The Economic Performance of Italy and Japan: Comparative Reflections

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Introduction: a Brief Historical Overview

In recent years, the comparative study of the economic performances of Italy and Japan has attracted the attention of a growing number of scholars in both nations as well as in other countries.[1] Indeed, given the many historical and structural similarities, a comparison of Italy with Japan is not only justified but is also an effective method for gaining insights and a better understanding of both countries' economic structures, conditions and policy options.

For many decades the two countries have followed similar paths of economic development, facing similar challenges and often overcoming them in a similar way. Specifically, "modernization" and industrialization started roughly at the same time: in Italy after the unification of the country in 1861; in Japan after the Meiji Restoration in 1868. In both countries the state and the banking sector played a major role in promoting economic development, while the capital markets have remained relatively underdeveloped. Public sector intervention continued also after the war. Regulation was widespread and the government actively promoted the development of certain industries. In Italy it occurred more directly and in a more pervasive form as the Italian government acted as an "entrepreneurial state," establishing and managing companies, often with poor results. In Japan, instead, the "developmental state" in principle limited itself to

[1] The first comparative analysis of the economies of Italy and Japan appeared in the early '80s in the *Rivista Internazionale di Scienze Economiche e Commerciali* (International Review of Economics and Business) and in the volumes edited by Fodella (1982 and 1983). Recent works include the excellent book by three economists: Andrea Boltho, Alessandro Vercelli and Hiroshi Yoshikawa (2001). Forthcoming is a volume by Richard J. Samuels of MIT on Italian and Japanese business and political leaders. Other scholars in Italy, Japan and also in other countries are working on specific issues.

the task of providing guidance and financial resources to the private sector with, however, important exceptions, including more than seventy special public corporations or *tokushu hōjin.* These corporations are expected to carry out specific tasks that the market might not adequately perform.[2]

As for the economic structure, it is possible to say that until the ’70s the two countries proceeded along parallel lines of development. Japan and Italy both started and supported their industrialization with foreign currencies earned by exporting silk and silk goods. They then went on to develop from labor intensive to capital intensive industries.

However, in the ’70s their paths diverged. Both countries were heavily affected by the oil crisis, but Japan reacted to the external shock rapidly and effectively, while Italy entered a long period of political and social instability. In Italy the ’70s and ’80s were two decades of high inflation and unemployment, large current account and budget deficits, accompanied by frequent and painful devaluation. Japan, on the other hand, enjoyed monetary stability (with the important exception of the rampant asset inflation in the second half of the ’80s), frictional levels of unemployment, large current account surpluses and a stronger currency, which helped Japanese companies’ expansion abroad.

At that time many in Italy looked at Japan with envy and admiration and continually asked what was wrong with Italian policies and institutions. In this

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[2] According to the Ministry of Finance, in the year 2001, 77 special public corporations are in operation, including the Government Housing Loan Corporation, the Japan Highway Public Corporation, the Japan Bank for International Corporation, and the National Space Development Agency.

paper there is no room for a detailed analysis, but one point should be made concerning the system of corporate governance. This is an area in which the two countries differed, and still differ profoundly. In fact, neither Italy nor Japan have adopted an Anglo-Saxon or Anglo-American form of corporate governance, but have developed their own distinctive systems.

In post-war Italy, families retained the control of large and small enterprises, while in Japan the controlling shareholders of large, listed corporations were a stable and silent group of friendly institutions tied together by a complicated web of cross shareholding. These stable shareholders were neither supposed nor expected to interfere in the decisions taken by managers of the controlled company and even less in the selection and appointment of top managers. As a consequence, the board of directors of Japanese firms was composed mainly of "insiders": salaried managers who had succeeded in climbing all the steps of the company ladder. Even large shareholders were not represented on the board. The only exception was the so-called main bank, the financial institution supplying funds to a firm and -- supposedly -- monitoring and disciplining its management.[3] As a whole, the Japanese system enhanced the power of managers and clearly favored employees' interests rather than those of the shareholders.

[3] A good example is provided by Nissan. In 1997, before being "rescued" by Renault, Nissan's board of directors was composed of 40 members, of whom only three were outsiders. The other 37 were "inbred" Nissan managers who had spent at least 27 years in the company. All the three outsiders came from banks: one from Fuji Bank, one from IBJ - the Industrial Bank of Japan - and one from the Japan Development Bank (Nissan Jidōsha, 1997).

