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The Power to Innovate

Japan Again

Hiroshi Mikitani (“Hiroshi”): Let’s talk about the theme of these conversations. I want to talk to you about why the Japanese economy has seen such persistent stagnation, and what we should do to revive it. But first, how are you feeling? How is your health?

Professor Emeritus Ryoichi Mikitani (“Ryoichi”): Oh, it’s all right, I suppose. I’m in a relatively good shape. I’m really happy that I can talk with you about the Japanese economy like this. I’m looking forward to it.

Hiroshi: For the past half a year [early 2013], I have been serving as a member of the Industrial Competitiveness Council, one of the three Abenomics control towers, and I have been participating in the debate there on Japanese economic growth. We announced our compiled growth

strategy in June 2013. At that time, I also created a document, as best I could, to serve as a starting point for discussion—a proposal that I called “Japan Again.” In that proposal, I wrote from my perspective as a business leader about what sort of growth strategy I would create if it were all up to me.

Ryoichi: It must have been quite a lot of work. I saw the news on television and read about it in the newspapers with great interest.

Hiroshi: Prime Minister Abe’s original idea was that there would be four members on the council from the private sector, but in the end a total of ten were appointed. I have the suspicion that behind this was an intention on the part of the government bureaucracy to increase the number of people on the council, appoint more people with differing opinions, and thereby dilute the arguments of the private-sector side.

Ryoichi: So there was conflict between the bureaucracy and private-sector members?

Hiroshi: In the beginning, I believe that Prime Minister Abe wanted the council to work with unusual resolve. But there was the strong sense that it was all being led by the government bureaucracy. In the end, we had a free exchange of opinions, but there was not really the mindset that we were out to produce radical policies. The main scenarios we talked about were ones for which the bureaucracy or Ministry of Economy, Trade and Industry (METI) led the way, with the private sector serving only to complement the members from the government bureaucracy.

Ryoichi: So the proposals were toned down.

Hiroshi: Yes, and as a result, some of our greatest challenges remain. One of the causes of the stagnation of the Japanese economy is industrial policy led by the government bureaucracy, which doesn’t do anything



except stifle competitiveness in the private sector. Look at any of the industries that METI has gotten involved in—every one of them has been ruined. I believe that the government need only create platforms for industry; there is no need for the government to set industrial policy. Regulation is fundamentally a bad thing. I want to move steadily forward with regulatory reform.

Ryoichi: I don't think that the issue is so simple as to be able to say that "regulation is bad," but I do believe that we must move forward with regulatory reform.

Hiroshi: Another cause behind the stagnation of the Japanese economy is the lack of sufficient managerial power. Look at the inventions of the DVD or fiber-optic cable: Japanese companies have superior technological capabilities. Our problem is corporate leadership. The biggest problem right now is how to enhance the power of management.

For example, take the Industrial Bank of Japan [now known as Mizuho Bank after merging with Fuji Bank and Dai-ichi Kangyo Bank], which was originally the main bank of Nissan Motors. The bank sent the management over to Nissan and tried to reform it, but nothing worked. And then Carlos Ghosn was hired as CEO, and Nissan completely turned around. The same can be said about Apple. When the company brought back Steve Jobs, it was at the brink of death, but as CEO, Jobs succeeded in a remarkable revival. In other words, it is all about who is leading a company. I think we need to remind ourselves of that.

Ryoichi: The revival at Nissan was definitely a surprise.

Hiroshi: That is why I indicated at the Industrial Competitiveness Council that we needed to bring in more managers who had achieved a corporate revival using bold ideas, as well as more of the young managers who are running leading companies.



Ryoichi: By the way, I know that you are acting as representative director of an economic group, the Japan Association of New Economy (JANE), but how does that differ from Keidanren?¹

Hiroshi: JANE is centered on the companies and venture/start-up firms that have developed Japan's e-business and IT industries. We have already been joined by more than 600 companies. We are an economic group that aims to contribute to the development of the Japanese economy through the creation of diverse new industries. We stand in opposition to state-led industrial policies that only protect vested interests. And in that sense, we are the opposite of Keidanren. We do not promote policies that will protect conventional Japanese industries. Instead, we encourage innovation, the reform of Japan's industrial structure, and boosting our economic metabolism. We are creating policy proposals to encourage the continued creation of the entrepreneurs who are needed to develop new industries. And we continue to work toward the realization of a more global and open marketplace through regulatory reform.

