2000s, because the economic situation has increased the uncertainty of Japanese households over future prospects. Consumer gloom is also reflected in a lower demand for credit, leaving dubious borrowers to the non-banking market sector.

The second key provision of this regulatory law is the limitation of the size of the loan to a third of the borrower's annual income. This measure is aimed at limiting the borrower's access to loans in the consumer credit market as a whole, whether banking or non-banking. Again, this is a significant change since it is known that a borrower could accumulate loans from five different establishments, or even more. This accumulation was the source of a downward spiral consisting of borrowing from increasingly dubious lenders to repay the initial loan, and therefore at higher and higher rates of interest, ending in most dramatic cases with the suicide of the borrower. Since the lenders were often well aware of the underlying distress of the borrowers, they used to have no compunction in accepting a life insurance policy as a guarantee.

It should be noted that this imposition of a limit on the loan relative to income reflects an awareness on the part of the authorities that some borrowers were not in control of their ability to repay. So it amounts to querying the validity of the principle of personal responsibility in the field of consumer credit.

But at the same time this measure raises certain questions of a moral nature, in a debate in which much ink has flowed. Limiting the amount of a loan to a third of annual income amounts to "lending to the rich", to quote the well known saying, without going into the individual motives for the loan which may arise from specific events in life (lay-offs, accidents, divorce, business collapse, sickness and so on).

Restricting the supply of credit always carries the risk of redirecting the borrowers towards the black market. In order to control the supply of illegal credit, in 2004 the government passed the *yamikinhô* - the law on illegal lenders (*yamikin*). Yet, as is shown by the results of many surveys conducted among those likely

to be affected by the new regulation, loans taken out from the *yamikin*, although still in a minority, have nonetheless increased. So, in certain cases, a measure to limit the size of a loan in terms of the level of income can worsen the financial situation of a certain type of borrower, if there is not a sufficiently precise assessment of the risk and the reasons for the excessive indebtedness.

The authorities seem aware of the potential negative consequences of excluding someone from access to bank credit. And in fact the bill passed in 2010 stipulates that the banks must honour their social role. But it is very problematic, and it requires a lot of thought, to try to identify the social role of banks in an economy that has been in deep crisis for the last twenty years, whose rates of savings are falling, whose population is ageing, and whose deflationary predicament offers little support to the indebted. However, there have been significant initiatives on the part of civil society involving the creation of non-profit making banks (NPO Bank) which offer low interest loans to people in financial difficulties. These provisions hark back to the mutual credit arrangements (*mujin*) established in the Meiji period, which consisted in putting the savings of a single community into a common fund in order to extend credit to villagers in need. The development of updated forms of these credit co-operatives somehow reflects a return to civic awareness among Japanese people. It is tempting to emphasise the contrast between the strengthened bonds of solidarity shown by contemporary Japanese civil society in the midst of economic crisis, and the individualism of the younger generation (*shinjinrui*) which was so widely deplored in the 1980s.

The third provision of the new law, which is the need to provide proof of income, is aimed mainly at restricting credit demand from housewives. Since their motives can often not be openly confessed (for example,

gambling addiction, pachinko, compulsive behaviour, etc.), they present an easy target for unscrupulous lenders.

Since 2006, the implementation of this new law has been the topic of a wide-ranging informational campaign by the Financial Services Agency (FSA), and also by the banks and all the consumer credit agencies. Thanks to this large media coverage, it has become difficult for a dishonest lender to rely on a lack of information as an excuse. Lawyers' associations like the *Nichibenren* have also played a decisive role in improving consumers' access to information and protection in the credit market. Numerous steps have been taken to clean up the consumer credit and personal loans market, with regards to both the dishonest lenders and the cunning borrowers who were previously able to take advantage of certain legal loopholes to get round their repayment obligations.

From now on it will be interesting to follow the development of the law on personal bankruptcy, and to trace its impact on the credit demand and the behaviour of borrowers. For example, in the United States the bankruptcy law favours consumers' interests, and so it encourages indebted borrowers to declare themselves bankrupt. This law therefore prevents indebtedness from becoming an obstacle to living a normal life, while putting a limit on the fall in the demand for credit. By way of contrast, in Italy the achievements in the field of borrowers's protection have induced the credit establishments to increase the regulations on their credit provision, thus restricting its availability. Which path Japan will follow remains to be seen ....

## 2. Does the regulation of the non-banking sector reflect the modernisation of the banking sector?

- **Adrienne Sala, EHESS.**

The reform of the Moneylenders Law (*kashikingyôhô*) regulating the consumer credit companies - the so-called *sarakin*<sup>4</sup> - was implemented on June 18th 2010. It struck a fatal blow to the non-banking market, and set in motion a wave of bankruptcies. In the early 1990s, the authorities had grown anxious over the growing problem of excessive indebtedness, and had introduced regulatory procedures consisting essentially in a progressive lowering of the ceiling on interest rates, and leading to a contraction in the number of lenders.<sup>5</sup> Four leading firms dominated the supply to the non-banking market (Acom, Promise, Takefuji, and Aiful), owing mainly to their ability to adapt rapidly to the economic situation. They were able to benefit from the deregulation of the early 1990s which was implemented in telecommunications and the development of electronic mass marketing.<sup>6</sup> However, in tandem with this technological advance in the supply of credit, the traditional small door-to-door lenders - the *shôko loan* - continued their lending activities, aimed mainly at the self-employed and very small enterprises (VSEs) particularly in the service sector.<sup>7</sup>

The regulations of 2010 allowed the non-banking personal loans market to be cleaned up through a series of strict measures aimed at eliminating those establishments which were unsustainable or operated on the margins of

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4 An amalgamation of *sararyman* (salary men) and *kinyû* (finances).

5 According to a study group belonging to the FSA (*Kondankai ni okeru koremade no giron*).

6 Report published by the METI (2005), (*Heisei no sesô to kurejitto wo meguru jyôkyô*).

7 JCFA (220), *Report on the credit companies (shôhishakinyukyôkai)*.

legality. Furthermore, following the implementation of these rules, the consumer credit market now operates within a more competitive framework embracing different consumer credit companies, such as the *shinpan* instalment sales companies, the credit card companies, the *sarakin* financial consumer credit companies, and the banks (the last to enter the consumer credit market, having been held back for a long time by the regulation and the divided nature of the banking sector).

