

Provisional Translation

July 2, 2008

“Living with the Globalized Economy”
-Recreation of the Japanese Economic System-

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“Structural Changes and the Japanese Economy”
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Living with the Globalized Economy
— Recreation of the Japanese Economic System —

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Living with the Globalized Economy

- Recreation of the Japanese Economic System -

The Japanese economy is seeking after a new growth path that is compatible with the world economy undergoing drastic structural changes, such as accelerating globalization, rapid growth of emerging countries and increasing constraints on supplies of natural resources and food. This report first, identifies the current situation and the challenges facing the world and the Japanese economies. It is followed by our vision of the Japanese economy in a decade's time and the tasks that lies ahead in order to realize the vision.

Chapter 1: Changes Taking Place in the World and the Japanese Economies

1. Drastic Changes in the World Economy

(New Wave of Growth)

The history of global economic growth is the one of market expansion and innovation. In the 1990s, the world economy underwent a drastic change and entered a new phase of growth, after the transformation of the centrally planned economies to market-oriented ones following the collapse of the Cold War regime, and the “digital revolution.” The pace of change accelerated in the 2000s, with the centers of growth expanding geographically. The world economy is witnessing the dawn of a new era of worldwide growth that owes to the following three factors:

(i) Global Market Integration

Since the turn of the century, the presence of emerging countries, including BRICs (Brazil, Russia, India and China), in the world economy has grown significantly. With the arrival of such new major players, most parts of the world have been closely linked with each other through cross-border flows of trade and direct investment.

(ii) “Flattening” of Global Market

The barriers that hamper cross-border flows of people, goods, money, services and information have been lowered by the progress in the liberalization of trade and investment due to free trade agreements (FTAs) and

economic partnership agreements (EPAs) as well as by the extended reach of the Internet.

(iii) Remarkable Technology Innovation

Research and development in cutting-edge science fields such as biotechnology and nanotechnology have rapidly advanced. Information technologies, technologies related to environment and energy, and financial technologies have introduced revolutionary changes in the development of products, contents, and business models. Designs and brands have also come to produce high value added.

(Virtuous Cycle of Growth Realized Globally)

The global economic growth driven by these factors has brought about significant benefits as explained below. At the same time, however, global-scale problems have also emerged.

As an example of the benefits brought about by global economic growth, we would like to cite the virtuous cycle of the vitality and labor force of emerging economies combining with the technological prowess and risk money of developed countries to enhance the affluence of the entire world.

In short, BRICs and a number of other countries have been given fresh opportunities for growth. By taking advantage of their abundant labor force natural resources and food, these countries have steadily raised their national income levels, creating a huge middle class. Developed countries, for their part, have attained higher economic growth through exports to and direct investments in the emerging countries. Also, it is obvious that consumers have benefited from this cycle as the prices of various consumer goods have dropped.

(Appearance of New Challenges the Globalized Economy is Facing)

Since the turn of the century, however, global economic growth has also posed the following new challenges, which must be tackled urgently.

Challenge 1: Inflation and Poverty

While the prices of goods in general have dropped, those of crude oil and grains have surged due to strong demands from emerging countries and an influx of speculative money into the commodities' markets as it is difficult to increase supplies of commodities in a short period of time. Thus, the conflict between growth and inflation has emerged. Meanwhile, the risk of poverty

worsening in resource-poor developing countries has increased.

Challenge 2: Expanded Flow of Funds

Financial technologies, such as securitization and derivatives, have made it possible to move a massive amount of funds instantly between markets around the world. The recent surge in the prices of commodities may have been temporarily magnified by globally expanded flows of money. While expanded flows of funds facilitate more efficient global distribution of financial resources, it may also destabilize the real economy by increasing market volatility.

Challenge 3: Further Global Warming

The emission amount of global greenhouse gases is increasing due to the combined effects of the soaring energy consumption caused by global economic growth including developed countries' and the poor energy efficiency of the rapidly growing emerging countries and developing countries. A strong anti-global warming initiative encompassing all countries is critical to tackling this challenge.

Challenge 4: Widening Wage Gap

While the wages of people in developed countries engaging in jobs not requiring high skills, which can be replaced by expanding imports and information technologies, remain flat or are declining, those of people engaging in high-skill jobs or creative work are rising. The widening wage gap is fomenting protectionism, making it imperative for developed countries in particular to tackle this challenge.