The Keys to Revitalizing Japan

Hiroshi: I want to talk about what would be the keys to reviving Japan and what the options are. I proposed five factors in my proposal, "Japan Again":

1. Efficiency of the country
2. Innovation capability

¹Keidanren (abbreviation of Keizai Dantai Rengokai, or Japan Business Federation in English) is known as one of the most powerful Japanese economic organizations. Established in 1946, it now has about 1,300 major Japanese companies advising the Japanese government on policy related to its member industries.



3. Operation capability
4. Global expansion and market capability
5. Brand power

I believe that economic growth means the creation of innovation.

Ryoichi: Joseph Schumpeter said that innovation means new connections. He believed that economic growth came about through the combination of new things.

Hiroshi: If that is true, then we need to create an environment in which innovation can occur. With innovation comes the birth of new markets and economic growth. The elimination of regulations is crucial to this goal. At the Industrial Competitiveness Council, I proposed the IT autobahn concept as an initiative symbolizing these ideas. Just like the German autobahn, which has no tolls or speed limits, my idea calls for the construction of the world's fastest and cheapest communications infrastructure.

The next important factor is operation capability. As the labor market solidifies, we are reaching a point in which corporations are finding it impossible to let go of old workers and hire new ones. We obviously need to hire more women, but that alone won't be enough to solve our labor shortage. We need to go further to relax dismissal regulations and promote the fluidity of the labor market. We also need to introduce a white-collar exemption that would free white-collar workers from restrictions related to the amount of hours they work. And at the same time as we do all of that, I believe we should hire more foreign nationals in fields like nursing and child care.

Ryoichi: The reality today is that the lifetime employment system that was once so prevalent in Japan has now broken down. I think many people are questioning how



we should make better use of the people we hire and what our response to the new situation should be.

Hiroshi: But let's look at the big picture—we could talk about a few ways to increase competitiveness. One solution is to increase the efficiency of the state. I think we need to consider how to reform the high-cost structure of the government. If it were a corporation, increased management efficiency would mean cutting headquarters expenses such as personnel and administrative costs. Similarly, if we think of the government as being the headquarters of the entire country, I think we must reduce administrative costs through the full use of IT.

Ryoichi: The United Kingdom at one time suffered from what was called the British disease, through which the state had led the steel manufacturing industry into a slump. I fear that we are now seeing the emergence of the Japanese disease, caused by the continued promotion of misguided policies. But there is little sense of a crisis among the Japanese public. The prognosis is poor if you do not even realize that you have a disease.

Hiroshi: Related to that, I also believe there is a need for global expansion and management capability. I think people realize that our televisions, mobile phones, and other consumer electronics have undergone a kind of Galapagos effect, in which they have moved away from international standards. But personally I don't think that this applies just to electronics. We see the Galapagos effect, in which we are isolated from the world, in other areas of our society. The decrease in the number of students studying abroad and trends in the number of foreign companies setting up headquarters in Japan are astounding. Rakuten started to make English our official language in 2010, and we completely switched over in July 2012. I believe the move toward English should be



happening on a national level. It is crucial that we continue efforts to create an environment that is easier for foreign nationals and foreign companies to work in.

Ryoichi: On that point, the role of journalism is very important. I don't believe we can really say that Japan is producing journalists who hold their own opinions and have an international mind-set. I also think that universities and the academic world bear a heavy responsibility for that.

Hiroshi: The last factor I want to mention is brand power. The branding of products is definitely important, but what is really crucial is the excess earning power created by the Made in Japan brand. The brand power factor asks us to consider how we can enhance that brand.

These are not small changes I've suggested. In order to eliminate regulation and promote innovation, we must completely change the entire structure of Japan. But how should we do that? I proposed key performance indicators (KPIs) to answer that question. This management method sets quantitative metrics for each issue of concern and continuously reevaluates when and to what extent those metrics are being achieved.

Ryoichi: Prime Minister Abe has recently been using the term *KPI* a lot. It may be that this was your proposal's biggest contribution to the Industrial Competitiveness Council.