How are we to assess the changes in the law going back to 2006 and finalised in 2010? Do they really operate in favour of consumers' interests and the protection of borrowers? Why did it take so long for the regulations to be put in place? An analysis of the banking sector may provide some keys for understanding why the separation between the banking and non-banking sectors in the consumer credit market lasted until 2010. In fact, it is not difficult to detect an inverted mirror effect operating between these two markets, at least in the following three aspects:

1. firstly, the impact of financial liberalisation on the decline in the banks' profits, and the parallel growth in the supply of credit from the non-banking finance companies;
2. secondly, the development of modern electronic means of providing credit in the non-banking sector, in contrast with the traditional, if not downright traditional business model of the Japanese banks;
3. and finally, the gap between interest rates which remained low despite the economic recovery from 2003 to 2007, and the high rates charged in the non-banking sector.

It is no exaggeration to see this almost perfect symmetry as the result of inverted complementarity rather than pure chance.

The very nature of the financial and banking institutions, which held back the modernising process necessary to increase their competitiveness in relation to the global banks of the advanced economies and to raise their profitability in the domestic market, explains why a non-banking market remained in place until 2010, at the expense of quite a number of economic actors and consumers such as the self-employed, the very small enterprises (VSEs) and the small and medium-sized enterprises (SMEs).

### **Financial liberalisation and the development of non-banking companies: a way of turning over savings funds**

Starting in the mid-1970s, and as a consequence of financial liberalisation, the large banks experienced a progressive fall in demand from their traditional clients, mostly the large enterprises. At that time these companies favoured the system of self-financing by raising funds on the capital markets. However, owing to the absence of any simultaneous deregulation of the banks, the supply of financial products remained limited while there was still an abundant volume of savings. This imbalance forced the banks to look for new, less trustworthy clients, such as the SMEs in the property sector, but also the non-banking finance companies. When the bubble burst in the early 1990s, this had a devastating effect on the banks' balance sheets. Nonetheless, despite the banking crisis, they continued to lend to risky sectors, including the non-banking sector even though the latter was at the centre of numerous scandals (as was shown by the *jûsen*<sup>8</sup> affair in 1995).

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8 The *jûsen* are mortgage lenders who played an active role in the real estate speculation which was at the heat of the financial and political scandals after the bubble burst. The amount of non-recoverable bad debt affected the whole of the banking system, which induced the authorities to intervene through a massive injection of public funds, giving rise to fierce debate.

Several factors can explain this behaviour. On the one hand, the insurance system which protected deposits was partly responsible for preventing families from withdrawing their savings following the banking crisis. So, being assured that part of their liquidity was being protected, the banks continued their risky lending operations. On the other hand, by maintaining their financial support for those sectors most affected by the bursting of the bubble (construction, real estate, and non-banking institutions), the banks sought to avoid their loans being registered as non-performing<sup>9</sup>.

As a result, following the bursting of the bubble, the non-banking credit companies did not suffer any withdrawal of their funds. On the contrary, their access to sources of finance enabled them to maintain the growth of their activities throughout the 1990s.

### **The delay in the supply of bank loans**

The next point is that for a long time banks continued with their traditional business model, limited to managing deposits and offering credit to customers. This means that they had only a small portion of the profits which could be earned by more sophisticated financial products, partly because of the banking laws which held banks back from diversifying their activities. Despite the “big bang”<sup>10</sup> which completed the process in 2001, the gap between them and the global banks of the other advanced economies was not closed. Even by the mid-2000s it was not uncommon to find that Japanese banks had not been able to innovate and catch up with their foreign competitors. Yet it is surprising to

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9 Ito, Patrick & Weinstein (2005) “Reviving Japan’s Economy”, MIT Press, London

10 Here this term means the financial and banking reforms carried out within the framework of deregulating and internationalising the Japanese financial system.

find that the indirect financing of companies has seen a constant rate of contraction since the 1980s, and that it accelerated in the 1990s (and is reckoned to have been around 50% in 2004), while the overall volume of bank credits only fell by 10%. This widening gap testifies to the low profitability of the Japanese banks, and the slow pace of their adaptability to changes in the economic environment. By way of contrast, the non-banking credit companies were able to take advantage of the deregulation in telecommunications and the mass-marketing provision of credit with large-scale geographical coverage, thanks to the development of an electronic network of providers able to meet the independent and rapid demand for unsecured loans.

The growth in promoting unsecured micro-credit loans in the 1990s bears witness to the dynamism of the non-banking market, and is in marked contrast with the slow development of knowledge and skills needed to offer viable credit products in the banking sector.

### **Interest rate disparities, scandals, public funds, and the low profitability of the banks**

Beginning in the mid-1970s there was a clear division, which grew deeper in the 1990s, between the low interest rates charged by the banks and State financial institutions on the one hand, and the high interest rates which fostered the activities of loan sharks on the other. What is surprising in such a highly developed economy as that of Japan is the lack of intermediate rates between the two. It is instructive to point to the difference between the bank rate which was 3% in 2004, along with an average of 1.25% for short term loans in 2005, and interest rates of 29.7% in the non-banking sector (this rate was charged from 2001, but we should note that the rate prior to its reduction to reasonable levels by the first set of regulations was as high as 109.5%). Different reasons can be found for this. The *shōko loan* are often aimed at funding small

businesses employing less than five people in the service sector, such as restaurants; this sector is notorious in Japan for its links with organised crime. As for the small enterprises, the fact that they faced uncertain prospects condemned them to seek funding from the non-banking money market.

Unless we are to be satisfied by the explanation that this dichotomy between the two sets of interest rates was justified by the risk represented by the borrowers, we need to pursue the analysis further, and look more carefully into the recipients of certain loans in order to highlight some peculiarities of the Japanese financial system. For example, subsidies channelled from public funds to certain target sectors via the Financial Investment Programme (FILP),<sup>11</sup> increased during the 1990s. These credits were provided at low rates in relation to the risk which the companies represented. So these funds were not invested in profit-making activities, and it was often a case of enterprises which either could not borrow from the private banks or were not very viable. Moreover, although these measures were originally taken to provide the SMEs with easy access to funds, they turned out to be ineffective. Some of the firms got themselves into excessive debt in relation to their ability to repay, and in the end these loan arrangements essentially served merely to delay a number of bankruptcies. In fact these distortions in the supply of credit are clearly

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<sup>11</sup> In March 2004, 30% of domestic deposit accounts (totalling 227 billion yen) were lent via the FILP, in a so-called «second budget» aimed at supporting projects which the government could not put on the books for the general budget. These savings were deposited in the Postal Savings System, which is the largest financial institution in the world. Until the 2001 reform, the funds were used to make loans to target sectors, and to finance the public debt through the purchase of Treasury bonds. The operations of public institutions within the FILP often lacked transparency, effectiveness, and viability.

noticeable in those sectors of the Japanese economy which have enjoyed a long period of protection from foreign competition, such as the retail, wholesale, and construction industries, where political interests predominate. In contrast to this, those individual enterprises whose creation of new kinds of activity could not easily be assessed by the banks, and which lacked the required technology, could be financially squeezed and forced to borrow at higher rates in the non-banking sector.

