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Short Curriculum Vitae) Ryozo Hayashi

Graduated from the Faculty of Law, Kyoto University, then in 1970 joined the Ministry of Trade and Industry where he successively served as the Director of the Consumer Goods Industries Bureau, Director of the Minister’s Secretariat, and Director of the Economic and Industrial Policy Bureau. Served as a Fellow at the Kennedy School, Harvard University, Fellow at University of California, San Diego, Consulting Fellow at Research Institute for Economy, Trade and Industry (RIETI), Professor at the Graduate School of Public Policy, The University of Tokyo (currently a guest lecturer), Director and Special Advisor (present post) Canon Institute for Global Studies (CIGS), and Independent External Auditor at Itochu Corporation (present post), before taking up his current post in 2011. His works include *Economic Assessments of Medical Technology and Public Policy* and *Green Innovations that Will Alter Japan’s Future*.

Miscellaneous Thoughts on Europe

Several weeks ago an international advisory committee for European companies was held in Portugal. Portugal was one of the first countries to be struck by the recent European economic crisis, and it is still in the process of rebuilding. The town where the meeting was held had a lot of tourists and did not appear to be faced with a serious recession, as Portugal is a cheerful Southern European country in which Islamic culture is intermixed. As for the problem of unemployment in Southern Europe, it had a culture of unemployment characteristic to Southern Europe, where I remember hearing comments to the effect that the people work in their own fashion and do not necessarily have trouble making a living.

The main theme of the meeting was “The Future of Europe.” Debaters from various

European countries, the United States and South America, Asia, the Middle East, major newly emerging countries, and more participated and held incredibly animated discussions over a variety of issues, including: How can the euro zone regain its footing economically? Can Europe occupy a central position in the world in a political sense? What roles are expected of Europe in a political and economic sense? Through what sorts of processes can such a Europe be achieved given its current state of suffering through the middle of the current financial crisis? In this column I would like to introduce some of the points that drew my interest as a layman when it comes to Europe.

First, when it comes to the current financial crisis in Europe, there is the pervasive sense of tension that even now the euro is on the verge of collapsing. At the same time, there is an unbalanced feeling as if the complexity of dealing with it concretely has not been fully understood. With respect to the first point, there is an enormous gulf in the recognition over the severity of the situation between Germany—which feels as if things have taken a turn towards its supporting the euro single-handedly—and the citizens of other countries. There is confusion and discord between top-level leaders in the major countries underpinning the political determination to not let the euro collapse, and there are clashes with the bureaucracy in Brussels that any initiatives must inevitably pass through when they are executed. For these reasons one can surely feel the sense of daily tension among Europe's leadership class.

This second point is manifested in the intuition of the time needed before it can make a tentative restart. The issues that should be handled by way of major structural factors and as the first stage have been set in order to a considerable degree. Since the adoption of the euro, wages have remained within the range of increases in productivity in Germany, yet conversely wages have continued to rise primarily in the Southern European countries. On the other hand, spreads in national debt between countries reached zero temporarily after the adoption of the euro. This speaks to the fact that the root causes of the current crisis lie in the wages surpassing productivity in the Southern European countries that are moving towards integration with the euro, as well as the easy borrowing backed by Germany's creditworthiness, a point which is also clearly revealed in the data. What is more, there is also a shared sense of crisis that the abnormally high levels of youth unemployment in Southern Europe will have a long-term negative impact on their labor markets. This has also led to a shared understanding that in order to recover from the financial crisis it will be necessary to create mechanisms for transparency, oversight, and corrective measures that take further steps towards centralizing the supervisory structures for financial institutions and financial regulations in each country.

However, superimposing Japan's experience from the 1990s onwards over this reveals that setting in place the conditions for righting financial institutions in this manner is nothing more than a first step towards getting economic activity as a whole moving again. Together with arrangements on the financial institution side, it will also be necessary to transfer resources away from the "zombies which produce no value in an economic sense but which account for part of social order" that the financial institutions of each country provide financing to.

