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"Japan's Financial "Brand" for the 21st Century"

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Japan's Financial "Brand" for the 21st Century

Discussion Paper

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To discuss Japan's state "brand," there are several questions that we must first address: What do we mean by a state's "brand"? Who is the audience? And what are the goals of "brand management"? While these are fairly straightforward questions for marketers of consumer products, they are much more complex for states or nations.

The Concept of a National "Brand"

Several important differences between states and firms can be identified that profoundly affect the ability of a state to create and manage its "brand." For example, contemporary marketers have the option of "narrowcasting," of focusing advertising or public relations campaigns at specific groups. If contradictory messages are delivered to different groups of consumers, there is not necessarily a problem, whereas states' reputations are far more vulnerable to charges of cynicism or hypocrisy. Also, commercial brand management addresses a rather limited set of attributes of the product or firm – for example, the quality of its goods or services, its trendiness, and perhaps the ethicality of its actions. States not only have a myriad of functions that may often contradict one another rather than create a single unified image, but their images are also primarily shaped by the actions of their citizens, firms, and other societal entities. The major implications of these facts are that states must seek to promote "brands" that reflect reality, and that we must be humble in believing that they have very much control over the ways in which they are perceived.

Nonetheless, this is an important exercise. From an academic perspective, both empirical and theoretical developments suggest the importance of a state's "brand." Constructivist theories of international relations and empirical studies of psychology tell us that perceptions matter, and they often matter in ways that are not purely rational. In interpreting the action of another actor (whether a person, organization, or state), people tend to have a coherent picture of that actor's preferences, capabilities, and intentions, from which they derive the meaning of the action. In the current U.S. election campaign, for example, those who see President Bush as a strong and determined leader are apt to see his continued equation of the war on terrorism with the war on Iraq as evidence of focus and consistency, whereas those who see him as a rigid ideologue find confirmation of their negative opinions of him in the same statements. When we raise internationally sensitive issues for Japan such as history textbooks, prime ministerial visits to Yasukuni Shrine, or Chinese policemen's violation of the Japanese Consulate in Shenzhen, we can imagine how prior assumptions of intentions – in other words, states' "brands" – can lead to very different interpretations and thus responses.

Disturbingly, people tend to be highly selective in how they amend our perceptions. Ideally, a rational actor would respond equally to information that supports or questions his model of another actor or situation. In fact, experimental evidence demonstrates that people tend to pay more attention to information that confirms their existing beliefs, while rationalizing away information that goes against them. In terms of international relations, many studies have confirmed the common-sense notion that reputations matter. However, this is not necessarily good news. As some studies have shown, the persistence of reputations can perpetuate conflict, and eliminate opportunities for reducing tensions. There is some evidence that this dynamic characterizes the Israeli-Palestinian dispute, for example. When one side becomes more aggressive, this reinforces the other's belief that it is dealing with an inherently aggressive opponent, which can only be dealt with by violence. However, when one side is more conciliatory, this is often seen as evidence of weakness, and so the logical reaction is again violence. Leaving aside the obviously important issues of historical memory and ethnic hatred, we can see the difficulties of dialing down the level of open hostility in such a situation. This example highlights both the potential dangers of mutual negative perceptions and the difficulty in changing one's own negative reputation.

Japan's "Brand" – Goals and Audience

While it would be interesting to discuss much more deeply the general issues involved in perceptions and state "brands," I think that I should return to the issue that was assigned to me, of what Japan's financial "brand" should be for the 21st century. This also brings us back to the questions that I raised in the beginning of this discussion paper. First, what does the Japanese government hope to achieve by refining its "brand"? Is it meant to support the effort to become a permanent member of the UN Security Council? To make the Japanese people more proud of themselves? To make other governments more willing to change their economic policies in ways that will benefit Japanese people and firms? My own preference is to avoid grandiose and unlikely aims such as permanent membership in the UNSC – far too much time and money in the form of PKOs and redirection of development aid have been spent by Japan over the last dozen years in vain efforts to show that Japan is "worthy" of membership. Similarly, pride in being Japanese, or even popularity in the world, strikes me as a misuse of the finite resources of the state. Thus, to me the purpose of this exercise is to promote economic cooperation where mutual interests exist.