Keidanren's Raison D'être

Ryoichi: Hearing your explanation, I began to wonder about Keidanren. During the period of high-speed economic growth, economic groups like Keidanren were a positive force. But when that period ended, we also



began to see their negative side. Well, that is just my opinion. What do you think? Would it have been better if Keidanren didn't exist during the period of high-speed economic growth?

Hiroshi: I do believe that Keidanren has brought many issues to the government and produced certain results that have contributed to the growth of the Japanese economy. But as industrial structure has dramatically changed, we've seen the emergence of Internet services. We've seen the steady expansion of globalization, but I don't feel that they have produced frameworks that are well suited to produce innovation powered by these new trends.

Ryoichi: I think infrastructure—like power, electricity, transport networks, and so on—are extremely important when thinking about efficiency. How do you view that?

Hiroshi: The complete liberalization of infrastructure would have been ideal, yet we ended up with a situation in which regulations are thoroughly enforced.

Ryoichi: No economic groups like Keidanren exist in the United States.

Hiroshi: In the United States, the Office of the United States Trade Representative (USTR) is fulfilling a role like the METI here.

Ryoichi: Right, but the USTR is an organization that dealt with external affairs, so it's different from METI.

Hiroshi: In Japan's case, the predecessor to METI, at the time called the Ministry of International Trade and Industry, was the government organization in charge of external trade, dealing with the crucial theme of how to best increase exports from Japan. I believe that Keidanren developed through its work on that theme.

Ryoichi: It's a fact that Japanese corporations are protected by the government in several ways. In Europe, too, I think we have seen the creation of a system of protection since



the time of the European Communities. My basic belief is that if it is true that Japan lost its productivity because of protective policies, then I don't think we have an option to recover from that. In terms of competing in the international arena without the protection of the government, there isn't a metric by which to measure the strength of competitiveness, but I suppose productivity per capita might be a good index.

Hiroshi: Looking at the data, Japan's productivity is very low.

Ryoichi: I wish that journalists and economists and other such intellectuals would do more to drive home that point. In the United States, many think that it's a bad thing for the government to protect industry like we do in Japan. Free competition is fundamental. The U.S. mind-set is that if negative elements emerge from free competition, we should correct them as they emerge. Of course, in the United States they also have the promotion of IT as a national policy, but I think the fundamental thought is that it is bad to protect industry.

Hiroshi: I have doubts about whether bureaucrats or politicians have the vision needed to select which technologies and services are going to catalyze the growth of each industry in the future.

Ryoichi: It's hard to foster the kind of vision among bureaucrats and politicians that will allow them to see the age they live in.

Hiroshi: I created a prescription to cure the Japanese disease that you mentioned. But the main points and important proposals about fundamentally changing the nature of the Japanese economy were consistently put off or postponed as topics of debate. And conversely, I feel like the scenarios developed by the government bureaucracy always made it on the agenda.



Ryoichi: What sorts of scenarios were proposed by the bureaucracy?

Hiroshi: The simplest example to explain the situation would be the restart of nuclear power stations. No matter how many times we tried to say that we should move forward—with caution—on that issue, they would not hear it. I asked at the end for them to at least consider both sides of the issue, but they were absolutely against it. There weren't many things proposed by the private-sector members that made it into the growth strategy, but many of the proposals from METI made it in.

Ryoichi: I would never know it just by reading the newspaper articles.

Hiroshi: When the U.S. economy was performing poorly in the 1980s, there was a time when a group of mostly business leaders got together and submitted a proposal to the U.S. government. And the government received that proposal and considered the creation of policies. But here, this time, METI started with a draft of the growth strategy from the very beginning. It's not a nice way of putting it, but I felt that a lot of things happened in the Industrial Competitiveness Council that were fueled by politics—by a desire for excuses to oppose the will of the prime minister. Proposals from the private sector that did make it into the growth strategy were things that did not interfere with the scenarios created by METI, the Ministry of Finance, and other bureaucrats.

Now, I would not say that the Industrial Competitiveness Council was entirely pointless. We managed to include a recommendation to participate in treaty negotiations for the Trans-Pacific Partnership, and to an extent, some of the assertions of the private-sector members were accepted in the Abe administration growth strategy, including those related to the sale of



over-the-counter or nonprescription drugs over the Internet.