In Italy, instead, “employees’ participation” was denied and this led to the crisis of governance in large firms and the radicalization of social conflict in the ’70s. Denied the right of co-decision, Italian workers and their unions -- supported by strong political parties, including the largest Communist Party in Western Europe -- adopted a confrontational attitude towards management and owners that led to frequent, long and even violent strikes. In the same decade, a new legislation was introduced to appease union demands, but this legislation has not modified the system of corporate ownership and governance. It has simply limited the power of managers to manage their workforce and made the labor market excessively rigid, which has affected the country’s competitiveness and economic dynamism in the following decades.

Only in the ’90s, as a result of external -- European -- constraints, market pressure and a new political agenda, did Italy gradually start to tackle the problem. As a result, economic conditions have improved, although growth rates remain low, unemployment high and unevenly distributed, and public debt high.[4] But as Italy started to recover, Japan got lost in a nightmare of falling prices, faltering confidence among consumers and investors and a growing amount of bad loans and public debt. From a different direction Japan arrived at the same crossroads, facing today the same problem that Italy faced: how to revitalize the economy and how to restore public finances. Thus, once again, it is particularly meaningful and interesting to compare the two countries’ economic performances and institutions. Indeed, today the Japanese are more interested in what Italians

[4] For a brief summary in English of Italian economic events and conditions in the ’90s see Signorini (2001).

have done than vice versa. If Japan has succeeded, why not Italy? This was the question in the ’80s. Today, the question is just exactly the reverse: if Italy has succeeded, why not Japan?

Focusing on Japan’s current economic woes, this paper analyzes some of the issues, pointing out the analogies and the differences with the Italian experience. Some of the policy options are also discussed, with a special attention to macroeconomic policies and the problem of non-performing loans that has been crippling the Japanese financial system over the last decade.

Fiscal Deficit, Public Debt and the Reform of the Pension System

At the top of the list of common features and problems is to be found the high level of public debt. In Japan, national and local government long-term debt has in fact sharply risen since 1991 and, according to Ministry of Finance statistics, in the summer of 2002 reached the staggering amount of 675 trillion yen, equivalent to 134 percent of GDP. This percentage is the highest among OECD countries since Italy, the main competitor in this race for the worst fiscal performance, succeeded in the ’90s to stabilize its public debt and to reduce it from the peak of 124 percent in 1994 to less than 110 percent in 2001. Moreover, Italy has been able to drastically cut the annual budget deficit, reducing it from 11 percent of GDP in 1990 to the current 1-1.5 percent, and with the objective to achieve a balanced budget in a couple of years.[5] Japan, instead, has seen its

[5] According to the latest government forecasts, in 2003 the Italian public debt will amount to 104.5 percent of GDP and the annual budget deficit to 0.8 percent. The government expects to achieve a balanced budget in the following year (Ministero dell’Economia e delle Finanze, 2002).

surplus of 1.9 percent in 1990 turning into a deficit of 6.3 percent in the year 2000 and still growing (Cabinet Office, 2001).[6]

However, the causes of the deficit are different. In Italy it is a structural problem: the result of the profligacy of politicians, who for many decades have generously spent -- indeed, overspent -- in order to accommodate the demands of their constituencies and their clients. Only in the last decade has the country been able to reduce the deficit and discipline its lawmakers. However, this has been more the result of external pressure and constraints than the result of domestic-driven efforts (although the role played by the campaign against corruption in the early '90s cannot be denied). Fiscal generosity has been constrained by international speculations against the Lira in 1992 and then, more importantly, by the Maastricht Treaty on monetary union and by the signing of the EU's "Stability Pact." On the other hand, in the case of Japan the massive growth of public debt in the last decade is the result of falling tax revenues and the contingent economic policies adopted with the aim to promote economic recovery.

The second major difference concerns the disparity in the level of tax and social contribution burden and, therefore, in the policy options available. In Italy the tax and social contribution burden rate is extremely high -- 44.2 percent of GDP in 1999 according to conservative estimate (ISTAT, 2001) -- while in Japan it is around 36 percent (Cabinet Office, 2001). In other words, the case of Italy is one of excessive expenditures; the case of Japan more of insufficient revenues.