The related question is that of audience. Should efforts to promote a Japanese "brand" focus on the United States, the "West," its major economic partners, East Asia, or the world more broadly? Moreover, should Japan be focusing on elites or populaces, government officials or private sectors? While the answers are not obvious, I think the basic criterion is a simple one: Japan should focus its efforts on changing those perceptions that are creating the greatest obstacles to mutual economic benefit.

At the moment, I do not see any particular ways in which either elite or popular perceptions of Japan in the United States and Europe are creating serious obstacles to mutual economic benefit. There is certainly a dismissive attitude toward Japanese politics and the Japanese financial system that may have some effects. But trade and investment opportunities are open in both directions, and extensive integration and cooperation suggest that mutual images are not currently a major problem.

The more serious issue is to be found in East Asia. There, although economic integration has proceeded at an impressive pace over the last twenty, and particularly last ten, years, deep mutual suspicions and lack of trust pervade perceptions of the Japanese state, the Japanese people, and Japanese corporations. Moreover, since there is significantly more to be done in terms of both lowering barriers to trade and investment and achieving deeper integration, these perceptions have potentially far more negative ramifications.

The most serious weakness of the Japanese "brand" in East Asia has to do with historical memory of the Pacific War and – for China and Korea – the colonial period. The "brand" image that emerges from historical memories is that the Japanese people and government are ruthless, predatory, and entirely self-interested. Such feelings are to be found among both elites and general populaces, although different countries present different patterns. Perhaps the most dangerous pattern is to be seen in China, where the state has effectively managed the latent anti-Japanese sentiment of many citizens to legitimize its own monopoly on power.

What Should Japan's "Brand" Be?

Clearly, economic policies have limited ability to overcome historical memory, especially when bitter feelings are cynically exploited by governments. Nevertheless, some actions can be important in changing perceptions in cases where Japan's economic profile is seen as confirming the vision of self-interest and predation. When Japanese economic aid is acknowledged in infrastructural or welfare-enhancing projects, or when Japanese firms are seen to be more attractive workplaces than firms based locally or in other foreign countries, the negative images can be reduced.

At least as important is what this conference is trying to do: To create a positive counter-image that has more truth to it than existing negative images. To be effective, such a counter-image, or "brand," must be a reasonable approximation of reality, must be attractive to the audience, and must differentiate Japan from potentially competing national "brands," such as the United States, European Union, or other East Asian countries.

In the 1980s, Japan's "brand" was clear and attractive, and helped to significantly reduce anti-Japanese sentiment and policies throughout East and Southeast Asia. Japan was seen as economically powerful and dynamic, and the creator of a developmentalist alternative to a declining and often dogmatic United States. The Ministry of International Trade and Industry (MITI; now the Ministry of Economy, Trade, and Industry, or METI) resurrected the pre-war concept of regional development as a "flying geese" pattern, in which Japanese industrial development helped to smooth the way for follower economies (South Korea and Taiwan in the first tier, Malaysia and Thailand in the second, and so on). While some Asians worried about the hierarchy implied in the "flying geese" model, and others feared an economic version of the "Greater East Asia Co-Prosperity Zone" of the Pacific War period, for the most part this "brand" was a positive one. At the popular level, many people and firms saw that they could make money and improve their lives by working with Japanese firms. At the elite level, a number of governments saw opportunities to advance industrial development in ways that Western governments and international financial institutions would not have approved. Most emblematic of this was the Malaysian "Look East" campaign of the early 1980s, but other examples could also be seen (including such failed concepts as Jose Concepcion's proposal to create a Philippine "DITI" to mimic Japan's MITI in the late 1980s). As Asian and Western scholars, journalists, and policy makers increasingly debated the existence of an "East Asian model" to be found in Japan and in the "Four Tigers" of South Korea, Taiwan, Hong Kong, and Singapore, Japan's economic "brand" gained cachet and value.

Now, unfortunately, both that "brand" and the economic system that it represented have come into some disrepute. The crash of Japan's bubble, a dozen years of disappointing economic growth, the bankruptcies and takeovers of major Japanese firms, the extended weakness of Japanese banks, sky-high fiscal deficits, and a host of other difficulties have considerably dimmed the luster of the Japanese "miracle." In the West, the problems of other East Asian economies in the 1997-98 Asian Financial Crisis only confirmed the negative perceptions of the Japanese developmental "brand."