(Amongst the Conflict between Growth and Inflation)

Of the new challenges faced by the globalized economy described above, the surging prices of crude oil and grains, stated in Challenge 1 and Challenge 2, require particularly prompt actions. They are the emergent challenges at present and the important factors for considering the vision in a decade's time of Japan, which has poor natural resources.

The price surge in natural resources and food has seriously impacted the life of people in resource-poor developing countries whose income levels are low, and is aggravating the problem of poverty. Other countries also face the risk of the surging commodity prices leading to inflation by triggering rises in the prices of goods and services in general. This risk, coupled with the signs of a

global economic slowdown induced by the subprime mortgage loan problem, makes macroeconomic policy management difficult.

The current seriousness particularly comes from simultaneous surging prices of both crude oil and grains. Although this has been caused by a confluence of various factors, we must keep in mind that the most important factor is the strong short-term constraints on the supply of primary goods.

In other words, the factors causing the price surge in crude oil and grains include a supply shortfall due to increased demand mainly in emerging countries, an influx of speculative money accelerating it, and demand unlikely to subside any time soon despite the higher prices, and so on. What is more important, however, is the fact that an increase in supply that would normally be induced by the price surge is unlikely to materialize in the short term in this case because of the supply constraints of crude oil and grains. It is hard to develop new oil fields, expand oil refining capacity, or increase crop yields in the short term.

(How to Confront the Price Surge in Natural Resources and Food)

Given this constraint on supplies of natural resources and food, the price surge must be addressed by not only implementing short-term macroeconomic policy but also devoting efforts to structural measures. Both developed and emerging countries must enforce the structural measures such as increasing the supply capacity and transforming the demand structure, based on the following principles.

- (i) It is essential to prevent the surging prices of crude oil and grains from leading to general inflation by implementing appropriate macroeconomic policy, mainly monetary policy.
- (ii) It is important to significantly enhance the development of alternative energy sources and strengthening energy conservation measures while encouraging the increase in supply and the investment for that purpose by coping with the oligopolistic control of crude oil supply.
- (iii) Especially developed countries should review their food policies so as to increase domestic production and enhance agricultural technical cooperation for developing countries so that agricultural production can be expanded in the long term.
- (iv) For regions where the food price surge may continue, aggravating the problem of poverty, the international community should quickly extend support.

(Taking Advantage of the Price Signals)

The important thing is to preclude temptation as much as possible for such measures temporarily alleviating pains as export restriction, higher export taxes and natural resource price control. These measures undermine the mechanism that encourages an increase in production and suppression of demand in response to a price rise, which not only hurts the countries adopting such measures but also could augment global volatility. Also, although the prices of natural resources and food may be significantly affected by the movement of speculative money, they are determined by supply-demand factors in the medium to long term. From this viewpoint, changes in relative prices are signals of what is in shortage or in excess. Therefore, individual countries should in principle seek to ensure that prices properly reflect the supply-demand condition.

Global environmental problems in Challenge 3 above are attributable to the constraints on supply of natural resources and food in a broad sense. This means that the environment, which is a limited resource, is being depleted by the increasing demand due to global economic growth. What is particularly worrisome about global environmental problems is that there is no price signal that would call attention to the preciousness of the environment. Therefore, it is necessary to introduce a kind of pricing mechanism for the environment in order to provide incentives for investment in its protection.

(Approach to Solving New Challenges)

These new challenges occurring with the development of globalization can be taken as adjustment costs accompanying the ongoing transition of the globalized economy towards the globalized economy with large scale of population.

It is inevitable anyway to suppress emission of global greenhouse gases and waste of limited energy resources, and to strengthen food supply capacity. How to distribute the fruit of growth within a country and lead it to sustainable growth must be the challenge to be explored for both developed and emerging countries, under the circumstances where information technologies flattens the world and human resources easily move across the boarder.

Therefore, the important thing is that we must try to transform our society to necessary economic system along with the transition of world economy to new stage. The later the transition to the economic system premising cross-border economic activities and constraints on natural resources, food and environment is, the larger the necessary adjustment cost is as distortion

occurs.