That said, I do not think enough was done to recommend a major shift, such as regulatory reform, or to create any new frameworks. We were also not able to include enough on the biggest problems related to competitiveness, such as corporate governance issues. There is still much to do. I believe that having passed the House of Councillors election in July 2013, we are entering a critical phase in which it will be possible for the Abe administration to promote economic reconstruction in the truest sense, including in relation to issues such as changes to governance systems and reforms in the agriculture and medical industries.

Abenomics should be commended in many ways, but I'm disappointed that we could not do away with the ideas of state capitalism that are entrenched within it. These plans call for massive investments in fields specially selected by government officials. Bureaucracy-led state capitalism [moratorium policies] is dangerous. I wanted to write this book so that we could bring these issues to the public.

The Nature of Innovation

Hiroshi: Among the five factors that I proposed, I want to first explain innovation. Where does innovation happen? One place it happens is in the academic world, in universities and research institutions. The second place is in major corporations, and the third is in venture or start-up firms. What is important here is to separate invention and innovation. They are not the same thing. For example, isn't the invention of the Apple iPhone really just a combination of technology that already existed?



Ryoichi: Well, they didn't use such revolutionary technology in terms of the device itself, but the combination of applications, the user interface, and the design was revolutionary.

Hiroshi: This is your area of specialty, so I realize that I am preaching to the choir here, but I believe that innovation is the main driver of economic growth. This is a theory of Joseph Schumpeter. He clearly stated that inventions and innovation were two different things. I think we need to really think about that. It seems to me that the politicians, bureaucrats, and economists of Japan are mixing up these two concepts.

Schumpeter was one of the 20th century's major economists. He said that innovation was the product of new combinations, and he proposed five patterns of innovation:

1. The production of a new good
2. The introduction of a new method of production
3. The development of a new market
4. The acquisition of a new source of supply of raw materials
5. The emergence of a new organization of any industry

I believe that these patterns have all changed with the emergence of the Internet. If we stick to the principle of face-to-face delivery in which you must meet with the other parties in a transaction to make decisions, or the principle of on-paper delivery in which the points decided on are always written down, it will be difficult to create new innovation. No matter if we are talking about education or health care or business-to-business services, new services will be created through the combination of new things in complex ways. And it is a problem that it is difficult to make that happen.



Another problem is that the technology and policies of Japan do not meet global standards. This is because they are being developed only within Japan. Some global companies are addressing this problem. For example, look at Samsung. They are working to create frameworks that can be developed into international standards. Every year, they send hundreds of employees to dozens of countries around the world. They have a system of regional specialists within the country, and they have the attitude that people should first go to a market and look around before doing anything else. They have their employees stay abroad for a year. While the employees are abroad, they are free to go to school or conduct research, or even in extreme cases, to do nothing. That is how Samsung is developing its globalization strategy.

Incidentally, Samsung is trying to do all of this with only South Korean employees. Our approach at Rakuten is completely different. At Rakuten we are not trying to have our Japanese employees lead the way. It might sound extreme, but I don't think there would be anything wrong if our management team was entirely foreign nationals.

The next thing that I think is important for the creation of innovation is the development of an environment in which it is easy to propose new solutions. This calls for policies that resolve work-related issues. In other words, eliminate regulations and create an environment in which it is possible to do the things that have not been possible up until now. If that was done, I think the basic pattern would be the creation of new markets followed by the emergence of new technology and development of new innovations. So the most important issue is how to eliminate regulations.

For example, even if distance education is possible using IT, education that is not carried out in a face-to-face setting



is not awarded full academic credits. Mixed medical care service regulations that prevent the free selection of medical care services present another issue. The obstacles to innovation created by regulations are a big problem.

An important issue related to this is how to best increase the number of venture or start-up firms giving rise to innovation. Because venture firms are accountable to their investors, and because they face the threat that if they do not act fast, they may fail, they work with a greater sense of urgency than large corporations do.

Ryoichi: The word “venture” comes from “adventure.”

Hiroshi: Right. Venture firms need to be adventurous. And what’s more, our efforts to create innovation require us to bring more foreign nationals into Japan. The reason Rakuten is growing at such a fast pace is because we are hiring foreign engineers.

Ryoichi: From which countries do you hire the most people?