But while the travails of the Japanese economy and the disaster of the Asian Financial Crisis have sullied the image of Japan's economic "brand," I believe that there is a real opportunity now for Japan to redefine that "brand" in a way that will reflect its considerable economic strengths and also distinguish itself from the United States or the European powers. To some extent, this will require some substantive shifts within the Japanese economy. But for the most part, some subtle redefinition, along with some reorientation of government policies to support the redefinition, should be sufficient. Best of all, I believe that the next few years offer Japan an opportunity to better align its "brand" with its interests, which in turn could offer significant economic and political returns in East Asia and perhaps more globally as well.

The broad contours of the redefined "brand" follow those of the 1980s version, with the addition of some of the principles enunciated by the Japanese government in the Asian Financial Crisis:

- Japan should be seen as a large, powerful, technologically innovative economy with a strong global orientation.
- Japanese firms should be seen as the "indispensable partner" for regional production networks.
- The Japanese government should be the place for regional governments to go for innovative public projects and cooperative arrangements.
- Japan should be the model for a new developmentalist model that combines deep integration into the world economy with pragmatic protections from the dangers of financial globalization such as limited capital controls.

In all, this is a vision of Japan as offering a pragmatic alternative to the so-called "Washington Consensus." As I have put it elsewhere, it puts Japan in the position of defending "economic policy pluralism" against the universalizing tendencies of globalization.

Instituting Japan's "Brand"

Any successful "brand" must not only be attractive to the external audience, but also must be a reasonable reflection of reality. In order for elite and popular audiences in East Asia accept the proposed "brand," Japan will need to make efforts in three separate but related areas of finance: reinvigoration at home, regional level initiatives for financial stability, and promoting financial development in the region. Its extremely large pool of net savings means that Japan has much to offer its neighbors from a financial perspective. Moreover, the need for Japan to achieve high returns to pay for its aging society means that this is an urgent task for Japan's national welfare as well as its national prestige. For the moment, at least, Japan's large net creditor position strengthens its hand.

Financial Reinvigoration at Home

Undoubtedly the most important part of any effort to promote an attractive financial "brand" for Japan will be to have a strong and attractive economy and financial system. This is, of course, an important goal for Japan in any event, but it is hardly worth even discussing a "brand" unless Japanese firms, financial institutions, and markets are dynamic and successful.

Clearly, this is an excessively broad topic for a paper and conference of this nature. So what I will do here is to break it down to three major financial issues that are a drag on the Japanese economy and on outsiders' perceptions of the Japanese economy: banking regulation, the postal savings system, and the unattractiveness of the Tokyo financial markets.

The problems of the Japanese banking system in the post-bubble period have constituted the greatest drag on both the Japanese economy and its image abroad. Years of opaque and inefficient management, regulation, and supervision contributed to extraordinary levels of non-performing loans (NPLs), financial institution bankruptcies, and the constant suspicion that even worse results were being concealed. The repeated mistakes on the part of both bank managers and regulators have destroyed the credibility of Japan as a potential role model for other countries in the region and have reduced the influence of Japanese banks as funding sources for businesses and governments.

Japan can become the role model for adapting a relationship-based banking system to deal with the challenges of financial and manufacturing globalization, but it is not there yet. Certainly, there have been important reforms and improvements over recent years. In the last year and a half, major banks have finally achieved large reductions in their NPL holdings and improvements in capitalization. Moreover, banking regulation has largely caught up with the "free, fair, and open" goals of the Big Bang, and supervision has become more consistent and transparent. Nonetheless, a number of major concerns remain. Many regional banks remain weak, and the mega-banks created by mergers over the last five years or so often suffer from muddled business plans, excess staffing, and weak profitability. Moreover, some of the high-profile actions by regulators – including the *de facto* government takeover of Resona Bank, pressures on Shinsei Bank to increase its lending to small businesses, and the way in which rival bids for UFJ Bank were handled just last month – have created concern that arbitrariness and non-transparency have not been fully eliminated from the system.