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[6] If the surplus of the Fund for Social Insurance is deducted, the Japanese annual budget deficit in 2000 will account for 7 percent of the GDP.

This fact is confirmed also by the presence of a very high fiscal or tax wedge -- the tax burden on labor -- which in Italy is almost 50 percent in the case of a single worker, while in Japan is less than 20 percent according to OECD calculations. This implies that in Italy the labor cost for a company is twice the net amount taken home by its workers. This is an incredibly high level of taxation that encourages tax evasion, provides a strong incentive to hire workers without a regular contract, and obviously reduces the possibility of future tax increases.[7] In short, if one considers the central and local government debt, Italy has its hands tied, while Japan has more room for adopting deficit-reducing fiscal policies, although the adoption of a restrictive fiscal policy should be postponed until the economy recovers and deflation is subdued. This point will be discussed later. First let us consider another common issue related to the accumulation of public debt: the reform of the welfare system and the pension system, in particular.

The problem of the public pension system is one of the so-called structural reforms that are advocated in both countries: *kōzō kaikaku* or *daikaikaku*, in Japanese; *riforme strutturali* or *grandi riforme*, in Italian. These are indeed the catchwords most frequently used by politicians in both countries and in both camps: the government and the opposition. Through this process of structural reforms both Japan and Italy are supposed to "modernize" and become "normal countries."[8] In economic terms, structural reforms are meant to

[7] The high level of taxation is also a disincentive for the foreign direct investment that the Italian government is trying to attract.

[8] "A normal country" is *Un paese normale*, to quote the title of a book written by D'Alema, the former

transform the country in an efficient market economy regulated less by the state and more by price mechanisms and free competition. This implies the scaling down of government intervention through privatization and administrative reforms; the deregulation of the product, capital and labor markets; and a change in the financial system and in corporate governance geared to making companies and their managers subject to financial market discipline. It implies the adoption of and adherence to principles of transparency, disclosure and accountability. Indeed in both countries several reforms, more or less structural, have been introduced along these lines. These reforms concern public administration, the financial system, the labor market, the system of corporate governance and the pension system.[9]

The reform of the latter is considered a fundamental problem in Italy, where old-age and seniority pensions account for a very large and increasing amount of public expenditure in proportion to the GDP. And this is the case notwithstanding the fact that three different governments have implemented significant changes during the '90s: the Amato government in 1992, the Dini government in 1995, and the Prodi government in 1997. As a result, the

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Italian Prime Minister and one of the leaders of the Democratic Left (D'Alema, 1995), or "*futsū no kuni*" to use the expression coined by Ichiro Ozawa, leader of the Japanese Liberal Party, liberal in name but conservative in reality (Ozawa, 1993). Of course, the landscape of their "normal country" is not exactly the same. However, the differences are not so pronounced and definitely not so sharp as they used to be. Regarding the political system, they both envisage a country with stable governments in what is basically a two-party system, a political system that is no longer hostage to quarrelling coalitions made up in Italy by different parties and in Japan by different factions within the main party. Such stable governments are expected to exert a strong political leadership and, in the case of Ozawa's Japan, discipline the powerful bureaucracy.

[9] On Japan's structural reforms, see Molteni (2001). For a critical view of structural reforms and their theoretical underpinnings, see Dore (2000 and 2002). The argument supporting economic reforms is developed in Lincoln (2001), who complains, however, of the slow pace of the process.

retirement age has been gradually raised (from fifty-five to sixty for female workers and from sixty to sixty-five for male workers). Some of the most inequitable privileges, granted in the past to politically strong groups, have been eliminated. And, more importantly, a gradual switch from a pay-as-you-go scheme to a defined-contribution pension scheme is taking place. Yet many economists assume that further reforms, including the adoption of better incentives to promote a system of private (company) pension schemes, have to be implemented in order to assure the stability and the sustainability of the system (Kostoris Padoa Schioppa, 2001).

In Japan too, the reform of the public pension system has been on the agenda for the last two decades. And, as in Italy, the main reasons are to be found in the poor state of public finances and the rapid aging of the population.[10] However, it should be noted that Japan has never been a fully developed welfare state like the European countries. Indeed, with a low level of public expenditures for welfare provisions and a low level of social contributions, Japan resembles more the United States than Italy. As pointed out by Tachibanaki (2000), families and corporations have been and still are the main providers of welfare provisions, compensating for the limited social services supplied by the state.