Hiroshi: We have some people from the United States, but most are from Northern and Eastern Europe. I notice a lot of people with Japanese wives. [laughs] Incidentally, this isn’t just happening at Rakuten—Andy Rubin, who developed the Android operating system used in mobile phones, is also married to a Japanese woman, as is Jerry Yang, the cofounder of Yahoo!

Ryoichi: They’re married to Japanese people? People in Sweden, Norway, and other Northern European countries also seem to like Japanese people.

Hiroshi: They are getting inspiration from Japan through their wives.

Ryoichi: They complement each other. There is inspiration to be found in Japan, but not that many people can turn that inspiration into a business.



Schumpeter's Contribution

Hiroshi: Since we have been talking about innovation, could you tell me more about Schumpeter's economy theory?

Ryoichi: A former professor of mine, Kobe University's Hiroshi Shinjo, studied abroad in Germany just before World War I, when Joseph Schumpeter was working as a professor at Bonn University. He was an economist who was known to be a genius at a young age, and he used to serve as the finance minister of Austria. Among the Japanese students who learned directly from Dr. Schumpeter were former professor at Tokyo University Seiichi Tobata and former president of Hitotsubashi University Ichiro Nakayama. Schumpeter moved to Harvard University after that, but when he did so he took the Trans-Siberian Railway across China and even visited his pupils in Japan at Kobe University of Commerce [currently Kobe University] and the Tokyo College of Commerce [currently Hitotsubashi University].

Schumpeter was originally from a high-class family and was a man of extreme pride. At Harvard he fell in love with an American woman and got married, and I hear that he became quite Americanized. His most famous theory was the one that you described a moment ago about innovation. Schumpeter was a man who wondered why the economy could develop the way it does considering that if we take price competition to the extreme, we should see the complete extermination of profit. When an economy expands, the number of workers increases, and the amount of wages that needs to be paid out increases as well. Real expansion is not just about an increase in scale; it is actually about a continued



rise in productivity through innovation. Schumpeter thought that this rise in productivity was the true marker of economic growth.

I believe that the contribution of Schumpeter to economics was extremely large. Up until that point, economics focused on the study of equilibrium and things like average rates of profit, as represented by the ideas of the English economist Alfred Marshall. It was thought that profit was being used for capital or for investments into research and development. Schumpeter believed differently, that innovation itself was the source of profit. That was his most important academic point.

I believe that we see only a handful of economists as remarkable as Schumpeter every hundred years, but it wasn't just his ideas that were remarkable. It is also amazing how many of his pupils became excellent economists. Schumpeter was involved with many topics, but he did not force his theory on his disciples. I think even Schumpeter himself understood after World War II that economic ideas like his were not applicable as the times changed, and that the study of economics needed to change as well. And so he let his students study what they wanted to. For that, too, I respect Schumpeter very much.

Dozens of his students became renowned economists. Among them was Paul Sweezy, a Keynesian economist [believing in the work of John Maynard Keynes, who postulated that governments should create jobs through active fiscal stimulus in order to overcome unemployment and recessions], who was at the same time also well versed in Marxian economics. He was apparently also rich, and so he did not look for work at any single university but instead came and went from different places as a visiting professor.



Back then, I was also interested in socialism, and I often talked with Sweezy.

Schumpeter passed away in 1950, but if he had lived just about 10 years longer, I would have been able to meet him in person at Harvard.

Hiroshi: I think the idea that price competition could lead to the end of profit is very interesting.

Ryoichi: Yes, that was something Schumpeter thought about extensively. According to the empiricism promoted in the United Kingdom, statistics suggested that the average rate of profit should be 20 percent. Schumpeter believed that as competition continued, the excess rate of profit would disappear. His ideas on innovation were the result of that thought and the desire to pursue an answer to that contradiction between theory and reality.

Hiroshi: Even today, METI seems to think that average profits should be protected, which is an idea so antiquated it goes back to even before Schumpeter. [laughs] There are certain aspects of French winemaking, such as the soil where the wine is cultivated or the traditional techniques used, that cannot really be copied by other countries, but in Japan, we are seeing the breakdown of the concept that Japanese-made products are special. Put another way, we are seeing the end of excess profit. I think that is the essence of branding. Then again, I don't suppose that Schumpeter had much to say about the concept of brands.