The simple fact is that Japanese banks must service increasingly sophisticated firms in an increasingly globalized world. Given the retreat from international operations by many Japanese banks and the weakness of Tokyo as an international financial market, this will mean primarily servicing Japanese firms for the time being, but the principle remains the same. Banks and other financial institutions will thrive only by providing effective risk management services for Japanese firms with global interests (including hedging against currency movements, maturity mismatches, etc.) and participating in the creation and marketing of products that offer them higher returns and lower risks than traditional banking services (for example, establishing a highly liquid market in asset-backed securities). It is undoubtedly possible to continue to emphasize long-term relationships and to fulfill traditional tasks such as heavy involvement in project finance that have created a Japanese "brand" of financial services over the years, but the tools must adapt to changed circumstances. If Japanese banks are then able to reenter international finance from a position of technical and financial strength, then the Japanese financial "brand" should make them very attractive counterparts for many growing firms in Asia.

While much of the discussion surrounding reinvigoration of the domestic financial system has focused on mistakes in regulation and supervision, another key aspect of the Japanese government's responsibility for reinvigoration is to be found in the postal savings system. With about a third of Japan's savings deposits and about forty percent of its term life policies (through *kanpo*), postal savings is by far the largest financial institution in the world. It is also highly inefficient, politically protected, and distortionary. While current political debate centers on how to improve its efficiency, to my mind it should simply be eliminated. Even if it becomes an efficient financial institution whose lending practices reflect responsible risk assessment and whose management seeks to implement best practices, it will have the ability to compete unfairly with other financial institutions based on its sheer size, tax-free status, subsidized branch network, implicit yet costless deposit and insurance policy guarantees, supervision by more lenient regulators, and intimate political connections. Postal savings is a threat to Japan's financial system and a symbol of lack of accountability of government spending that can only weaken Japan's "brand" as a financial leader.

The final point I would like to make with regard to Japan's domestic financial system is the continuing parochialism of its capital markets. It is certainly true that there has been substantially increased foreign participation in the stock market, and foreign financial firms are major players in the Tokyo markets for a variety of products. Moreover, some Japanese firms are major players in global capital markets. However, Tokyo remains a essentially "local" market, which does very little business that is not directly related to either Japanese firms or Japanese financial institutions. In many ways, it is less of an international market than Hong Kong or Singapore, and it lags far behind New York and London in that regard.

This parochialism creates several problems for Japan in its quest to again become a global or at least regional financial leader. For one thing, it contributes to the tendency of Japanese savings to be invested domestically (often for disappointingly low returns) or to be recycled through New York or London by more sophisticated foreign institutions. It also inhibits the use of the yen as a serious reserve currency for regional governments. While significant improvements have been made in the openness and technical efficiency of Tokyo's markets, weaknesses in the government bond and asset-backed securities markets make it difficult to pursue sophisticated risk management operations without going abroad for a significant portion.

Altogether, it is clear that Japan's financial markets are not yet ready to fully support a vigorous and attractive financial "brand." The problems of the banks and other financial institutions make it hard to look to any that could be seen as leaders in international or regional finance. Continuing concerns about regulation and postal savings mean that the system itself has limited luster. And the fact that Tokyo markets are for the most part bypassed even by regional governments and firms in their participation in global capital markets lessens Japan's perceived relevance in this respect. This makes it unlikely that the yen will seriously challenge the position of the dollar in East Asia in the near future, despite its huge net creditor position. (The Chinese renminbi, of course, will not be able to have an international role for many years to come, given China's capital controls, lack of financial development, and its position as a developing economy.) Fortunately, the key to renewing Japan's prestige in this regard is exactly what the Japanese public and private sectors should be doing for the sake of Japan's own economy.

Promoting Regional Stability

One of Japan's great strengths in its regional financial "brand" derives from its actions in the context and aftermath of the Asian Financial Crisis. Its support for threatened neighbors has opened up an important window of opportunity in building up a more attractive image that will help to improve the likelihood of public and private cooperation for mutual economic gains.