In order to promote the indirect financing of the SMEs and the creation of innovative companies, the private banks must return to a healthy financial state and develop a modern business model. The banks' traditional practices must be jettisoned accordingly, in favour of workable ways of evaluating risk and providing a wider range of modern financial products.

Studies have shown that the average productivity of firms which went bankrupt in the 1990s and 2000s was often higher than that of firms which survived in the protected sector. The decision to declare bankruptcy was often related to a lack of capital, and these studies demonstrate that the allocation of funds was badly managed and ineffective from an economic point of view. The same applies when, for example, borrowers are forced to pay off their debts at the high interest rates charged in the non-banking sector, in order to provide support to debtors in default. In such cases, poor risk assessment is likely to entail a social cost for those who have no other course but to borrow at high interest rates in the non-banking market when, for example, they fall victim to an accident of life (such as sickness, accidents, divorce, loss of employment etc.), or have to repay previous loans following a downturn in their financial situation.

The government must therefore get more involved in the financing the provision of social

credits capable of discriminating between different individual cases, in order to make more accurate risk assessments. It could provide guarantees - to the banks, for example - along the lines of those offered to the SMEs via its financial underwriting institutions within the FILP framework. I also have in mind a system of low or zero interest loans which would enable indebted people to pay off their earlier loans. This would allow them to escape from the downward spiral fomented by the non-banking sector, which only leads into deeper indebtedness, and even to suicide in the most dramatic cases.

The essential role of the public financial institutions is to offer support against the risks arising from certain activities, including those of the SMEs. This involves eliminating the problem of unreliable information, because the rationing of credit can sometimes be the consequence of inadequate information about prospective borrowers, and the costs of obtaining fuller information are not always recoverable. By replacing the private institutions in this role, the government can fulfil a real social and economic function, provided that its loans are not made simply to serve political interests.

## Conclusion

Unlike the Americans among others, Japanese households do not hold many shares or property portfolios. Since 2001, following the financial deregulation, they have a wider choice in the management of their assets, but the deflation and the loss of confidence in the capital markets has delayed any changes to their behaviour. Nonetheless, more recently there has been noticeable progress in persuading Japanese people to put their savings into financial products which yield more than Treasury bonds or life insurance policies. Since at certain times it may be better to get into debt instead of selling off one's financial assets, the banks' development

of credit facilities can be seen as part of the modernisation of the whole banking sector, which has long been held back by its sclerotic regulations and its traditional business model. The fact that Japanese households are holding increasingly diversified assets portfolios may be the counterpart of the developing supply of credit options aimed at the middle and upper income brackets. Here too, the reciprocal mirroring effect between the banking and non-banking sectors of the market still seems to hold true, in view of the fact that the clean-up of the non-banking sector is related to a more strategic supply of banking credit options.

## POINTS OF VIEW ON THE NEWS

**Yamaguchi Yoshiyuki,**

**« Internationalising the small and medium enterprises will save the Japanese economy », [Chûshi kigyô no kokusaika ga nihon keizai wo sukuu]. *Sekai*, October 2010, pp. 168-177 (translated by Amélie Corbel, graduate student at Sciences Po).**

*Yamaguchi Yoshiyuki is a Professor of Economics at Rikkyô University. Here he outlines the measures to be taken to prepare Japan for the structural changes required for this century.*

The global economic crisis whose effects we have been undergoing since 2008 is bringing about major structural shifts to which we will have to adapt. This adaptation concerns mainly the move away from a growth model based on surplus domestic demand in the US to a model oriented more towards the emerging countries.

The Japanese Democratic Party (DPJ - Minshutô) is focusing on this development, because it carries a strong risk of undermining the basis which has been beneficial for the growth of the Japanese economy until now. One of their main worries is the fragility of Japan's Small and Medium Enterprises (SMEs). On the one hand, the latter are lagging behind in penetrating the markets of emerging countries, and on the other they are ill-prepared to face the future needs for industrial restructuring. Under these circumstances, there is no doubt about the need to implement policies directed towards SMEs. Policies devised without serious consideration will no longer suffice. The real

question to which the government will have to find an answer is how to support SMEs so as to make them the source of the country's future development. To achieve this, there are at least two policy directions which must be followed.

### **Policy number one: support the internationalisation of the SMEs!**

Many Japanese SMEs wish to launch themselves into the markets of the emerging countries, and they envisage co-operation with firms in those countries. However, apart from the simple fact that they do not enjoy market recognition in those places, there are a number of other problems, such as lack of information, lack of experience, lack of local connections etc. These problems paralyse quite a number of SMEs, causing them to give up their plans for overseas expansion. There should be an "internationalisation support programme" to overcome what they lack.

By way of example, some observers cite the German Public Private Partnership (PPP) system. Briefly, this is a system of co-operation between the German government and the private sector, which consists in using public development support aid in order to nurture the activities of the SMEs abroad. Whereas the Japanese government prefers its overseas delegations to include representatives of the large companies belonging to the Nippon Keidanren (Japanese Federation of Economic Organisations) when it considers how public development aid is to be disbursed, the German government chooses rather to side with the SMEs and to promote their interests in discussions with foreign governments. For example, a German SME specialising in software programmes to deal with sufferers from drug addiction has been invited by the German government to export its products to India, with the assurance that it would receive the latter's support via credits from the

public aid development (PAD) programme. With the benefits of this initial experience on the ground overseas, the company will then be able to develop its own activities in other emerging countries. By means of the PAD, the government has in some ways taken the first step on behalf of those SMEs which, lacking sufficient market exposure, are not yet able to get recognition at the international level. Are there grounds for hope that the Japanese Ministry of Foreign Affairs will be able to pull off a similar achievement?

It is quite possible that one day the global market will be filled with more sophisticated products from the emerging countries. In the case of the automobile industry, the export of Chinese cars to Japan could not fail to cause us great damage. Nonetheless, this bald statement needs a certain accompanying nuance. In fact, supposing that this new generation of Chinese cars included components from Japanese SMEs, such a step forward by the emerging countries would not directly weaken the Japanese economy; hence the immediate importance of medium-term support for the SMEs.

### **Policy number two: support the profitability of the new sectors with the help of improved inter-ministerial co-operation!**

It is well known that the Japanese government is trying to promote innovations in the field of social well-being and medical care. That is not a bad idea in itself, but it still needs to be decided how to make use of Japan's SMEs in this sector. Until now the latter have been far too oriented towards the car industry. That is why it is currently very difficult for "ordinary" SMEs to meet the challenge of re-orienting themselves towards the aforementioned sector. Therefore they need to be supported.