What is expected to Japan is to contribute the world economy in overcome of the constraints by the knowledge and technology, and to positively participate in formulating the framework of the new world economy. The environmental initiatives at the G8 Hokkaido Toyako Summit this year will be the starting point.

Japanese economy itself also has to change. It has to enhance flexibility for promptly moving to the new stage. For that purpose, the Japanese economic system has to be recreated by fresh human resources, knowledge and capital being provided. It is necessary to aim to the goal where the cutting-edge value-added is developed in Japan as the base of activity through new ideas, technology and human resources gathering. This will be shown as the concept of an open “platform” in Chapter 2.

2. Change in the Position of the Japanese Economy in the World economy and Future Challenges

(1) Change in the Position of the Japanese Economy for the Last 20 Years

In 1986, in which the “Maekawa Report” was released, the Japanese economy had grown rapidly for 40 years since the end of World War II, to the point of taking an important place in the world economy. On the other hand, the issue of the imbalance of current account raised a big challenge of how to cooperate with the world economy.

Since the 1990s, more than ten years had passed to deal with negative legacies of the burst of the bubbles while the world economy had grown, and at the time Japan’s “lost decade” of economic slump ended at last, the position of Japanese economy in the world economy had drastically changed as seen below. Of course, export-driven manufacturers have successfully expanded their overseas operations, but Japanese economy as a whole was late to address structural changes in the world economy. It is necessary to perform actively again in the world economy and implement the role of the Japanese economy, starting from looking straight at the change in the position of the Japanese economy for the last 20 years.

(i) Reduced Economic Clout

Japan’s economic clout has declined as the country has failed to fully seize the expanding opportunity for growth. Japan’s economic growth rate so far in

the 2000s stands at 1.7% in real terms, down from 3.8% in the 1980s, although it is up from 1.5% in the 1990s. Japan's share in the world GDP in 2007 has declined to 8.1% (on a purchasing power parity basis), down from 17.9% in 1994. In terms of per-capita GDP, Japan fell to 18th among the OECD member countries in 2006, down from second in 1993.

(ii) Eroded Competitive Edge in Many Fields

Japan's competitiveness has declined, according to general competitiveness indices. On the world competitiveness ranking list compiled by the IMD (International Institute for Management Development), Japan has plunged to 22nd place in 2008, down from the top position in 1993.

Behind the reduced competitiveness is a lag in Japan's efforts to adapt to the globalization wave. Regarding efforts concerning economic partnership agreements (EPAs) and free trade agreements (FTAs), Japan is behind the United States, the EU and China. The ratio of trade with EPA and FTA partners stands at only 9.4% for Japan, compared with 35% for the United States, 72% for the EU (including trade within the EU) and 19.5% for China. The number of foreign companies listed on the Tokyo Stock Exchange declined to 25 in 2007, down sharply from 127 in 1991.

(iii) Exposed Weakness as a Resource-Poor Country

Increasing constraints on supplies of natural resources and food have exposed the economic weakness of Japan as a resource-poor country. Japan's food self-sufficiency ratio (on a calorie supply basis) declined from 48% in 1990 to 39% in 2006, compared with 128% for the United States, 122% for France and 84% for Germany (the figures for all three countries are for 2003).

The energy self-sufficiency ratio (including nuclear power) for Japan has mostly stayed in the 15%-20% range since the 1990s, against around 70% for the United States and around 50% for France.

(2) World Economic Prospects and Challenges of the Japanese Economy in the Coming Decade

How will the world economy, which has rapidly changed since the last decade, change in the coming decade? Although it is hard to anticipate, in advance considering the vision of what the Japanese economy should be like in a decade's time in Chapter 2, as premises of it, we describe expected changes in the world and the Japanese economy, and challenges emerged from

them as follow.

(Share of the Japanese Economy in the World economy Will Continue to Decline)

The globalized economy provides various growth opportunities to countries, and if they could make use of them, it drives them up to new growth paths. “New Emerging Countries”, following BRICs, will continuously appear among developing countries, which left behind, in Asia, Africa and Latin America. They will grow dynamically while incorporated in a network of free trade and investment by means of FTAs and EPAs.