Even more important is the fact that Japan's public pension system has large reserves of more than 140 trillion yen that do not appear on the Ministry of

[10] Italy and Japan are among the countries with the highest life expectancy at birth (estimated in 1999 to be respectively 82.0 and 83.99 years for females and 75.8 and 77.10 for males). Both countries are also concerned by rapidly falling fertility rates and, consequently, a high and growing aging population (in 2000 the aging index -- the ratio of the population aged 65 or older to that aged 0-14 -- was 124.8 in Italy and 120.7 in Japan).

Finance's balance sheet.[11] It should be borne in mind that 140 trillion yen is more than the total Italian public debt! This is a fact often neglected by government officials when advocating radical reforms of the public pension system. They prefer to point out the diminishing rate of accumulation of the reserves and the fact that one day the aging population will wipe away this surplus. But this is not going to happen in the next few years and not even in the next decades. There is no cause for excessive anxiety. Imagine how relieved and delighted the Italian Prime Minister and his Treasury Minister would be if they were to find all these funds in the government's coffers. But the Japanese government, the Ministry of Finance in particular, has for at least two decades been orchestrating a campaign to reform the public pension system. Such a campaign is a powerful deterrent against consumption and an incentive to increase savings: exactly the opposite of what the Japanese should do today. In a country where the citizens are already concerned for the security of their jobs and their bank deposits, there is certainly no need to scare them further with the prospect of a bankrupt pension system that will not be able to provide them a living after retirement.

Japan's Deflationary Spiral

When considering the policy options available in Japan to rehabilitate public finances, one has to keep in mind the fact that today the Japanese economy is plagued by deflationary pressure that is causing the stagnation of domestic

[11] If the reserves are included in the general account, the Japanese public debt will be automatically reduced by a fifth.

consumption and investment activities. This deflation is a major problem for Japanese policy-makers and also a major difference from the Italian experience and, in general, from the experience of other countries with a large public debt, which historically have been confronted with the opposite problem of rising prices and interest rates. In the case of Japan inflation is not occurring and is not expected to occur soon. The result is that the real value of the Japanese public debt is constantly increasing, year after year. With a large debt amounting to 670 trillion yen a 1 percent decrease of prices means in fact an annual increase in the real value of the debt of more than 6.45 trillion. In other words, even if the government were to succeed in reducing public expenditures and increasing taxes, these achievements could easily be offset by the effect of declining prices. Therefore, as long as deflation is not defeated, it is unwise for Japan to adopt restrictive fiscal policies such as those adopted by successive Italian governments during the '90s. The priority should be given instead to monetary and fiscal stimulus aimed at the expansion of domestic demand. In particular, as suggested by Paul Krugman, Joseph Stiglitz and other economists, Japan should adopt a policy of moderate monetary expansion, for example, by printing money to finance part of the government's fiscal needs and, as will be discussed later, to solve the issue of bad loans. This policy, if properly managed, could lead to an inflation rate of around 2-3 percent, which is expected to spur consumption and investment. As for tax policy, the available options range from a temporary reduction in sales taxes, which will stimulate consumption, to temporary measures for investment tax credit and to the amendment of the tax code, which could stimulate housing investment and revive the real estate market. Such a policy-mix should also weaken the yen and in this way facilitate exports and economic recovery. Depreciation of the yen, however, would just raise concern and objections in other countries -- particularly in the Asian countries -- if it were not accompanied by a serious effort to stimulate domestic demand.

Japan might have one more policy option to defeat deflation: a “reverse incomes policy” to raise wages and, as a result, push up prices. This idea has been advanced in an essay by Ronald Dore originally published in a Japanese magazine. To quote from his essay, “what is needed to counter deflation is to push wage increases up….If the decision can be made at the industry-association level individual companies will understand that not only they but their competitors too will face the 3 percent, or whatever it may be, increase in labor costs. They will probably judge that they will be safe in hiking the domestic prices of their products so as to cover the cost increase” (Dore, 2002). In other words, Dore is proposing the exact opposite of the incomes policy aimed at keeping down wages and wage cost-push inflation that was successfully adopted in Italy in the early ’90s after the abolition of the “*scala mobile*,” the system of wage-indexation linked to the cost-of-living index. Dore’s is a bold and unorthodox proposal that so far, however, has not been taken up by any politician or business leader in Japan with enough courage to “take upon themselves the Herculean task of bringing about the necessary change in public opinion and accepted conventions.Ŧ To be fair, such a policy requires a concerted effort by management and labor that might be difficult to achieve in these days when