What is more, it will be necessary to correct the institutional weaknesses that have led to an expansion of bad debt and the rigidity that has hindered the re-fluidization of resources. There will be enormous resistance from those being retrenched through this process, and the larger the interests entangled in the institutions that must be corrected are the greater will be the resistance. Moreover, as this is an endeavor that will continue to unravel—simultaneously and in parallel—the complex relational expressions between multiple interested parties who are in a state of paranoia, it has not been simple even within individual countries. To say nothing of the fact that getting 17 respective countries to march in lockstep to promote reforms and rebuild mutual trust between the interested parties to the dealings will be no easy feat. This will require a powerful sense of crisis and a unifying political force. And above all else if the return to soundness is delayed under a situation where the excess funds from the global interest rates are moving around globally, this could potentially give rise to a bubble somewhere, as well as its bursting and then a financial crisis, which would serve to further dampen the recovery. When you consider it in this manner, it will not be an easy task for Europe to smoothly bring this first stage to its conclusion.

The second matter concerns the structural reforms to enable the long-term growth of the European economy after the immediate issues have been dealt with. It will be those European companies that are able to prevail amidst global competition that will bear the burden for restoring the European economy. This will not depend merely on the managerial capabilities of the companies, but rather on whether or not an economic environment can be set in place in which such companies can take root and be fostered in Europe. As evidenced from the fact that delays in structural reforms were a major factor in prolonging Japan’s economic stagnation, when structural reforms are being promoted around the world, such as in newly emerging countries, delays in reforms can prove fatal. The conventional growth policies that rely on increasing demand purely by expanding the number of participating countries are lacking in redeeming value, as evidenced by the mistakes that became apparent this time around. What is more, in such instances the general implication is that other countries should reinstate manufacturing industries that can stand up to intense competition, as is asserted by German companies. Yet by definition it is its diverse economies that serve as the source of Europe’s comprehensive economic might and competitive edge, so this is neither a feasible nor a wise approach to take.

Naturally, the only option is to start by going back to basics by changing the European market itself from subdivided, protected markets to a substantially integrated competitive market. Such a massive competitive market would serve as the ideal forum for forging companies’ competitive edge and eliciting their creativity and originality. What is more, breaking down the rigidities of capital markets and labor markets and setting in place an environment in which the right people can find their way to the right jobs within such a massive integrated market will give the companies of Europe a sustainable competitive edge. Doing this will also make it possible to prevent the structural disparities between countries from becoming entrenched and expanding. When a bright future for European companies and the European economy begins to dawn, this could potentially shift the mentality of business operators and consumers over to a more innovation-oriented and risk-oriented mindset.

However, it appears as if it will not be easy to achieve these reforms given the current political situation in Europe. The current situation in Europe reveals how difficult it is to take political leadership when the people of each country are expressing their own distinct preferences. The atmosphere I sensed was that there is no other way other than for Germany to play a leading role in pushing towards reforms. It was not an atmosphere that readily acknowledged that thanks to the currency of the euro Germany avoided the distress it would have suffered from an appreciating mark, as I see it from an outsider's perspective from Japan. On the other hand, there has been harsh criticism of the strengthening of dismissal restrictions and worker protection by the new administration in France as measures that will not only further weaken the already compromised French economy, but will delay reform throughout Europe as well. Yet conversely a report from the OECD has also appeared which claims that the pace of reforms has been slowing down recently in Germany. For the sake of the regulatory reforms and improving mindsets, the leaders will have to identify the obstacles to be surmounted, demonstrate that they have the ability and intention to overcome them, and convince people of the bright future that will arrive after they have been overcome. FTAs with powerful economies appear to hold promise as a role to supplement this difficult leadership. FTAs are oftentimes discussed as measures for taking part in growth markets, but viewing the US-European FTA in particular as a measure for breaking free of Europe's rigidities serves as an extremely powerful means for doing this.

One further complication for this problem of leadership is the strength of the notion of Europe's reinstatement in international politics. Politically speaking, ever since the conclusion of the Cold War paradigm Europe had expanded in the aim of becoming a region with the international clout to stand up to the United States. But now it is fundamentally marked by impatience over the fact that prior to the rise of Asia it is US-China relations that serve as the linchpin of international politics. The creation of integrated political structures in Europe is oftentimes talked about in terms of this contest.

Participants from the United States do not deny that there are limitations to Europe's influence. But this is not meant to repudiate Europe's importance as a force for achieving global balance, as it is irreplaceable in its role as a region with various types of accumulated experiences and wisdom related to international politics in particular. There are high hopes from the Middle East and China for a Europe that is strong both politically and culturally. In thinking about a European Community with this sort of coordinated strength, aside from the question of whether its substance is apt or not, it will most likely contain elements that it will be impossible for Europe to make the case for through German leadership alone based upon its historical experiences.