Entering 2010s, growth rates in some Asian countries such as NIEs and China are likely to be somewhat slowing since increases in population will be no more a contributor to economic growth due to the ageing society and upward turn of depending population ratio. As a result, average growth rates during 2020 are expected to be over 2¼% in developed countries and around 5% in developing countries. While developed countries will account for around 62% (71.8% in 2007) in the share of the world GDP, the figure of developing countries will rise to around 38% (28.2% in 2007)¹.

Meanwhile, the relative size of the Japanese economy in the world is expected to decrease continuously, mainly due to the effect of the population decline. If there is not a large increase in the labor participation rate, the labor force population will decrease by around 4 million over the next decade, that is to decrease by an average of 0.6-0.7% annually, and that will make a negative contribution to the economic growth by around 0.4%. This means that the rate of increase in labor productivity being equal, Japan’s potential economic growth rate will fall to around 1%. Thus, the Japan’s share in the world GDP falls to around 6% (8.1% in 2007) in 2020². However, if the decline in labor force population due to the population ageing and the population decline could be curbed by policies for raising the rate of labor participation and the rate of increase in labor productivity would be realized, the potential growth would be around 2%³. In this case, Japan’s share in the world GDP in 2020 would account for around 7%.

¹ The figures by 2011 for Japan are cited from the Reference Projection in “Direction and Strategy (2008)” by the Cabinet Office and the figures by 2010 for other countries are cited from the estimations by IMF. The rest of figures are estimated based on the method of “Japan’s 21st Century Vision (2005)” compiled by the Cabinet Office.

² See also footnote 1.

³ See also footnote 1.

If Japan aims for the real economic growth of 2% or higher, it is essential that more women and elderly people will join the labor force and the increase of improvement in labor productivity will be maintained or accelerated by technological progress and improvement of economic efficiency.

(Changes in the World Economy and Challenges of the Japanese Economy)

Concerning structural changes in the world economy and challenges of the Japanese economy to them over a next decade, it should be noted as follows.

(i) International Convergence of Institutions

In the process of liberalization of trade and investment advancing further, various institutions, which are different among countries, are expected to be accommodated through competitions, and that leads to enhance international convergence of institutions. Countries and areas with a large economy will get advantages in institutional competition, and exercise strong leadership for establishment of international standards and rule-making.

Big challenges for Japan will be the way of enhancing economic integration in Asia and economic partnerships with large economies such as the EU and North America, and influencing establishment of international standards through them.

(ii) Strengthened World-Wide Efforts Addressing Global Warming

The new framework of the Post-Kyoto Protocol will lead efforts to halve the amount of global greenhouse gas emissions to be well-established, and environmental consideration will be an essential factor for economic transactions and intercorporate competitions. In developed countries, consumer preferences will shift to environmentally friendly items from environmentally loaded ones. Environmentally loaded items, as a result, will be culled out. On the other hand, since developing countries with high growth will be still large sources of emissions, it will be essential to enhance energy efficiency in those countries.

It will be important for Japan to take advantage of its advanced environmental and energy technologies to efforts in countries with high emissions, while fulfilling its own responsibility for reduction of green gas emissions by half.

(iii) Further Increase in Demand for Natural Resources and Grain

Continuous increase in population particularly among developing countries will provide abundant labor force to the global market, and that will have downward pressure on prices of labor-intensive commodities. On the other hand, demand for food and energy will continue to increase mainly among developing countries with high growth, and that will have upward pressure on prices of natural resources and grain. In this context, the framework for international coordination towards global stability of supply and demand for natural resources, grain and others will be reinforced. It will be more important for Japan to heighten the self-sufficiency of energy supply including to put alternative energies into practical use and to enhance its agricultural productivity.

(iv) Intellectual Creation as a Source of Growth

As constraints on natural resources and food will be binding and have a greater impact on the real economy, a source of growth in developed countries will become to create added value by using intangible assets such as knowledge and information more than ever. Both manufacture and non-manufacture will further strength their characters as a knowledge-intensive industry, and human resources that create new values will be of increasing significance. The importance of intellectual creation for Japan will become higher than other countries because of the acceleration of the population ageing and the population decline. In order to continue to raise income level, it is essential to utilize knowledge and ideas, to generate innovation uninterruptedly and to create high added value.