One of the first things to be done is to improve co-operation between the ministries in charge

of the policy of aid to the SMEs. Currently the SME “ministry” is a sub-section of the Ministry of the Economy, Trade, and Industry (METI) designated to take care of matters concerning such firms. However, the complexity of the policies to be put in place requires the co-operation of several ministries. One possible way of improving this co-operation could be to set up a “Council for Supporting the SMEs”, chaired by none other than the Prime Minister. Once this council was up and running, improved co-operation between the Ministry of Foreign Affairs and the METI could only help in bringing about policies in support “internationalising the SMEs”. By the same token, co-operation between the METI and the Ministry of Health and Social Security will enhance the effectiveness of policies intended to encourage the SMEs to turn towards the social well-being and medical care sectors. In this way, effective support for the SMEs is a real possibility.

In fact the idea of creating a “Council for Supporting the SMEs” was the brainchild of Mr. Nakayama, a deputy who assisted the former Prime Minister Hatoyama in preparing the dossier on questions relevant to the SMEs. Moreover, Mr. Nakayama’s proposal was accepted by the former Prime Minister, who put forward the need to set up such a council before the Diet on March 4th 2010. Unfortunately, with Hatoyama’s departure from office, the plan was not enacted.

Another proposal aimed at improving ministerial co-operation through creating a post of Minister in charge of SMEs has also been made. Moreover it was one of the electoral promises of the Minshutō (DPJ).

That being said, if the proposed “Council for Supporting the SMEs” or the “Minister in charge of the SMEs” have experienced difficulties in being put into practice, it is not because of an alleged lack of financial

resources but rather because of a lack of will on the part of the new government.

### **The “SME Charter”**

The media paid no attention to it, but on June 18th 2010 the Council of Ministers of the Hatoyama government approved an “SME Charter”. The issues addressed in that document are very close to the ones covered in this article. In particular, the Charter includes “a guide to the measures to be taken”. Here are several excerpts:

*“In order to enable the SMEs to succeed in their quest for new outlets internationally, we will strengthen the co-operation between the government and the private sector. We will also have to provide information connected with the changes in foreign markets, give assistance to the expansion of our outlets, and put in place various forms of support, particularly with regard to settling differences over intellectual property rights. The training of personnel competent to handle international issues, along with the provision of advice over making the best use of foreign human resources, will be integral parts of the government’s support for a real internationalisation of the SMEs.”*

The Charter also contains references to the importance of inter-ministerial co-operation.

If the government were to end up by considering this Charter to be just another electoral promise, that would be to commit an act of betrayal, not only of Japanese entrepreneurs but of the people of Japan as a whole.

### **Should we be worried about the public debt?**

As was clearly shown by the polemic over VAT just before the elections to the Senate, the government and the media share the same view of the current crisis, since they both focus

on the problem of the national debt. In my view, this assessment is a mistake.

*“If we do not correct the imbalance in the public finances, there is a risk that the IMF will step in to dictate terms to the Japanese economy”*. This statement made by Mr. Kan when he was still the Minister of Finance has since become the mantra of those who defend the legitimacy of raising VAT levels. However, in my view a period of calm reflection on the issue reveals the gaps in this way of reasoning.

Placing Japan “under IMF supervision” presupposes an injection of capital from that institution. But, since Japanese borrowing is calculated entirely in yen, repaying Japan’s national debt could not be carried out by resorting to foreign currency but from funds held in yen. And in that respect, there is no reason for Japan to seek credits from the IMF.

Of course, that does not mean that the problem of rebalancing Japan’s national debt can be set aside. However, the prospect of finding ourselves under IMF supervision again is not linked to this but to quite a different question: the trade gap. Indeed, since a deficit in the balance of trade means in the medium term a shortage of foreign currency, borrowing from the IMF would become a possible way of getting out of the crisis. To guard against such a risk, what we need is not the clamour for a reduction in Japan’s national debt, but a strengthening of the international competitiveness of the country’s SMEs.



**Excerpt from a dialogue between Motani Kôsukey and Oguro Kazumasa,**

**« First let the companies increase young people's pay! » [Mazu wa kigyô ga wakamono no jinkenhi wo fuyase], *Voice*, January 2011, pp. 138-145 (translated by Amélie Corbel, graduate student at Sciences Po).**

*Motani Kôsukey, an advisor to the Japanese Bank for Development, and Oguro Kazumasa, an associate professor at Hitotsubashi University, discuss the size of the generation gap confronting Japan, and the long term consequences for the country's economy. The solution which they recommend is to raise young people's pay.*

*Motani:* As we all know, the government is trying to raise the levels of family consumer demand. Nevertheless, we have to recognise that some of its policies are aimed at "mistaken" objectives, mostly by focusing on indicators like economic growth. Now, at a time when stimulating domestic demand cannot be confused with stimulating economic growth, to make such a confusion leads to outcomes which, if not disastrous, are at least unforeseen by the original development plan. This point is well illustrated by the situation in the Yamaguchi and Wakayama prefectures. These two regions display a "natural" contraction in the numbers of workers in the chemical and metallurgical sectors, owing to the large numbers reaching the age of retirement and moving away. The consequent reductions in labour costs have enabled these two prefectures to improve the international competitiveness of their products,

making them the ones where GDP growth rates are particularly high. However, owing to the reduction in the number of workers, domestic demand is falling; the commercial areas are emptying, the number of bars is visibly decreasing, and the main retail chains are in no hurry to open new shops there. So, although the growth rate in these two prefectures is unparalleled at the national level, there is also the other side of the coin, namely a falling population and stagnant domestic demand.

*Oguro:* In the overall framework for supporting domestic demand, the government ought to concentrate more on the intergenerational income gaps afflicting the country. No-one can deny that nowadays the elderly enjoy a far higher standard of living than the young. In a sense, one might say that this is one of the effects of democracy: in a world where the number of old people is clearly on the rise, and if we agree that each generation behaves egotistically, it must follow that the politicians will pay attention to the opinions of the numerically larger generations. That can only reinforce the politics of headlong advance which have led to the present levels of public debt, which will therefore add to the burden on

the younger generations.

*Motani:* There is a similar situation to be found within the enterprises themselves. In order to improve the balance sheets, the natural fall in the numbers of employees as they retire is not compensated by the recruitment of younger replacements. In effect, that is how the choice is made to protect the wages of ageing employees by sacrificing those of the younger. But, if every enterprise behaves in the same manner, maintaining the buying power of former employees now in retirement, and lowering that of the younger ones, risks dragging Japan down into a vicious spiral of economic depression. Younger people are now impoverished to a level which the older generation cannot imagine. In an enquiry which asked the respondents what they would do if they had any money, the commonest reply from people between 20 to 29 years old was "get married"! With wages which do not even allow marriage to be undertaken, it is a waste of time to try to revitalise domestic consumer demand! The first step to be taken is therefore to raise the pay levels of the youthful labour force.