Ryoichi: The term *brand* was coined by Schumpeter's student James Duesenberry. For example, why is it that the famous French brand Louis Vuitton can be so profitable? Because it differentiates its products. Duesenberry's contribution was to state this principle in what he called the demonstration effect.



Hiroshi: You don't mean the same Duesenberry whose home I once lived in for about a month? [laughs] He was a great man.

Ryoichi: He was a very good person and was close to everyone in our family. He visited Japan three times or so. He was a big boss in the field of economics, and I mean that with great affection. He wrote his theory on the demonstration effect in 1949, right after the end of World War II, and it propelled him to instant fame.

Hiroshi: The brand effect is not something that works geometrically. People will buy Sony products if they trust that brand and think that they make good products. But internationally, we are seeing the breakdown of the Sony brand. It occurs to me that innovation is fairly important for the creation of a brand.

Ryoichi: Just after the end of World War II, there was a conflict in the field of economics called the consumption–function controversy, which related to consumption propensity. Consumption propensity means the ratio of income that people are willing to spend on consumption. The demonstration effect emerged as a part of the conversation about which elements contributed to the way consumption propensity was decided. There was the thought that when people buy products, they do not just think about whether the product is good or bad, but they also consider the demonstration effect. And that demonstration effect is corroborated by shifts in macroeconomic statistics related to the total share of consumption within aggregate amounts of income. This is why Duesenberry became so famous so quickly at such a young age.

Hiroshi: And I stayed in his house as a student without knowing anything about it! [laughs]



Building Infrastructure

Hiroshi: From the perspective of prioritizing innovation, I wonder if Schumpeter didn't take a cool stance to the fiscal policy of monetarists and Keynesians?

Ryoichi: No, from what I have heard, Schumpeter thought a lot about the Keynesian framework. Then again, Keynes was the top economist at the renowned British university Cambridge. Schumpeter may have harbored some feelings of envy toward him.

Hiroshi: One of the three arrows of Abenomics is the use of Keynesian fiscal stimuli. However, because the multiplier effect of fiscal stimuli is low, I suppose the government will need to build a lot of expressways and bridges.

Ryoichi: When you say the multiplier effect, you are referring to times when investment increases and the resulting increase in income is greater than the increased investment amount? For example, a fiscal stimulus of 100 million yen will yield an increase in gross domestic product or national income several times larger than the initial investment. That amplification is the multiplier effect. If the government invests 10 billion yen, then the public will consume that funding as income and use that income for consumption again. The amount of money circulating through the economy will gradually decrease, but adding everything together, the effect on national income should total around 40 billion yen. Usually the multiplier effect should quadruple the initial investment, although in reality it usually approximately doubles it. The remaining money goes somewhere else.

One explanation for that is fiscal leakage. It is extremely important to have as little leakage as possible and to figure out ways to increase the number of times that the consumption and investment cycle occurs. If you



can do so, you can enhance the effect of your initial 10-billion-yen investment just by changing systems. That point is something that people in charge of policy at the Ministry of Finance, the Policy Board of the Bank of Japan, and economists must always think about. It does not cost anything to change a system, and doing so can enhance the multiplier effect. I think this is an important point.

Hiroshi: In terms of the multiplier effect, as you explained, the public consumes, and that consumption becomes income. That is the multiplier effect you are talking about, right? But there is also another kind of multiplier effect that refers to the creation of new markets and enhancement of the economy's efficiency through investments in communications infrastructure and education. I think those two ideas get mixed up.

Ryoichi: With the term *investment* as well; there is both demand-side investment and supply-side investment. When talking about the multiplier effect, attention up to this point has tended to focus on the demand side, but the multiplier effect caused by infrastructure investments on the supply side is important, too.

Hiroshi: I feel like the bureaucrats of the Ministry of Finance think about only the demand-side multiplier effect.

Ryoichi: It's a terrible thing. If we were seeing a situation like in the 1930s when unemployment was high, it would be fine to think about only the demand side, but that isn't the situation in Japan.

Hiroshi: In a prosperous society like Japan, I wonder if the multiplier effect on consumption won't really increase that much, even if we do increase income. By which I mean that I wonder if we haven't reached a point in which the effect of fiscal stimuli is not as great as it once was?



For that reason, I think there is a need to put precedence on thoroughly computing the supply-side multiplier effect over work on the multiplier effect usually talked about in economics textbooks.