(v) Massive Global Money Flows

Funds flowing into resource-rich countries such as middle-east countries and pension funds in ageing developed countries will influence greater on international money flows. The role of international financial centers, as financial intermediary, will be of importance, and Tokyo and Shanghai in addition to Singapore will be prospective. The presence of Islamic finance may grow against the background of the oil money and the rapidly growth in middle-east countries. While the U.S. dollar and the euro are expected to be the key currencies of global finance, the influence of the Japanese yen and the Chinese yuan are also expected to grow in Asia.

In order to play an aggressive role in international money flows, international competitiveness of the financial sector and attractiveness of

Tokyo as an international financial center will be tested.

In addition to those challenges raised by the world economy, following domestic challenges will have more importance.

(vi) Achieve Economic Growth Overcoming Population Ageing and Population Decline

Advance in structural changes of the population ageing and the population decline will be a critical factor in consideration of the future Japanese economy. We assume the total Japanese population will decrease by around 4 million over the next ten years. Meanwhile, the number of people aged 65 or higher will increase by around 7 million and that of people aged 15 to 64 will decline by around 8 million. We assume that nearly all prefectures will experience a population decline. Meanwhile, if the total number of municipalities is to remain unchanged, the number of municipalities with a population of less than 5,000 will increase by 24% and reach 969 (29.9% of the total) in 2020 from 781 (24.1% of the total) in 2005.

We anticipate this will have an influence on various aspects such as a reduction in the domestic consumption, a decrease in the saving rate, an increase in the social benefits payment and a reduction in the tax revenue in addition to a decrease in the labor force. In order to make potential consumption demand apparent, it is essential to implement regulatory reforms in areas such as medical care and nursing care from a view point of consumers and concentrate in urban areas so that elderly people can use urban oriented services in regions. And rate of return on financial assets should be increased because the property income becomes more important as ageing advances. Moreover, it is a big challenge to establish a sustainable social security system which prevents a burden from being placed on younger people and future generations.

It is required to build a resilient economic structure to external shocks. This is because if the increase in the domestic consumption slows down as the ageing and the population decline, the Japanese economy is more likely affected by the foreign demand. The capital market is also susceptible to changes in global money flows because of growing dependency on foreign savings due to the decrease in the domestic saving rate.

Chapter 1 discussed current situations and challenges in the world economy and the Japanese economy. The confirmed structural changes there is enough large to make us review the past framework of thinking, that is to say the

paradigm. On the basis of them, Chapter 2 describes the direction that should be taken by the Japanese economy and the necessary structural reforms to realize it.

Chapter 2: Pursuing Further Openness and Living with the Globalized Economy

1. Recreation of the Japanese Economic System

(1) Making Japan an Open “Platform”

As is seen in Chapter 1, the world economy is under dynamic change involving the developed, emerging and other countries. A virtuous cycle to make overall wealth has been realized because developed and emerging countries supported each other, though we have been facing conflicts of both inflation and economic growth. Amid the aforesaid situation, in order for Japan to come into the virtuous cycle and establish the economic growth path, it is necessary to shift the domestic economic system to match with the new stage of the world economy and establish a scheme to grow with the world. Getting out of the economic system we have had since the high-growth period, and building a new economic system to integrate the dynamism of the global economic growth, which are to say “recreation of the Japanese economic system” is essential.

Having a decline in population and few natural resources, Japan’s path to go is becoming a platform to create knowledge. In other words, it is a path of investing human resources which have fresh idea, cutting-edge knowledge and technologies to the Japanese economy, thereby creating an environment to continuously produce origins of growth. By doing so, Japan’s potential will be utilized as a strength on the new stage of the world economy. We call such environment as an open “platform (base of activities)” in this report.

(Magnet for Technologies, Human Resources and Information from around the World)

An open “platform (base of activities)” means a place to which fresh ideas, advanced technologies and human resources with sophisticated skills are attracted across national borders, spurring intellectual innovation and creating cutting-edge value added on a sustainable basis. It is a place opened both

inwardly and outwardly and bearing origins of growth, with people, goods, money, knowledge and information flowing in and out without restriction and in a dynamic manner. If Japan shows an advantage of the “base” which is described later and becomes such an open “platform”, the Japanese economy will grow in tandem with the world economy, producing synergy effects and creating a “win-win” mechanism of growth. It would be possible for Japan to have an ability to create the global standard under the environment which international competition and convergence for institutions are undergoing.