*Oguro:* Some people believe that the low buying power of the young is not a problem because the consumption by the older generation, who have greater resources, is growing. But we have to acknowledge that the desire to consume is potentially stronger among the young than among the ageing and the elderly. If a decision were taken to transfer money towards the younger generation, and if their anxiety over future prospects could be ended, a large part of those transferred funds would certainly be spent on consumer goods.

*Motani:* If you look closely at the balance sheets of certain large Japanese companies, you will see that from 1995 to 2006 the wages bills went down by around 14%! A great part of that reduction in labour costs fell on younger

employees; it is no wonder that there was a fall in domestic consumption. If we could provisionally transfer some of the retirement payments to the wages of the young, we could certainly sustain a proportion of domestic demand.

*Oguro:* We should not pass over the negative effects of the salary system based on seniority. Such a system increases the downward pressure on the wages of the young. By putting restrictions on recruitment to permanent posts, while increasing the number of temporary jobs, companies manage to keep all wage levels down.

The disquiet over the recruitment rates of qualified personnel has been met with rather unconvincing explanations. These present the low recruitment rates as one of the consequences of the global economic recession. According to this reasoning, the problem of youth unemployment would only be temporary, and the situation should be quickly rectified with the upturn. However, it is clear that such an argument takes no real account of the ongoing demographic changes.

*Motani:* And neither does it explain why the recruitment levels were lower in 2010 than in 2009. Moreover, since the employment of salaried staff represents a long term investment, logic ought to dictate that, in a period of recession, companies should not hold down labour costs. Actually a quick look at company balance sheets shows that business has picked up again. So the real explanation must be found elsewhere. If companies are not recruiting, that is because they think that domestic demand will fall in the long term. But why do they take such a pessimistic view of the future? It is certainly because they themselves are not investing in the younger generation.

*Oguro:* Since that point is not fully grasped, even the present government's policies for supporting recently qualified people are only temporary measures, which merely serve to defer the problem.

*Motani:* Some people have put to me the argument that increasing remuneration to the young could only lead to a return of inflation. However, if young employees were to receive half of the reductions in overall labour costs achieved through retirement, it is doubtful that inflation would be hovering on the horizon. There has been a failure to assess the real situation.



Ishiba Shigeru<sup>12</sup>,

**« North Korea, China, and Russia have made a fool of Japan! Trampling on the Japanese-American alliance is an unforgivable blunder by the JDP » [Kitachôsen, chûgoku, roshia ni wazawareru nippon], *Chûô Kôron*, January 2011, pp. 94-101 (translated by Alexandre Roy, PhD candidate at Inalco and lecturer at the University of Toulouse).**

North Korea has bombarded the South Korean island of Yeonpyeong, and in the seas off the Senkaku islands (Diaoyutai in Chinese) there was the collision between a Chinese fishing boat and a Japanese coastguard vessel. Then, as though mocking the posture adopted by the LDP government, the Russian President made a visit to the Northern Territories.<sup>13</sup> Our neighbours permit themselves such actions because they know full well that Japan will do nothing. The reason for this is that the government of the Democratic Party opened a breach in the Japan-US alliance on the question of Futenma [the American air base]. That can only weaken Japan's position in East Asia. The conduct of foreign policy cannot be entrusted to the Democratic Party, which lacks both strategy and wisdom.

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12 A member of the LDP and Chairman of the party's finance committee, he has occupied several ministerial posts, most notably that of Minister for Defence.

13 The four islands in the Kurile chain (Habomai, Etorofu, Shitokan, and Kunashiri) claimed by Japan - *trans.*

### The "perspicacity" of North Korea

On November 23rd 2010, for the first time since the armistice of 1953, North Korea made an attack on South Korean soil. It happened very suddenly, but for my part I was convinced that something of the sort was going to occur, so I was not particularly surprised.

The attempted assassination of the South Korean President Jeon Duhwan in Rangoon in 1983, and the mid-air explosion onboard a Korean Airlines flight in 1987,<sup>14</sup> occurred at the time when Kim Jong-Il was going to be the acknowledged successor to his father, Kim Il-Sung. I do not know whether this was a ritual for declaring allegiance to the new leader but, in periods of interregnum, North Korea [always] stages some event or other. For the present succession, the events in question are *Cheonan* affair<sup>15</sup> and the bombardment of Yeonpyeong.

But they too are not complete idiots. It is quite possible that on this occasion the "ceremony" will stop there, because they know that if they

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14 Blamed on North Korea - *trans.*

15 Named after South Korean warship said to have been sunk by North Korea on March 26th 2010.

go too far they end up hurting themselves. I believe that the planners on the other side, in North Korea, have grasped that if matters go no further, there will be no problem; moreover, at the time of the *Cheonan* affair, China was willing to cover up for Pyongyang. South Korea having ceded overall military command at times of emergency to the United States, it was in no position to decide on a general counter-attack on its own. Naturally, then, neither that country nor Japan can hope to inspire fear.

The country which has the power to stop the mad course of action followed by North Korea is of course China. As long as North Korea has the Chinese shield as a rearguard, it will most probably continue with its unrestrained displays of bad temper towards the international community, even after another change of leadership.

To get China to change its position, the United States, Japan, and South Korea need to speak convincingly with a single voice. For China, the need to protect North Korea constitutes a real burden, and then, when something untoward happens, the flood of migrants poses serious problems. I believe that approaches from this practical point of view are the only way to convince the people in charge. It is crucial that we reach a consensus before North Korean missiles become more accurate and capable of reaching the North American continent.

To achieve that, a strong and resistant Japanese-American alliance is indispensable. I will return to this.

### **Why did the Senkaku islands incident happen?**

It was on September 7th that the incident involving the Chinese fishing boat off the Senkaku islands occurred. In September and October the East China Sea is regularly hit by

many typhoons, so it is normally a time when fishing boats do not go out. But, exceptionally, this year the boat in question set out "to fish" and what is more, it was reportedly in a deliberate collision with a Japanese coastguard patrol vessel ... is it really going too far to wonder whether that too was not a matter of a deliberate governmental decision?

This is only my personal opinion, but I cannot help feeling that China was "testing" Japan. The newly appointed Japanese Prime Minister [Yukio Hatoyama] had announced that the Futenma [marine] base would be moved "overseas, or at least out of the department of Okinawa". After trampling underfoot an agreement which had taken over ten years to hammer out [eventually signed by Japan and the US in 2006], he calmly declared that he had "finally understood, after much reflection, the importance of the marines as a deterrent force". This made him look tough. .. Yet, during an official visit to China in the company of forty parliamentarians, [Ichirō Ozawa] cheerfully declared "I am the commander of the People's Liberation Army in Japan". Some observers, and not only the Chinese, might rightly wonder what is going on in our country...