Although most American analysts would not agree with me, I am convinced that the Japanese government was one of the few heroes of the Asian Financial Crisis. Starting with the Thai crisis, Japan was the first major actor to recognize that the crux of the problem was liquidity rather than fundamentals of the Thai economy. (This is not to say that there were no fundamental problems in the Thai or other crisis economies – there clearly were. However, they did not explain either the timing or the extent of the crises.) It was the largest bilateral contributor to each of the IMF-led packages. It created a special fund within the Asian Development Bank to deal with potential contagion issues. In 1998, the New Miyazawa Initiative sought to increase the amount of funding available to affected economies both through increased aid and by supporting private capital flows with bond guarantees. In the aftermath of the crisis, several of Japan's proposals for reforming IMF procedures were adopted, increasing the amount of funds that could be released to member countries in future crises. Perhaps most famously – although, I am convinced, foolishly – it called for the establishment of a $100 billion Asian Monetary Fund that could potentially have rivaled the International Monetary Fund's role in dealing with future regional currency crisis. After this proposal was roundly defeated, a more limited arrangement to promote currency stability was created in the Chiang Mai Initiative (CMI). Interestingly, the current ASEAN+3 efforts have not drawn the expected opposition from the United States, probably because the U.S. government no longer sees the Japanese financial "brand" as a threat to its own.

I believe that there are several important results to be seen in these events that are relevant for Japan's financial "brand." First is that the Japanese government moved boldly in putting forward an interpretation of the situation that was not only highly attractive to crisis countries, but also supported by fiscal and political actions. The strength of the Japanese government's convictions motivated changes in IMF and ADB procedures and may have had some effect in prompting a more positive response by the United States to the Korean and Indonesian crisis than it had shown in the Thai situation. Japan's stance was seen as brave and supportive in much of East Asia, and its willingness to put up large amounts of money to help its neighbors certainly caught their attention as well.

This illustrates the second point: that these actions by the Japanese government (although not really supported by the private sector) helped to shift the mindset among many in Southeast Asia and South Korea that Japan's activities in the region were purely selfish or even predatory. It helps that the AMF proposal and Chiang Mai Initiative were designed to fit Japan's emerging "brand" – in particular, the expectation that each country should be able to choose its own approach to financial globalization and domestic economic policies. Collective arrangements like the CMI (and especially the AMF) are meant to protect such individual approaches from externally-driven market pressures.

The third lesson has been that there is at least a limited willingness to accept Japanese leadership in financial matters. I do not want to minimize the importance of China as either a sticking point (as in the AMF proposal) or facilitator (as in the Chiang Mai Initiative) for Japanese or Japanese-inspired financial arrangements. But the regional currency arrangements and financial cooperation that now exist through the ASEAN+3 and particularly the Chiang Mai Initiative are the result of Japanese initiative and generally reflect the interests and concerns of the Japanese government. There are, I believe, some rather important flaws to the current arrangements, but it is hard not to see them as a triumph for a Japanese vision and thus for Japan's financial "brand."

As part of its international "brand" management, I believe that Japan should continue in the path of regional institutionalization. Expansion of Chiang Mai Initiative swap lines is less important than improving the institutional arrangements surrounding them. For now, activation of CMI swaps has largely been delegated to the IMF, as major creditors like Japan worried about both the potential negative reaction of the IMF and United States and the possibility of having to bail out economies that had acted irresponsibly. However, there is certainly some regional sentiment in favor of returning greater discretion to ASEAN+3 member states. In order for that to be considered seriously, it would be necessary to improve regional surveillance and moral suasion over financial policies in order to reduce the likelihood of unnecessary crises.

Perhaps more importantly, Japan could use the leverage of reducing IMF power over swap lines to push forward the kind of surveillance and moral suasion that would allow it to shape regional financial systems to its own (and of course the region's) benefit. So far, there has been relatively little done to improve the quality of regional surveillance. This is somewhat ironic, given early efforts by the Japanese-sponsored ADB Institute and others to create a set of indicators that would be regionally specific in predicting future Asian crises. If those efforts are serious and actually bear fruit, surveillance based on them could become a useful tool for Japan in promoting a stable, prosperous region that respects the contexts existing in each country rather than promoting rapid capital liberalization in an indiscriminate manner. Such economic policy pluralism is a keystone of Japan's post-developmentalist alternative to U.S.-led globalization. Even if the ultimate goal is to have national financial systems converge in terms of regulation and openness to global money, Japan can have a role in shaping the sequencing and timing leading up to that final point. For example, the Japanese government has been rather supportive of the maintenance of some capital controls in Malaysia and China. This reflects its own prioritization of liberalization compared to other goals, as well as its position that each country should choose its own pace of financial liberalization.