(Attractive Economic System)

In order to develop Japan into such an open “platform”, our economic system must of course be attractive in the eyes of people in other countries. For an attractive base of activities, it is necessary to have a structure utilizing human resources in an appropriate manner, providing funds smoothly to growing sectors and making venture entrepreneurs actively participate as well as markets based on the fair rules. So far, we have not built such structures enough. It is because Japan is still on the way of shifting from the economic system which supported a high-growth period and building the structure matching with the new stage of the world economy. If looked at from a different angle, however, this means that there is substantial room for Japan to boost its economic potential and make greater contributions to the world economy.

(2) “Intellectual Capital” and “Natural Capital” as Japan’s Potential Strengths

We would like to draw your attention that Japan has potential “strengths (capital)” it could use in order to create an open “platform”. First, there are strengths such as excellent human resources, superior technological prowess, accumulated financial assets that have been strengths until now and can also make good performances again by recreation of the Japanese economic system. Second, Japan has bountiful and beautiful motherland, mild climate, profound culture, safe and reliable society, and advantageous location in Asia, which could be new strengths under open economic system.

As is written below, if Japan creates the open “platform” exploiting these advantages to become a base, thereby providing all people willing to work, including women and elderly people, with employment opportunities, we believe that the country will overcome the decline in population and achieve

sustainable growth. Furthermore, Japan will be able to make significant contributions to resolving globally common challenges such as problems related to the environment and energy.

(Utilization of “Intellectual Capital” Such as Human Resources, Technologies and Know-how)

As is repeatedly mentioned in this report, it is “intellectual capital” (human resources, technologies and know-how) that provides a source of growth.

As the information technology revolution proceeds, industries, whether they are manufacturing industries or non-manufacturing ones, are becoming increasingly knowledge-intensive, and the intellectual capital provides the driving force for such knowledge intensive industries. Japan has “strengths” in the form of capable human resources, both individuals and groups, and technologies and know-how produced by them. If the open “platform” attracts various human resources from abroad, too, thereby enhancing Japan’s intellectual capital, it would spur intellectual innovation in a broad range of fields, from advanced technologies and manufacturing to service frontlines.

(Utilization of Accumulated Environment- and Energy-Related Technologies)

Japan has enhanced its prowess in technologies related to the environment and energy conservation that are comparatively advantageous intellectual capital we gained with a resolve to overcome a lack of natural resources. If its technological prowess is applied to business and industrial models through an appropriate division of roles and risks between the public and private sectors, Japan will be able to provide solutions to problems related to the environment and energy, which are likely to impose severe constraints on the world economy.

(Utilization of “Natural Capital” Provided by Our Motherland)

Japan is endowed with a rich reservoir of natural capital, such as bountiful nature, mild climate and abundant water resources. If the country makes full use of its natural capital, its agriculture, forestry and fisheries industries as well as tourism will be enhanced to levels that deserve global acclaim. In particular, Japan’s foods-related industries have technologies that meet detailed and elaborate needs and the world’s highest level of know-how regarding safety and quality control. Therefore, as foods demand grows in the future, Japan could take advantage of its “strengths” in these areas both at

home and abroad.

(Utilization of Rich Financial Assets)

The rich financial assets held by Japanese households, one of the largest in the world, should be utilized more effectively through financial and capital markets where sophisticated technologies are available and discipline is properly exercised. If these assets are connected, in the form of “risk money,” to intellectual and natural capital systematically, they would enhance the growth of the Japanese and the world economies.

2. How We Can Achieve Structural Shift

(1) Friction Caused by Changes

Although Japan has potential strengths as described above, we must carry out a major overhaul of economic system so as to be an open “platform”, and to be the hub of knowledge-building by taking full advantage of them. Japan is in the process of a shift in its new economic system, from a system based on the assumption of continuing economic and population growth to a system suited to a stable growth and declining population. The structural shift of economic system is supposed to cause various frictions in any age and in any country. In our country, the shift is not proceeding smoothly with “distortions” arising in various areas in the transition process. Also, a movement to protect the old system is leading to “friction.” Inefficient arrangements and frameworks have been preserved as people wishing to keep the status quo and trying to protect their vested interests, such as subsidies or regulatory protections, have served as the bulwark against reform. In short, Japan is experiencing the following frictions generated by the collision of the old and new systems.