In this situation, Beijing wished to mount a coup, picking a moment when Japanese politics was absorbed with the election of a new leader to head the party,<sup>16</sup> and persuading itself that even if the government would be affected to a certain extent, that could not cause serious damage. Wasn't that sort of thinking behind Beijing's actions?

Whatever they were thinking, in fact as soon as the Kan government took office, it faced

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<sup>16</sup> In September 2010, Naoto Kan and Ozawa Ichirō were struggling for leadership of the Democratic Party (at that time the majority in the parliament); Naoto Kan won the primary round and was reinstalled, which meant his return as head of the government - *trans.*

great difficulties from the incident and was finally seriously shaken by it. The completely senseless response by the government to this matter not only aroused anger among the Japanese but also, in turn, caused embarrassment to China.

With regard to the behaviour of the Chinese fishing vessel, it is clear that, even if its exact motives are unknown, it was not a matter of simple poaching. But it would be a mistake to say that “it only had to be forced out, as on previous occasions, to avoid any problems”. No, it was necessary to arrest the captain, as was in fact done. Otherwise, we would have undermined our position by wishfully asserting “that no territorial problem exists in the Senkaku islands”. Next, however, the right decision would have been to just put the matter before the courts, and let them decide the outcome according to the laws of Japan.

But the way out taken by the Democratic Party government, by freeing the captain without legal proceedings, was a real abdication of political responsibility. So the government attempted a wholesale denial of the political ramifications of the incident by declaring that “the decision to release the captain was in the power of the prosecution service of Naha [Okinawa prefecture]” .... an unimaginable reaction. (...)

### **A blow to the Japanese-American alliance**

I suggested above that the Senkaku islands incident was a coup staged by China. In early November, the Russian President A. Medvedev paid a visit to the island of Kunashiri. This was the first time, even going back to the Soviet era, that a Russian leader had set foot onto the Northern Territories.

In fact, Hu Jintao and Medvedev had met five times that year [2010]. Right in the middle of the Senkaku incident they met and issued

a statement that they “share the same awareness of history”. It is rather strange for a [Japanese] political leader not to consider that an act of aggression. And what more can be said about a government so weak that it was unable to assess the true measure of the crisis, when it even tried to play down Medvedev’s visit to the Northern Territories by calling it “a purely domestic matter” and limiting its response to affirming “we are in the right”?

Such a move on the part of a neighbouring super-power cannot be a fortuitous act. I believe that, underlying this whole series of events, including the actions of North Korea, is the enfeeblement of the Japanese-American alliance.

Since the problem of the Futenma base arose, there have unquestionably been strains within the alliance. Despite this, the Democratic Party government declared from the outset its intention to “stand firm in our dealings with China”. Likewise in its dealings with Russia, the government produced empty condemnations of its “illegal occupation of the four islands of the Northern Territories”. At a time when our alliance with the US is facing difficulties, what is the point of seeking a quarrel with China or Russia? And if the intention is to stand firm against China, for example, it is necessary not to alienate Russia.

When I was Director of the Self-Defence Agency,<sup>17</sup> Sino-Japanese relations were at such a low point, owing to the visits by Prime Minister Koizumi to the Yasukuni shrine, that an official visit by my predecessor (Nakatani Gen) had been turned down. When I became a minister shortly afterwards,<sup>18</sup> I first went to Washington where, with my opposite number D. Rumsfeld, we were able to reach a broad

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17 From September 2002 to September 2004 - *trans.*

18 The Self-Defence Agency became a ministry in January 2007. Ishiba became its Director again between September 2007 and August 2008.

agreement in our respective views. I then decided to make Russia my next stop. There too I was able to reach an agreement with the Defence Minister, Sergei Ivanov, the present deputy Prime Minister. A few months later it was his turn to honour us with a visit to Japan. Through these actions I drew the attention of China; they did not like the situation but they did not know what to do about it. Then I visited India. That was when China suddenly showed an interest and invited me to make an official visit there.

Diplomatic exchanges are games of advance and retreat based on relationships of trust. At present there is no trust in relations with Obama, or with Medvedev either. In this situation it is impossible to consider entering into discussions with China.

### **The Henoko “stop-gap”**

This year, when I looked at the usual Chinese military parade, I was shocked. Hu Jintao presided in uniform, not in civilian dress. Those images showed that the army had “increased in power” within the regime.

If it is the army which is in control, obviously its control by civilians becomes problematic. This is a frightening situation, particularly if the navy, which will necessarily go on trying to limit the influence of the army, should openly stake a claim to extend its prerogatives at the very same time when the desire to expand its naval power is gaining ground in China. Every day I feel more deeply the growing importance of strengthening the Japanese-American alliance and the need to recognise the deterrent power it exercises on a daily basis.

So where to begin? With regard to relations with the United States, the step by step repair of the damage done can only be approached through concrete actions. While it is true that, in the context of the elections to the governorship

of the department of Okinawa, Nakai Makoto himself (who was re-elected) had to stand on the basis of removing the Futenma base from Okinawa, the full responsibility for this retrograde step falls on the shoulders of the Democratic Party. It should not be forgotten that the whole problem arose from the fact that absolute priority was given to neutralising the dangers of the military base [for the coastal population].

There are very precise reasons why the US marines want to station their helicopters on Okinawa. If it was only a matter of covering the Korean peninsula, anywhere on the shoreline of the Sea of Japan would do. But the island of Okinawa is situated precisely at a favourable geographical point which enables the Americans to integrate Taiwan into their theatre of action, while also being able to mount operations involving the use of air power. Obviously, the base's deterrent ability would amount to nothing if it were situated abroad, but that would also be the case if it were simply relocated away from Okinawa. So it is quite impossible for the American army to leave Okinawa. As for the dangers from the Futenma base [to the coastal dwellers], it must be conceded that its relocation to Henoko would provide the best outcome.

That does not mean that there should be a permanent military establishment on the ground in Henoko. If the cargo-carrying Osprey MV-22 helicopters were to be put into service, that would increase their speed and range, which would make the “relocation away from Okinawa” conceivable. My personal belief is that there should be a clear direction towards making the relocation to Henoko a temporary stop-gap solution.

Now is the time to take this measure: it is by making an effort to re-establish trust that we will put the Japanese-American alliance onto a new footing. It is not a question of just renewing

the previous arrangement, but of proceeding to an absolutely necessary “rebuilding” of links, taking full account of the current state of the global situation.

Is the present Japanese-American alliance really working? In reality, there are many problems. For example, overall command is divided between Japan and the United States, which could severely impede the need to respond in the case of a sudden attack.