Ryoichi: Yes. In the past, we have seen palliative economic stimuli, but the current situation is different.

Hiroshi: Because even if there is a multiplier effect, that effect will gradually decrease, and I think that at some point we will even see a negative economic effect due to leakages.

Ryoichi: That is why the design of systems is so important.

Hiroshi: I believe that the greatest multiplier effect comes from communications infrastructure. And in that case, I wonder if there isn't a need for a drastic measure in which we might thoroughly invest in communications infrastructure, nationalize it, and make it free. That is what I proposed when I thought up the IT autobahn concept that I touched on earlier. Based on the concept of the German autobahn, this idea calls for the nationalization of IT infrastructure and the creation of the world's most advanced, free, and open communications environment. I think this would be revolutionary.

Investment in education is another issue. I don't think that investment needs only to go toward hard infrastructure. What do you think of that?

Ryoichi: Japan doesn't have abundant natural resources. Our people are everything. I actually think it is more important for us to invest in people, although I doubt whether this opinion is shared widely in this country.

Hiroshi: For example, the return on investment (ROI) for investments into education—in other words, the amount of expenditure in comparison to the effect produced—is actually more than 20 percent. It is in fact far higher than the ROI of any other infrastructure investment.



Turkey, which competed with Tokyo in the bid to host the 2020 Summer Olympics, is making an annual investment of 100 billion yen into English-language education in order to improve the English-language ability of the population there. You may think that 100 billion yen is a lot of money, but the budget for reconstruction following the Great East Japan Earthquake is 25 trillion yen. It is a mere 1/250th of that amount.

Ryoichi: The need for English-language education has been talked about for some time, but we still have not achieved our goals related to that. At the end of the day, we may not be able to do this without education reform.

How should the money gained from innovation be used? Some part of it will go toward labor costs. We must change the tax system if we are going to get rid of economic disparity. But it would be a terrible thing if the tax system set up in an effort to reduce disparity also stifled innovation.

Hiroshi: In the beginning, the economy of the Soviet Union did really well. Their planned economy worked. But at some point, people started to feel that working no longer had meaning, and the economy slowed down.

Ryoichi: A precondition for the development of an economy is surely the stable maintenance of economic order. And so I think the debate inevitably ends up being about the extent to which people who make money should give back to society and the extent to which they should use their money for innovation.

Hiroshi: Whether we are talking about socialism or the kind of organizational system seen in Japan, there are always free riders who work without taking risks. Or rather, a special class of society is extremely inefficient. But in principle, as the Japanese expression goes, “Those who don’t work should not eat.” I don’t think there is



anything positive we can say about people who make money off disparities in the financial system rather than making investments based on a long-term vision. That is why I always say that morality is even more important than legality.

Business Innovation

Hiroshi: Schumpeter believed that innovation was the source of economic growth, assuming appropriate fiscal and monetary policies are in place. And the reason for that is related to what you explained earlier—excess profit decreases with time.

In the end, innovation does not need to mean inventions like induced pluripotent stem cells or anything else. The emergence of new discoveries is absolutely a good thing, but even without inventions, a country can still come out ahead of other countries through global expansion and market capabilities [explained in Chapter 5] and through its business innovation capabilities.

Again, look at Samsung: They have not created any new technologies or products. In fact, Japan is where the inventions have been happening, such as the development of DVDs and CDs or the invention of fiber-optic cable. It is important to have technological capabilities, but I feel it is more important to have business innovation capabilities that can make the combination of new things possible. Even the iPhone is just a piece of technology combining a mobile phone, the Internet, and a camera. As an idea, it is exactly the same as i-mode,² yet the iPhone went global and i-mode went Galapagos. All of this is why we need to

²i-mode was the world's first web service for a feature phone, developed by NTT DoCoMo in 1999, which was adopted only by Japanese cellphones and compatible only in Japan.



take a step forward in international competition and develop the capability to expand business globally.

At one time, Sony had this capability. How did it lose that? I believe that the reason is simple—the founder of Sony, Akio Morita, passed away. Similarly, Steve Jobs passed away, and Apple’s innovation has stagnated. Google is a slightly different case. They have a framework in place that enables innovation. In the end, I think management capabilities are extremely important for business innovation. Business leaders without the ability to analyze global trends or those lacking global expansion capabilities should excuse themselves from positions of power on principle. Or if not, companies without these kinds of leaders should be absorbed by companies that do have such leaders.