(Friction Caused by Overhaul of Corporate Arrangements)

A unique economic system created in Japan during the period of high economic growth has been based on such arrangements and systems as lifetime employment, mutual shareholding, strong business ties within “keiretsu” corporate groups and the “main bank” system. However, it is now difficult to maintain these arrangements and systems as the environment surrounding Japanese companies has drastically changed, for example, globalization and information technologies. With new systems introduced only

insufficiently, distortions have arisen in the transition process.

For example, such distortions are typically evident in problems related to the increasing number of non-regular workers. If companies are to reduce excess employments without abandoning the lifetime employment system and the seniority-based pay system, they have no option but to curb new employment while increasing non-regular workers. Furthermore, as Japanese companies face continued pressure from global competition, drastic reform of the employment system remains unfinished, leading to gap between regular and non-regular workers which could perpetuate.

(Friction Caused by Preservation of Bureaucracy-led System)

When the economy grew strongly and the population continued to increase, it was possible to redistribute the benefits of growth widely under the bureaucratic initiative. The combination of high economic growth and population growth led to the establishment of a system under which the central government distributes tax grants to local governments and supports weak industries through subsidies and regulations.

However, the bureaucracy-led system of benefits distribution turned into a hotbed of vested interests at some point and has been preserved until now despite the changes that have occurred in the economic environment since then. This system has hampered market entry of new companies that offer the potential of innovation, leading to a decline in the productivity of services industries and a slump of regional economies. The influence of the forces that try to stop change has curbed the growth of industries and regions, fueling a sense of helplessness and hopelessness and triggering a drain of human resources from stifled industries and regions.

(Burden of Ageing Society on Younger Generations)

Although Japan's population structure is now represented by a dwindling population of young people and a swelling one of elderly people, no significant progress has been made in the review and reform of government expenditures and the social security system. Young people are worried that the social security system could crumble by the time they start to receive benefits. Meanwhile, elderly people are concerned that their benefits may be reduced.

In particular, young people face the gloomy prospect of shouldering the huge load of debts accumulated by the central and local governments, in addition to bearing the burden of the increasing payments of social security benefits to the elderly. Furthermore, as the say of middle-age and elderly

people in the management of government policies increases due to their growing proportion in the total population, young people feel increasingly helpless and hopeless about the future.

Thus, the ageing of society has caused friction in the social security system, and young people and children are set to be saddled with the resultant unprecedented burden.

(2) Need to Carry Out Reform without Seeking Stop-Gap Solution

Stop-gap measures such as a return to the old systems and redistribution of income are often proposed as ways to resolve these frictions described above. However, a return to the old system would only work to sap the vitality of the whole Japanese economy. If Japan shrinks from the wave of dynamically changing economic globalization as the rest of the world embraces it, the country would face a massive drain of capital and human resources. Furthermore, if we are preoccupied with the stop-gap measures, without taking drastic response to the economic environment lie beneath and the change of demographic structure, new economic system will never be established for a long time, but only to expand the distortions.

What Japan must do now is to carry out the comprehensive and simultaneous reforms regarding whole economic system, such as production/consumption, labor and finance, so that Japan could be a fascinated platform. It is imperative for Japan to carry out with courage a shift to a new economic system while reforming its fiscal and social security systems in ways to avoid leaving an excessive burden to young people and future generations.

(Need to Create Society that Offers Hope for Young People)

Young people and business entrepreneurs bring some energy which can lead the shift of economic system. Putting in place an environment that will enable young people to have motivation, will break the rigid economic system and rejuvenate the whole economy.

For that purpose, we must face up to the serious conflicts of interests that underlie the friction. In a society where vested interests generated by the existing system are preserved and willingness to tackle new challenges tends to be disregarded, the motivation and vitality of young people and business entrepreneurs are stifled. If such people, who should act as the driving force behind the economic growth, feel helpless and hopeless as they continue to

see their efforts and capabilities remain unrewarded, there will be no bright future for Japan.

(Need to Rebuild Safety-Net)

If young people and business entrepreneurs begin to feel hopeful for the future, it may be a sign that Japan has achieved a shift to a new economic system. At that time, not only young people, but women and elderly people, who have ever been given insufficient chances to play a role, can take advantage of this opportunity. To be the hub of knowledge-building provides equal opportunity to all people irrespective of age, gender.

