Message from the President

Let me begin by extending my sincere thanks to all our supporters for your continued understanding of our aims and activities.

The COVID-19 pandemic continued to rage in Japan during the fiscal year that ended on March 31. A succession of new, more infectious variants emerged, each time causing a rapid spike in case numbers and putting pressure on the healthcare system. This situation continued throughout FY2021. It was in this context that the Tokyo Olympics were held last July, one year later than originally scheduled. The games were held under the government of Prime Minister Suga Yoshihide. Prime Minister Suga had vowed to continue the same policies as the preceding Abe government, whose position the previous year had been to proceed on the assumption that the games would be held no matter what happened. Shortly after the games, Japan entered the fifth wave, with more than 3,000 cases of infection per day. Questions were raised about a decision-making process that seemed not to be based on data or an objective analysis of the science. If we can secure the right standard of members, the Institute hopes that when the time comes to launch a study group that will examine the measures and policies introduced to contain the COVID pandemic. We will aim to scrutinize the state of political decision-making in Japan, like the famous “Essence of Decision”, which analyzed the political decision-making process in the Kennedy Administration during the Cuban missile crisis.

In the same month (July 2021), ceremonies were held to mark the 100th anniversary of the Chinese Communist Party. These bore a close resemblance to similar ceremonies held in North Korea, with the personality cult of Xi Jinping everywhere in evidence. One got the impression that the symptoms of China's disease had become chronic. As of April 2022, China remains determined to pursue its "zero COVID" policy. The situation remains deadlocked in Shanghai, and there are signs that Xi Jinping's election to a third term as president may not be quite the formality that had been expected.

These events were followed in August by the withdrawal of US troops from Afghanistan, ending the longest war in American history. With the Biden administration having campaigned against Donald Trump under the slogan of a "foreign policy for the middle class," this decision was unavoidable to secure funding for the new president's Build Back Better bill, which pledged new spending on domestic infrastructure. Even so, the decision and its announcement were too sudden, and how the decision was made is likely to harm relations with allies in the future. In September, general elections in Germany produced that country's first Social Democratic Party-led coalition in sixteen years. In Japan, this was followed by the coming into office of a new cabinet under Prime Minister Fumio Kishida, promising to introduce a "new type of capitalism."

With China espousing a policy of “common prosperity,” and the United States following a “foreign policy for the middle class”, this means that the world’s four biggest economies, which between them account for 51% of the global economy, are now following policies designed to correct income disparities. The anti-globalist movement that had gradually been coming to the surface since the global financial crisis of 2008/09 in the form of Brexit and the Trump presidency has now conquered most of the global economy. One has the feeling that the pendulum has swung away from markets, efficiency, and Hayek to government, fairness, and Keynes. As I note below, we are almost certainly entering a period of stagflation. It was the markets, Thatcher, Reagan, Hayek, and Friedmann who solved the problem of stagflation in the 1970s. By contrast, we face today’s period of incipient stagflation with policies around the world dominated by the ideas of government, fairness, and Keynes. It is hard to look with confidence to the future when this is the case.

At the COP26 environment summit held in Glasgow in November, it was announced that an International Sustainability Standards Board will be established under the aegis of the IFRS, and climate change will be incorporated into rules that will have an impact on corporate value in the form of financial accounting. This differs from the Paris Agreement, in which membership was voluntary and which carried no penalties, and represents the most significant event in the legal framework affecting companies since the “Big Bang” in Japanese accounting in 2000. The new regulations are likely to have a major impact on corporate behavior. In the EU, for countries that are in the vanguard of the move, the new regulations may come into effect as soon as the beginning of the accounting year which starts on January 1, 2023. In Japan too, the new rules could be introduced from the start of the new accounting year on April 1, 2025. The details are still undecided, and it seems likely that it will take around ten years before the ISS settles into a place where all those who concern can live with. It seems likely that the new regulations will cause major changes to corporate behavior and could also change the industrial structure. At the very least, the increase in the cost of compliance-related expenses will put pressure on profits and will probably dampen economic growth. However, introduction of the ISS may be indefinitely delayed due to the global economic slowdown caused by the Russian invasion of Ukraine, just as the 2008 Financial Crisis delayed some conceptually similar accounting changes.

On February 24, two months after the thirtieth anniversary of the end of the Soviet Union on December 25, Russia invaded Ukraine. For the economy and politics of Japan and the world, this is likely to prove an epochal turning point of the kind that occurs once every few decades, and it may bring major changes to society in the future.

