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ECONOMIC VIEWPOINT

By Glenn Hubbard

A Free-Market Cure For Japan's Chronic Cold

Two moves by Koizumi could help capital go where it's needed

Japan's economy, a titan of the 1980s, has experienced more than a decade of lost economic growth and might well continue just to limp along. But Japan can expand faster by boosting its productivity. A revitalization of the world's second-largest economy would improve global growth. Two initiatives championed by Prime Minister Junichiro

Koizumi could bring this possibility to life by increasing the effectiveness of Japan's capital markets in allocating savings. They deserve strong U.S. support.

U.S. experience demonstrates how competitive and efficient capital markets can stimulate expansion. The increase in U.S. productivity growth over the past decade is not just a story about information technology. Innovations, while important, are globally available, and America's productivity gains have outstripped those of other countries. Key to the quick adaptation of productivity improvements in the U.S. is capital markets that fund major companies and entrepreneurial upstarts alike. Therein lies the lesson for Japan.

JAPAN IS ALREADY MAKING PROGRESS in corporate restructuring. For example, nonperforming loans -- which act as a tax on entrepreneurship by keeping capital from reaching up-and-coming borrowers -- have been trimmed. Now Koizumi seeks to promote mergers and acquisitions and privatize the slumbering Japan Post, the state-owned corporation whose savings and insurance arms manage a gargantuan \$3.3 trillion. He has provided crucial economic leadership. But execution is still a challenge.

The M&A debate is really about making management face the discipline of capital markets. Recall the U.S. experience in the late 1970s and early 1980s, in which corporate raiders forced inefficient managers to maximize the value of shares, leading to entrepreneurial wealth creation and greater productivity. Foreign direct investment in Japan -- tiny relative to that in China -- can jump-start M&A activity. Here is where policy changes are required. The Japanese commercial code must be amended to allow foreign acquirers to pay for acquisitions with stock as well as cash, the practice in most of the industrial world.

Such foreign direct investment is less about hostile takeovers than about friendly acquisitions. There have been some successful high-profile M&A transactions, such as private-equity firm Ripplewood Holdings' restructuring of the Seagaia resort project on the island of Kyushu, Eastman Kodak's ([EK](#)) acquisition of Chinon Industries, and Wal-Mart Stores' ([WMT](#)) pairing with retailer Seiyu across Japan. These ventures have injected capital into local economies, saved and created jobs, and added managerial knowhow, calling to mind how Japanese investment in the U.S. in the 1980s helped

make American companies more competitive. To stimulate M&A in Japan, the Koizumi administration needs to maintain its strong support for allowing cross-border M&A using stock swaps.

Encouraging a competitive market for corporate control is also important. Political opposition is focusing on protecting managers. This recently came to a head when Takafumi Horie, the young boss of Livedoor Co., an Internet-services company, mounted a bid to take over staid Nippon Broadcasting System Inc.

The second potentially transforming policy change is Koizumi's proposal to privatize Japan Post. Moving the huge assets under its management into private hands could stimulate competition in financial services and productivity, as capital becomes allocated more nimbly and efficiently.

Koizumi wants to split the Japan Post behemoth into separate pieces for mail, banking, insurance, and property management. Government ownership (and preferential tax treatment and state guarantees) would cease by 2017. But in the transition, Japan Post units should fall under the same regulators as their competitors. All advantages accorded Japan Post over its private-sector rivals in insurance and banking should be eliminated as soon as possible.

Reform would allow entrepreneurs such as Horie to thrive. People all over Japan would gain from faster productivity growth and higher incomes. And the global economy would benefit as well.

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