Ryoichi: If you were the CEO of Sony, how would you reform it?

Hiroshi: That is something that I could not know unless I actually tried it. [laughs] But if I were CEO of Sony, I think I would be able to do something with it. Rakuten acquired Sony’s prepaid e-money service Edy to start Rakuten Edy. Under Sony, Edy was in the red from the very beginning, but we have made it profitable since bringing it into the Rakuten group.

Related to that, I would have you know that the rate at which people open new businesses in Japan is as low as 4 percent. Actually, the rate of business failure is also 4 percent. One reason for that is the moratorium policy of national and local governments. A typical example of these kinds of policies is the relief measures for small- and medium-sized enterprises (SMEs) being implemented by the Tokyo Metropolitan Government (TMG). TMG invested 100 billion yen in 2004 to create ShinGinko Tokyo, Limited, in order to support SMEs facing harsh



business conditions through the provision of unsecured loans and other measures. In just three years, the bank was nearly 100 billion yen in debt, and it took on an additional public investment of 40 billion yen. These policies implement moratoriums so that failing companies do not fail. It's stupid. Bad companies should fail; it is good for the world. Because people are indomitable—even if they fail once, they go on to produce something new.

Ryoichi: Because that failure gives birth to wisdom and invention. It gives rise to innovation.

Hiroshi: The relief measures given to Japan Airlines (JAL) are the definition of a moratorium policy. I have many friends at JAL in my personal life, but I think it would have been for the best if the company had been allowed to fail. If it had, we would have seen the emergence in Japan of low-cost carriers, and plane ticket prices would have fallen. And that would stir demand for the travel business, as well as businesses in areas outside of major cities. It would have been a good thing. But instead, a massive national investment was made, and we lost that opportunity.

Ryoichi: Schumpeter had a famous phrase describing that: *creative destruction*. If you mean to create, you cannot avoid destruction.

Hiroshi: The point is that we should gradually transfer goods and services that have lost their added value or that have low added value to companies overseas. At the same time, within Japan we should foster excellent human resources who can initiate innovation, and we should draw them from abroad as well.

Ryoichi: On that point, China may not be gathering people from abroad. No matter how much an American likes China, most stay only for a short period. I don't think there are very many people who move to the



Shanghai area for a long period, settle down, and establish a business.

Hiroshi: Right. But at the same time, China has created a framework at the national level by which it is sending its human resources to Stanford and MIT and then bringing them back home. Samsung is doing the same thing. I think it would be a huge mistake to think that China [or Samsung] can only imitate what others are doing, as has been the case in the past. The people who gain PhDs from America's top universities return home like salmon. [laughs]

Ryoichi: How should Japan interact with China?

Hiroshi: I would propose that an appropriate distance be maintained and that we treat each other like adults. And I think we must deepen our friendly relationships with neighboring countries and the United States. As you have often said, it is extremely important to advance friendly relations with South Korea.

Ryoichi: Absolutely. We cannot overlook the value of South Korea for Japan–China relations.

Hiroshi: In the past, Japan was number one in terms of both technology and intellectual property, but since the emergence of the Internet, the gap between countries has narrowed. And I think our 100 million to China's 1 billion population difference has been very effective for that. India faces many religious and class issues, but China does not. And because it has a kind of controlled economy, it can quickly advance infrastructure development.

Ryoichi: I am extremely interested to see what will happen in China from now on.

Hiroshi: I think we will see the emergence of new innovation to an extent, but I doubt that China will outdo us. Japan not only has more diversity than China, but we also possess a level of tolerance that enables us to



accept many different cultures. I think we can differentiate ourselves with that, and I think people believe that Japan is a good country.

Summary

- What is economic growth? It is the continuous development of innovations arising from combinations of new connections. Eliminate the principles of face-to-face and on-paper delivery, and construct an environment in which innovation can occur.
- The role and purpose of the government should extend no further than the creation of platforms for industry. Advance thorough regulatory reform.
- Set the key KPIs needed to change the entire economic structure of Japan.
- Promote the IT autobahn concept to construct a faster and cheaper communications infrastructure throughout the world.