In the immediate term, because of the invasion, Russia has been "ejected" from the global economy and political life in the form of economic sanctions. After the fall of the Berlin Wall, when Russia seemed to have overcome the collapse of the Soviet Union, on October 1, 2003, Goldman Sachs published its now famous "Dreaming with BRICs" report on the so-called BRIC countries: Brazil, Russia, India, and China. Since then, Russia has been one of the darlings of globalization, playing a leading role in the global economy as one of the newly emerging economies.

In a worst-case scenario, Russia may join with China and form a separate economic bloc incorporating a considerable number of countries that are participants in the Belt and Road Initiative. If this happens, the age of globalization that has lasted since 1989 and survived the Tiananmen Square massacre will end after Brexit and the Trump presidency, and the world will once again be fragmented, perhaps along a north-south divide. In this case, the growth of the global economy will surely experience a serious slowdown. Incidentally, the combined GDP of the G7, the remaining EU economies (discounting Germany, France, and Italy, which are G7 countries), South Korea (G20), Australia (G20), and Mexico (G20), accounts for 55.8% of the world's GDP. By contrast, the combined GDP of Russia (G20), and the main economies of the thirty-five countries that abstained from the UN resolution criticizing Russia, namely China (G20), India (G20), Bangladesh, Iran, Pakistan, South Africa (G20), and Vietnam comes to a total of 23.6% of global GDP.

Next, on March 16, Jerome Powell, Chair of the US Federal Reserve Bank, announced a stiff interest rate hike to take place in seven increments across the year, marking a break from more than a decade of low-interest-rate policy that the Fed had followed since the global financial crisis. Originally the increase in prices would probably have been transient inflation caused by a labor shortage accompanying the easing of the pandemic in the United States, but this was exacerbated by cost-push inflation resulting from decreases in exports of fuel and primary commodities brought about by the sanctions on Russia. This package of determined interest rate rises was the result.

The Fed's decision to increase interest rates has already had a major impact in Japan, affecting the yen-dollar exchange rate and driving the yen down against the dollar owing to the growing gap between the US and Japanese interest rates. In addition to a low-interest rate policy, the Bank of Japan has conducted quantitative easing and share purchases. If the BoJ is unable to move speedily to raise interest rates and reduce the size of the interest rate gap between the United States and Japan, it will have no way of stopping the inflation that will result from the increasing cost of fuel and imports, and inflation and rising prices will likely have an impact across the whole economy. In exchange for accepting the long-term stagnation sometimes referred to overseas as “Japanization,” the country has so far managed to avoid bankruptcies and has defended jobs in the country’s estimated 300,000 “zombie firms,” but this wave of inflation will bring strong new realignment pressure to bear on this environment that has continued for thirty years.

Finally, if an economic slowdown coincides with inflation, the result is likely to be the first stagflation since the oil shock fifty years ago. For Japan, with its debts in the public sector and zombie companies, this promises to be a testing time. This will only further increase the risk of adjustment inflation, fiscal collapse, a rapid fall in the yen, and the acquisition of Japanese assets by China. We are entering a phase in which policy management will be required to walk a tightrope.

As we mark fifty-five years since our foundation under this environment of dramatic change, the Institute has established several new study groups, listed below. For more details, please see the explanations given for each study group in the relevant section.

- Study Group on Geostrategic Hotspots, run in collaboration with the PHP Soken policy think tank (Chair: Masafumi Kaneko)

- Climate Change Study Group, in collaboration with the Swedish think tank Institute for Security and Development Policy (Chair: Nobuyuki Hiraizumi, Kajima Institute of International Peace)
- Study Group on Reconstructing the Relationship between National and Local Governments, chaired by Professor Hideaki Tanaka, Graduate School of Governance Studies, Meiji University

By contrast, the following study groups ended after publishing their results, or were replaced by newly established groups.

- Study Group on Intergenerational Fairness and Litigation to Rectify Inequalities, chaired by Kazumasa Oguro, director
- Study Group on Rebuilding the Social Insurance System, chaired by Kenichiro Otake, visiting research fellow

In closing, it is with great sadness that I must report the passing of Kenichi Ito, an advisor and former trustee of the Institute who died on March 14, 2022. His loss will be deeply felt. Our thoughts are with his family at this time.

April 25, 2022

Nobuyuki Hiraizumi
President, Kajima Institute of International Peace