And then it must be said that the treaty of alliance itself has certain limits. The statement by Secretary of State Hillary Clinton, to the effect that “the Senkaku islands are covered by the treaty of alliance” surprised many people<sup>19</sup> ... because this statement contrasted with her earlier reply to the Senate when she was asked whether the US army would be “mobilised” or not. In general terms, then, it is up to us to defend our isolated islands, since the treaty itself only covers the territory where Japanese executive, legislative, and judicial powers are exercised. If we were to be subjected to air attack outside our territory [defined in these terms], the treaty would not apply.

It is a matter of urgency to reconsider the terms of the treaty on security, and to expunge from it all the problems of a legal nature or those connected with installations and equipment. We also need to reform the law governing the Self-Defence Forces, so as to allow them to act independently, at least in order to come to the aid of Japanese nationals and to ensure the security of our territorial waters. We also need a complete revision of the Defence *white paper*. The important point is that it must be Japan who proposes these reforms, and to collaborate with the United States in building together a solid edifice which can be relied on in the future.

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<sup>19</sup> This was reported by the Japanese Minister of Foreign Affairs (S. Maehara) following his meeting with Clinton on September 23rd 2010 - *trans*.



**Tsuji Kôgo<sup>20</sup>,**

**« China's decision making process in foreign policy: the discord between the 'tiger and the panda' », [Chûgoku taigai seisaku no kettei katei. « tora to panda » no fukyôwa-on] *Sekai*, December 2010, pp. 108-114 (translated by Alexandre Roy, doctoral candidate at Inalco and lecturer at Toulouse 2)**

### The three trends in China's foreign policy

Chinese diplomacy has two faces: the peaceful lazy panda, and the roaring tiger with claws bared. As it becomes a great power, China seems increasingly inclined to show the face of the tiger. Good examples of this are the recent tensions over the Senkaku islands problem and the award of the Nobel peace prize to Liu Xiaobo. It is quite normal for a country to alternate between the tiger and the panda (or between the policies of the carrot and the stick) to achieve its diplomatic purposes. But, in the case of China, the gap between the two is extreme, suggesting even that it is not a matter of one and the same State. Can the same State really make use of a display of two completely contradictory faces? Or does it perhaps do so unintentionally? Without becoming lulled by the smile of the panda or startled by the roar of the tiger, I would like to analyse the issue by taking the process for formulating foreign policy in China as my starting point.

In the background to this question is the fact that China has changed greatly in every domain (political, social, and cultural) following the policy of reform and opening up launched in the 1980s. As a result, the interests and attitudes of the social groups have themselves become diversified. The overall dynamic is centred on the complex interrelationships between three crucial problems: China's dream of becoming a great power, the wish to undergo increasing economic development, and another issue which is becoming a particularly sensitive topic nowadays, namely the desire to ensure social stability. Don't these three objectives explain why China oscillates haphazardly between the face of the panda and the face of the tiger? (...)

### China's behaviour over the problem of the Senkaku islands

Firstly, with regard to diplomatic channels, the first secretary to the Cabinet, Sengoku [Yoshito] declared after the captain of the Chinese vessel had been set free, "There was a lack of information. With China one must not depend exclusively on the Ministry of Foreign Affairs" (*Mainichi*, October 1st 2010). The substantial issues behind this statement remain unclear, but by mentioning the need

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<sup>20</sup> Born in 1934, formerly director of the daily newspaper *Mainichi* in Beijing, and a professor at Tôkai University.

to go through several different channels, he was recognising the impossibility of reconciling the different components in the diplomatic exchanges between the two countries. It is obvious that diplomacy, in the broadest sense, is constructed out of different state and civil interests. For example, at the time of the normalisation of Sino-Japanese relations [in 1972 - *tr.*] the situation had already been normalised to a certain extent through the system of "Trade on the basis of specific agreements" [*Memorandum Trade*, 1967-1971]. This was trusted by both parties, and trust was also sustained by the mediation of the Kōmeito [the centre right party]; but nowadays such intermediary channels have almost ceased to exist.

On the question of the problem of the Senkaku islands, two different tendencies can be extracted from the Chinese reaction. The first is of course the so-called "hard" reaction which runs right from the beginning of the incident through to the public reaffirmation of its territorial claim to the islands. At the United Nations on September 25th, Prime Minister Wen Jiabao declared in a harsh tone that "China gives as great importance to friendly relations as to principles, and unbendingly defends its major national interests. In the matter of gaining full and complete sovereignty, and the unity of its territory, China will never make any concessions". For his part the spokesman from the Chinese Foreign Ministry made further fierce declarations, and on September 20th four Japanese were held hostage.<sup>21</sup> But despite that, at the same time the Vice Minister of Foreign Affairs Dai Bingguo skilfully called for "political conciliation" (September 12th). On October 4th there were meetings between Japan and China in Brussels, and the importance of "reciprocal strategic relations" was reaffirmed. Following the freeing of the captain of the Chinese vessel, the Japanese

<sup>21</sup> Employees of the Fujita company in China who were accused of spying.

hostages were released in their turn; a calmer atmosphere was established and the territorial problem was mentioned less and less. At that moment, the incident was about "to be shelved without being settled", just as it was under Liberal Democrat rule. But then, on October 16th and 17th anti-Japanese rioting broke out and spread; and tensions rose again.

(...) [On the internet, in China] regrets have been expressed over China's having "seas but no ocean" (the East and South China Seas are easily reached, but the Pacific and the Indian Oceans are not). At present, China for the first time in its history is breaking out into the open seas and wants to control a large maritime area, with its eye as much on undersea resources as on oil pipelines and territory. A book came out last year under the title of *China's maritime supremacy* (by Zhang Shi Ping, *People's Daily* publications) which goes back in history to the time of the great explorations to assert that a necessary condition for a powerful State is the preservation of its "maritime rights". Similarly, within the context of the Senkaku islands incident, aggressive statements with a militaristic edge have become more common in civil society. One blog, for example, proclaimed "China's navy has now become powerful and must attack the Senkaku islands". And: "Japan is training with the American navy in joint exercises for the reconquest of isolated islands, and as the preparations are complete, they are ready for action!" according to *Duowei xinwen* (September 21st). Or again "The real goal of the Japanese-Americans is the defence of Taiwan (*ibid.* October 7th), and "Is China targeted?" (*Jingjin guan*, internet). There are also extreme proposals to be found, such as going so far as to say that in order to let the Chinese navy break through, the Senkaku problem should be used to seize the islands of Okinawa. (*Nanfang*, internet October 23rd).

