

Darkest before the dawn?

Tragic upheavals sometimes shock a society out of patterns of behaviour that have endured for decades or even centuries. Could the triple disaster that has befallen Japan be a case in point, asks David Rowe

One vivid memory of my college days in the mid-1960s was a brief conversation with a Japanese exchange student. This was a time of great upheaval in the US related to the Vietnam War and youthful rebellion against authority of all kinds. My Japanese acquaintance was greatly puzzled by the ethos of the time. He said he and other Japanese youth were determined to rebuild Japan after the terrible devastation wrought by defeat in World War II. The disrespect of American youth for their country and their nihilistic disregard for the necessary role of institutions and authority in building a better society for all was nearly impossible for him to comprehend.

Had I enjoyed greater wisdom at that time, I might have taken lucrative advantage of this encounter. Certainly, starting a mutual fund investing exclusively in Japan would have proven to be a rewarding decision. I think it is still difficult for those of us in the West to appreciate how great a shock Japan suffered from defeat in World War II. I recently read a biography of Emperor Hirohito that portrayed the profound, indeed almost mystical, devotion to him exhibited by Japanese society at every level.

This devotion coexisted with an almost equally profound belief in the superiority of the Japanese people and their way of life. This latter belief was so strong that the ultimate ability of the Emperor to impose a decision to surrender after the second atom bomb fell was far from assured. In the end, of course, his decision did prevail. In the aftermath, Japan had to deal with a shock to its national psyche at least as devastating as the physical destruction it suffered.

In the end, the nation rallied and created the post-war Japanese miracle. With the help of W Edwards Deming, Japanese business adopted statistical process control and trans-

formed 'Made in Japan' into a global symbol of first-rate quality. Of course, this approach to manufacturing excellence meshed well with traditional Japanese cultural values of discipline and respect for hierarchy. Largely lacking was a countercultural respect for innovation, a competitive desire to surpass one's peers, and a regard for ability and merit over age and seniority.¹

The traditional Japanese *keiretsu* system of business conglomerates meant most banks were largely captive lenders to related companies in their group. The lack of genuine competition in the banking sector allowed a massive build-up of speculative exposures that unravelled rapidly in the early 1990s. A more flexible and competitive system would have restructured insolvent institutions, forced claimants to recognise their losses, recapitalised the resulting institutions and laid the groundwork for renewed economic growth. Instead, the authorities tried halfway measures that allowed non-performing loans to drag the economy down for two decades and counting.

In late 2006, I speculated whether the shock of China's rise would trigger the necessary cultural changes for Japan to escape its long malaise (*Risk* September 2006, page 113, www.risk.net/1498161). So far, the dysfunctional political system (which other nations, notably the US, seem to be emulating rather than rejecting) has shown little sign of change. Emergence of a more competitive and innovative culture is doubly important for Japan in light of the special severity of its aging population and falling ratio of workers to dependent retirees.²

There is certainly no guarantee that the tragedy Japan is suffering will trigger the necessary cultural changes to allow it to recapture its role as a leading economic power. Sometimes, however, it is darkest before the dawn. For the sake of an ancient and proud people, we can only hope that Japan makes the necessary adjustments and once again surprises the world by its resilience in the face of a historic calamity. ■

¹ One of the most notable exceptions to the lack of Japanese innovation was the introduction of the Sony Walkman in 1978. Then Sony chairman Akio Morita was long regarded as a notable exception to the tradition of low-profile conformity among Japanese business leaders

² According to a recent special report in *The Economist*, Japan is projected to reach a ratio of only 1.2 workers per dependent retiree, a worse ratio than any other major industrial country. See www.economist.com/node/18502005?story_id=18502005

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