Japanese companies are sharply divided between successful and poor performers, with the latter striving to restructure their business, reduce costs and regain competitiveness. Moreover, several major "Japanese" corporations are now partly or wholly controlled and managed by foreign interests operating in line with their global strategies and are unlikely to listen to any appeal for the sake of the country or the welfare of its citizens. And, last but not least, a generalized wage increase followed by a price hike of the same proportion will not stimulate domestic demand, which should be the ultimate objective of a policy aimed at curbing deflation.

So far, however, the Japanese government has been reluctant to take any decisive measures and, more importantly, to stick with them for a sufficiently long period of time. It seems that there is no agreement concerning either the priorities or the action to be taken. Within the government and the bureaucracy -- particularly at the Ministry of Finance -- the conviction is still strong and widespread that inflation is the worst enemy and that all the efforts should be focused on reducing the deficit. As for the current Prime Minister, Junichirō Koizumi, who is not particularly familiar with economic issues, he wavers between the different courses proposed by his ministries and advisers. Inaction is fostered also by the fact that Japan continues to be after all a successful economy, with a large current account surplus, a strong currency and a huge amount of domestic saving. Apart from the domestic saving, this is quite a different condition from the one faced by the Italian government in September 1992, when the Lira was under speculative attacks and interest rates were skyrocketing. In

Japan, instead, there is no real sense of urgency, which leads to the postponement of difficult decisions. Issues are tackled and discussed within the traditional framework of lengthy and often inconclusive discussions aimed at consensus building and ending more often than not in murky compromises. The result is that no goal is achieved: economic stagnation continues and at the same time public debt grows even larger. The government seems to rely only on a weak currency and external demand, but this policy might soon become ineffective with the foreseeable economic slowdown in the United States and in Europe. Then, at last, the Japanese policy-makers will feel the urge to act and act resolutely.

The Issue of Non-Performing Loans

The second major cause of the current stagnation of the Japanese economy is the huge amount tied up in non-performing loans that have been held by banks and other financial institutions since the collapse of the speculative bubble of the second half of the '80s. At that time, Japan experienced an unprecedented and abnormal asset price bubble, created and sustained by speculative purchases of shares and real estates. The Nikkei Stock Index, a broad average of Japanese share prices, rose from 12,755 points in September 1985 to 38,915 in December 1989. In the meantime, the price of residential land almost doubled and commercial land prices tripled. In other words, from the mid-'80s to 1989, Japan, its institutions, and a large number of its citizens greatly benefited from a tremendous growth in the value of the country's financial and nonfinancial assets. They did join and enjoy a collective intoxication caused not by traditional *sake* or *shōchū*, but by different kinds of liquid or supposedly liquid substances. These were the shares and the convertible bonds abundantly issued by Japanese companies and eagerly bought by individuals and institutions at skyrocketing prices. The Japanese were also intoxicated by speculative deals on real estate, bought and sold at unbelievably high prices in the illusion that in a mountainous, densely populated country like Japan the value of land could not follow the law of supply and demand and could only increase. (In Japanese this illusion is referred to as *tochi shinwa,* or the "myth of land price").

However, the Japanese bubble had to burst, as happens with every bubble, and, indeed, it burst when, at the beginning of 1990, the Bank of Japan decided to raise interest rates, increasing the cost of the loans that the financial community had generously provided to all speculators. In a matter of months the huge bubble collapsed.[12] The amount of wealth thus created and then dissipated was simply enormous and, consequently, the impact of this financial earthquake on the real economy has been extremely severe. With the collapse of the stock and real estate markets the banks found themselves with a large amount tied up in non-performing loans granted even to dubious individuals and organizations. These "bad loans" or *furyō saiken*, had been provided against the deposit of a collateral or real guarantee (mainly land and buildings), whose evaluation was

[12] The Nikkei Stock Index fell from its peak of 38,915 points to 20,221 in October 1990. Then, after a brief recovery, it continued to fall reaching a level of 16,577 points in April 1992. Since then, the Tokyo Stock Exchange has never recovered and currently (summer 2002) share prices are even lower than the level registered in September 1985, when the bubble started. Meanwhile, the prices of residential and commercial land dramatically decreased as well. In particular, the price of the latter fell to only 20 percent of the peak level.

based on the unrealistic price levels reached during the bubble years. When the price of real estate fell so did the value of the collateral and, consequently, both the banks and their clients were left with assets that could not be disposed of without incurring huge losses.