(...) Obviously, with regard to the Senkaku problem, as far as the central authorities

(or some of them) are concerned, if it was necessary to whip up “patriotic feelings”, the anti-Japanese demonstrations could just go on. However, reports showing that ordinary people are not interested in the incident, or else know nothing about it, are winning out over statements to the effect that “the whole Nation is in indignant uproar”. What can be seen clearly is that the Chinese Americans - who are strongly opposed to Japan joining the UN Security Council - have kept silent, and that even most of the countries which receive massive aid or enjoy economic support from China (apart from North Korea and Venezuela under President Chávez) have not made any statements in support of Beijing.

### **Domestic debates and “primary interests”**

What is even more interesting in the case of the Senkaku problem is that there have been debates inside China itself. The participants have argued for very different positions. One example is the distinguished diplomat Wu Jianmin, the former ambassador to Paris and president of the China Foreign Affairs University, who argued that it is possible to follow other policies rather than harping on about a trivial territorial issue. He added that the boycott of Japanese goods was pure madness. In response the celebrated leftwing blog *Wuyou zhixiang* (“Utopia”) put out an article calling Wu a “traitor to the Nation” (October 1st). The closing communiqué of the CCP Central Committee at the end of the 17th Congress focused on domestic policy and economic construction, and was content to call for the development of China’s “soft power” without even mentioning the Senkaku islands problem or the “interests of major importance”. That is perhaps due to the fact that within the CCP, no consensus has been reached over Sino-Japanese relations.

However, at the same time, and it must be admitted that it has no connection

with the Senkaku issue, there has been the award of the Nobel peace Prize to Liu Xiaobo. That came at a bad moment for the Chinese government. China’s reaction, as it criticised the jury’s choice, served to increase international distrust over China’s growing power and exacerbated the denunciations of the “Chinese bogeyman”.<sup>22</sup> On October 14th, a hundred intellectuals (including the philosopher Xu Youyu, the writer Dai Qing, and the former Director of the research centre on Japan, He Fang) openly signed a declaration spread on the internet, calling for the release of Liu Xiaobo. On October 7th, the editorial column of *Huanqiu shibao* (World News) fiercely attacked “the award of the Nobel Peace Prize ... intended to break China apart in the same way as the USSR”. So public opinion was well and truly divided. (...)

### **The identity which China wants internationally recognised**

As we have seen, the contradiction between “the tiger and the panda” is basically linked to the fundamental political direction needed to resolve domestic problems, along with the debates taking place to decide on which direction to take. That is to say, it would seem that China is attempting to settle the issue which is the key to its future: what kind of internationally recognised identity does it want? Or, in other words, “Where is China going?”

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<sup>22</sup> *Chūgoku ishitsu-ron* means literally “Chinese particularism”. This expression refers back to the international friction faced by Japan during its economic rise in the 1970s and especially the 1980s, accompanied by numerous publications and debates drawing a xenophobic image of the new power of Japan (*nihon ishitsu-ron*). Here the writer is applying the expression to modern China, which explains the quotation marks (although the expression is not Chinese, it is often quoted in Chinese press reports of Japan’s analyses of the Senkaku islands affair).

Nonetheless, China is different from previous totalitarian regimes, such as pre-war Italy, Germany, and Japan, or the Soviet Union, in that lively debates over the future of the country are semi-authorised. Of course, this is a long way from complete freedom of speech, as was shown by the way Liu Xiaobo's "Constitution no. 8" was considered an attack on State security. Nevertheless the publication of articles, essays, and analyses which are totally different from one another, including strong criticisms - admittedly within definite limits - of the Party and the government, is now allowed, and all these documents circulate widely on the internet.

China is facing a series of choices over its political regime, its economic policies, its social problems, and its cultural development. In every domain the problems are getting more serious. In the first place are the problems concerning human rights, the environment, and investments, but there are also the issues of social inequality, corruption, social security, health care, education, civil law, population growth etc. To deal with all these problems, political reform is needed, and at the diplomatic level China must make clear what role it wishes to play on the international scene. But the recent communiqué from the Central Committee makes no mention of the political reforms for whose adoption Prime Minister Wen Jiabao was recently calling. Without going into detail, at the heart of the problem is the issue which is now assuming major importance for China's foreign policy. The clearest example of this is the debate between "universal values" - which have been making progress for several years in China and are supported mostly by liberals wishing to see the development of values like democracy, freedom, and human rights, - and the "Beijing Consensus", otherwise known as "the Chinese model", which is supported mostly by conservatives who preach a Chinese way and reject Western, especially American, forms of

modernisation.

At all events, Japan has suffered from flabby political leadership over the Senkaku issue; but at the same time this has coincidentally shown up the confusion at the heart of Chinese diplomacy, throwing light on its underlying problems. For both Japan and China, it is a matter of finding the best way of dealing not only with the basis of their relations with each other but also with their broader international environment. But it would seem that this ideal way is not yet in sight. In this situation, their irresponsibility is undeniable. All of this recalls the "Five principles for dealing with China" which grew out of the experience of Japanese businessmen who had all sorts of contacts with China over the half-century prior to the official normalisation of relations.<sup>23</sup>

These principles, also known as "the Five Ns", were: "Not to get too involved, not to get tired, not to lose patience, not to panic, and not to give up". When trade negotiations were suddenly broken off by the Chinese without explanation, even in the midst of making a proposal, it was important "not to get too involved". When discussions were begun, conditions likely to "tire" the interlocutor were set up, and then it was extremely important "not to give up". The negotiations might drag on interminably, but it was essential "not to lose patience", so as to be able to propose a compromise later. In those cases where there was no reply to the questions being raised, it was necessary "not to panic", at the risk of making a mistake. Therefore, if these guiding principles were followed, it could happen that the negotiations might suddenly reach a satisfactory conclusion.

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23 After the First World War, Japan engaged in a policy of economic and political penetration of China by making use of many businessmen or trade attachés as negotiators or political agents on the ground - *trans.*

China's foreign policy is somewhat opaque and indecisive. For Japan, and for China too in the final analysis, would it not be best to continue to show patience and to watch the situation closely, without dramatic gestures or over-excitement?

Finally, I would like to dispel the gloom with a joke which has recently been doing the rounds on the internet. Formerly, many amusing stories about the USSR used to be circulated; now it seems that, as a great power, China is affected by the same phenomenon. This joke goes: *To punish Norway for awarding the Nobel Prize to Liu Xiaobo, the Chinese leaders held a meeting together. As China does not have many political or economic links with Norway, they realised that they did not have much in their hands. They were all scratching their heads over the problem, when a clever cadre blurted out, "Isn't there that scandalous book Norwegian Wood<sup>24</sup> which is selling well in the town's bookshops? Let's ban it immediately!*

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<sup>24</sup> This alludes to the title of the world-famous novel by the Japanese writer, Murakami Haruki.

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