Before leaving this topic, it should be useful to make one last point about the ways in which Japan can help regional governments to create systems of financial regulation and supervision that will be more effective and more stable, as well as compatible with the interests of Japanese firms and financial institutions. At least since the 1980s, the Japanese government has offered advice and training on financial system management and fiscal and tax systems to other countries through the Ministry of Finance think tank and related private-sector organizations. However, such programs have lost a great deal of credibility in the face of Japan's financial and fiscal problems over the last dozen years. But if efforts to clean up the domestic problems are successful, such programs will be a useful adjunct to the ASEAN+3 efforts noted above.

All these efforts could also be complementary to a reinvigorated APEC if that organization were to regain relevance. Indeed, I would suggest that these measures would strengthen Japan's hand to shape the agenda of APEC. However, it is important to note that positive leadership in financial issues will not excuse Japanese intransigence in issues such as agriculture. Having allowed its protected agricultural sector to sink APEC's Early Voluntary Sectoral Liberalization efforts in the 1990s, the Japanese government should certainly be wary of injuring its financial "brand" with such an ill-considered linkage.

Regional Financial Development – An Asian Bond Market?

While there is much that can be done to help develop regional capital markets using the leverage of the Chiang Mai Initiative and by offering aid and advice to financial regulators within other Asian countries, I believe that there are inherent limitations to Japan's ability to force the development of markets that would benefit it. This can be seen in two initiatives of the last several years.

The first is the multi-year and multifaceted efforts to promote internationalization of the yen. While many if not most of the specific policy initiatives in this regard have been positive for both the Japanese economy and Japan's "brand" (for example, liberalization of the Japanese government bond and bill markets, changed rules on tax withholding for foreign investors, and efforts to improve clearance systems), others are counter-productive. These include policies that have sought to impose use of the yen on individual firms or countries even when they would prefer to use dollars or euros or local currency. Internationalization of the yen is a goal that will not work if it is not market-driven; moreover, efforts to force yen-based transactions on neighbors will not contribute to a positive image of Japan's "brand."

The second is the Asian Bond Market proposal that has been put forward by the Japanese Ministry of Finance. The goal of the proposal is to create regional capital markets denominated in regional currencies in order to allow East Asians' savings to finance projects within East Asia without going through New York or London markets. While the goal is an attractive one, the existing proposals are excessively complicated, excessively interventionist, and potentially a serious waste of government resources. Moreover, they are extremely unlikely to work. To my mind, it would be a sad squandering of Japan's tax money and hard-won regional "brand" to pursue this scheme.

The point here is that initiatives must reflect real possibilities as well as the principles on which Japan's "brand" is to be based. As Japan's own economy becomes more and more globalized and market-oriented, so must its policy initiatives.

Summing Up

This discussion paper has sought to do three things. First, it has considered the concept of a state or national "brand" from a general perspective, and to draw out some guidelines for thinking about the determination and implementation of a financial "brand" for Japan. Second, it has suggested a feasible and attractive "brand" that will promote Japanese policy goals. Third, it has considered some of the elements and obstacles to establishing this "brand."

A discussion paper of this length inevitably raises more questions than it answers, and leaves a great deal of important territory unaddressed. For example, I have focused on Japan's regional "brand" largely to the exclusion of its role as a global player. I believe this can be justified partly by the more substantial opportunity costs of Japan's current "brand" in East Asia than elsewhere in the world, as noted earlier. Moreover, I believe that a strong case can be made that Japan's regional identity will increasingly define its ability to sway Western governments and multilateral organizations – the willingness of the IMF and United States to consider Japanese reform proposals in the wake of the AMF episode certainly suggests that Japan can derive strength in the world from greater strength in the region.

Despite the inherent limitations of a paper such as this, however, I do hope that it will be able to generate useful debate that will improve Japan's ability to promote its national interests in the financial sphere. I very much appreciate the opportunity to participate.