The disposal of bad loans is a key issue in Japan and also another key difference with Italy, although in Italy too in the early '90s some financial institutions -- particularly in the South -- were in trouble. However, the monetary authorities (the Bank of Italy) intervened promptly and succeeded in limiting the damage to a few institutions that were merged or acquired by healthier ones. No systemic risk occurred.

In the case of Japan, however, the authorities are confronted with a problem of a totally different magnitude and scope. There is in fact a systemic risk as all the banks have large amounts of money tied up in non-performing loans. The actual amount of these "bad loans" is not easily ascertained. One reason for this is the fact that there are different standards and criteria for defining "bad loans."[13] Moreover, for several years, the banks themselves have tried to minimize the problem, pretending that the situation was under control and no risk was involved. However, as time passed the problem grew worse, and banks were compelled to admit the existence of large sums tied up in non-performing loans. According to the Financial Services Agency (FSA), at the end of September 2000 the balance of bad loans held by Japanese banks reached the impressive level of 31.8 trillion yen (6 percent of the GDP!), although recent estimates by the same

[13] On this point see Hoshi and Kashyap, 1999, pp. 26-31.

Agency suggest that the actual amount is considerably higher. It is important to note that the amount in the year 2000 is larger than the amount disclosed two years before. This is so despite the fact that banks had already spent over 60 trillion yen for the disposal of their non-performing loans. Thus, instead of disappearing, the problem is becoming even more severe, badly affecting both households and business investment, as banks have adopted an extremely cautious and risk-averse lending policy. In particular, the large city banks are reluctant to provide funds to small and medium-sized enterprises, which are considered less credit-worthy and, more importantly, are not affiliated with the same group to which the banks also belong. Economic stagnation then produces new bad loans, creating a vicious circle that has crippled Japan for more than a decade.

Under these circumstances, it is important to act rapidly and resolutely in order to restore public confidence in the financial system. But in this case, too, the Japanese government and the top managers of financial institutions seem to be affected by a postponement syndrome. They are reluctant to follow economists' calls for action that will avoid the risk of a systemic failure. In their hearts, bank managers hope that, as time goes by, problems will be solved and…their necks will be spared. But this might not happen. The Japanese financial system is like a strongly-built athlete with a very bad infection. But instead of placing him in an intensive care unit, the government prefers to wait and rely on the patient's strong constitution. It does not work and with the passing of time the problem gets worse.

To be fair, the current Prime Minister, Koizumi, has pledged to give top priority to the solution of the problem. The declared objective is to get rid of all the existing bad and doubtful loans within two years and to liquidate any new debts within three years. To this end, the government announced in September 2001 that it would strengthen inspections by the Financial Services Agency (FSA) and would make a better use of the Resolution and Collection Corporation (RCC), a public agency established in 1999 specializing in the collection of bad loans. Under this plan, the RCC would take on new functions, including active purchase and auctioning off of bad loans. However, these decisions have received a lukewarm response, as the announced measures do not appear to match the magnitude of the problem. Some observers have also pointed out several flaws in the government plan. Firstly, the RCC has no power to compel banks to remove bad loans from the balance sheet. Secondly, the scope of RCC activities could be severely limited by the fact that it must not post losses when it disposes of loans purchased from the banks. Consequently, it might be unable to offer prices sufficiently high to induce the banks to sell their loans. Thirdly, the RCC is allowed by law to purchase only the loans granted to companies that have already gone bankrupt or are at risk of doing so. Fourthly, as the RCC President Akio Koi himself conceded, his agency could be hampered by limitations in staff and expertise (*Nikkei Weekly*, December 3, 2001). This is a serious limitation since the RCC is required by law to attempt to rehabilitate the indebted companies. Additional recruiting of professionals, cooperation with private firms, and further amendments of the law might reduce some of these constraints.

Yet, the fact remains that unless banks are forced to sell bad loans and unless the government is ready to accept losses, the RCC will not be able to carry out its task effectively.

What else can be done? Provided that Japanese banks and their managers have to bear the costs and the responsibility of the excesses and the mistakes of the '80s, the government should consider a more assertive course of action, including the possibility of injecting public funds into the capital of the troubled banks. Public funds could be made available to the banks in the form of capital injection guaranteed by the shares of other companies owned by the banks. The value of these shares was about 40 trillion yen at the end of 2000. It is less today, due to the decline of stock prices, but still larger than the disclosed amount of bad loans.

The injection of public funds could be financed in several ways: by printing money, issuing new bonds, disposing of government-held assets, or using a mixture of all three. As for the disposal of public assets, the government could go ahead with the privatization of the companies that are still partially public-owned, such as NTT. But it could also privatize the so-called special public corporations -- *tokushu hōjin* -- which have already performed and completed their task as public corporations, or whose services can be provided with different policy measures. It is true that some of these agencies like the Japan Highway Public Corporation have accumulated a conspicuous debt, but they also own major assets that could be mobilized. For example, the Development Bank of Japan, a healthy financial institution, registered a net profit of 23.4 billion yen in fiscal year 2000 and has a capital ratio of just over 10 percent, a level as high as that of major city banks.

Here the comparison with Italy is again useful. Italy adopted a privatization policy in the ’90s, when several state-owned and state-managed companies and financial institutions were sold to the private sector. The list is very long and it includes the banks and the companies controlled by IRI -- the Institute for Industrial Reconstruction -- which had been set up in the ’30s as a “temporary” institution to save those financial institutions on the verge of collapse after the great depression. The revenues were then used to reduce the public debt. Japan, instead, could use the assets of public corporations to restore the stability of its financial system. This policy should not be carried out for the sake of privatization per se, but for the sake of the country and its economy, following the pragmatic approach that has for a long time been the trademark of Japanese policy-making.[14]

Needless to say, to implement such a policy there is a need to overcome the resistance of powerful vested interests and the resilience of the system. The Italian government succeeded, thanks to external pressure from Brussels and thanks to the fact that in the wake of several scandals the system had lost its credibility. In the case of Japan the government is confronted, first of all, with the opponents of reform within the ruling Liberal Democratic Party, who obtain votes and support for their attention to public corporations and their investment

[14] Given the unfavorable current conditions of Japan’s stock market, the government could issue convertible bonds as the present Italian government is planning to do for the privatization of public-owned assets.

plans. In order to overcome this "internal" resistance it is necessary to go beyond the traditional consensus-based policy-making that prevents controversial bills from being even submitted to the Diet. Then there is bureaucratic resistance.[15] Public corporations provide, in fact, well-paid and secure job opportunities for government officials after retirement, although this practice is also a possible source of collusion between the company managers and their regulators. In this context *gaiatsu* -- the Japanese term for external pressure -- is not sufficient to quell the resistance. The government has to act boldly and to do so it needs strong public support that was certainly available when Koizumi was appointed as Prime Minister. However, support is fading and so far no clear plan has been announced.[16] And there is a risk that after the "lost decade," Japan might lose another ten years and become the sick economy of Asia just as Italy used to be the sick economy of Europe a few years ago.

[15] A revealing example of this resistance is the Transport Ministry's plan for the Japan Highway Public Corporation and three other agencies operating in the road sector. The plan, presented to the Prime Minister in September 2001, did not even mention a tentative timetable for privatization. Moreover, according to the *Nikkei Weekly*, when Nobuteru Ishihara, the state minister for administrative reform, asked a ministry official to provide the details, he was "informed" that discussion on privatization will be completed in … 20 years (*Nikkei Weekly*, October 1, 2001).

[16] A plan for the privatization of Japan's three international airports has been drafted by the Ministry of Land, Infrastructure and Transport, but the details are not clear and opposition is strong. A Committee is discussing the privatization of Japan Highway Public Corp. and other expressway operators, but in this case, too, it is faced with the strong opposition of local politicians who are afraid that their constituencies might be penalized.

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