The society which is urged to challenge for something new is, at the same time, also the society which is required more reliable safety-net. It is indispensable to rebuild safety-net and to make people's life firmly stable in accordance with the shift to new economic system. People feel hopeful for the future when we are able to prepare a reliable safety-net for people who fail to keep up with social competition for some reason or other. We face a test of our courage and patience to stick with the reform initiative and radically overhaul the old system that has become ineffective, which prevent vested interests from obstructing challenges for new things.

3. Five Goals to be Achieved for the Desirable Vision of Japanese Economy In a Decade's Time

In order to establish a new economic system without fearing frictions that we could face in the process of structural change, it is essential to share a vision of post-reform Japan and to carry out reform with confidence in the potential of Japanese economy. Below, we describe five goals to be achieved for the desirable vision of Japanese economy ten years from now, by imaging an open "platform".

Goal 1: Development and Mobility of Human Resources

Japan should create a society in which human resources move across various industries and business sectors and between the public and private sectors as well as across national borders. This would enable the appropriate positioning of personnel, encouraging them to make active contributions to the globalized world with their innovative ideas. In particular, it is important for Japan to become a platform for developing intellectual capital by accepting

personnel from around the world for posts related to intellectual creation, such as financial services and basic research.

(Human Resource Development as a Key)

In order to realize this vision, it is important to expand investment for human resources and to develop human resources suited to mobility. It is necessary to ensure that the quality of education is improved, that people are allowed to choose school irrespective of their age and the income level of their families and that various and abundant opportunities for vocational training are provided.

It is required that dividends for labor are proportional to the productivity, and that companies give their employees different kinds of work motivation from the ones offered in the era of high economic growth. Also, in order to facilitate the mobility of workers, it is essential that their careers are covered by the safety net we describe later.

(Removal of Mobility Barriers)

Furthermore, it is necessary to remove institutional barriers that hamper the mobility of human resources, such as the retirement benefit tax system that favors people who work at a single company for a long period of time and the inequality between regular and non-regular workers. Also, the government should minimize the harmful effects of the ministerial sectionalism by promoting the mobility of personnel across ministries and agencies.

It is also important to make the Japanese society attractive for skilled foreign workers by making the most of Japan's advantages, such as high-quality clothing and foods, safe and clean city and safe and reliable public transport systems. In addition, Japan needs to further promote acceptance of personnel from abroad by taking measures such as supporting returnee students, helping foreign students find jobs in Japan, easing the criteria for immigration and providing support, including housing.

Goal 2 : Breeding Ground for Innovative Firms

Japan should aim to become a platform for corporate activity where active M&A deals, both domestic and foreign, can be seen and where companies with innovative ideas and advanced technologies come from around the world. Particularly important is the advance of financial services. The financial industry is the economic infrastructure which gives birth to growth sectors and

is itself an important growth sector based on advanced knowledge and information. Also, Japan's services industries, whose productivity is low compared with that in other countries, could also grow, mainly led by services related to the ageing of society, if they improve productivity by making the most of globalization and information technology so that they can satisfy the needs of not only Japanese consumers but also consumers around the world.

(Establishment of Fair and Transparent Rules)

In order to achieve the goal mentioned above, it is essential to take full advantage of Japanese tendency to value quality and safety, and to establish fair and transparent rules concerning competition. Of particular importance is to ensure equal treatment of domestic and foreign companies. In addition, it is necessary for the administrative and judicial authorities to enhance the predictability of their actions and decisions, raise the level of professional expertise and promote the use of English.

(Financial Center with High Asset Management Capacity)

Predictability, professional expertise and the use of English are particularly important for the financial sector. Japan should become a core financial center of Asia by enhancing the competitiveness of financial and capital markets and by providing various financial products.

The competitiveness of Japan's financial and capital markets will be significantly enhanced if the public pension funds are managed in a professional and efficient way and the mobility of personnel as mentioned above, including foreigners, is assured. This would promote liberal and dynamic asset management and spur financial innovation, which in turn would attract world-class financial experts to Japan from other countries and enhance the asset management capability of Japan as a financial center. As a result, vast amounts of financial assets held by Japanese households and the public pension funds will be utilized for various economic activities both at home and abroad. In this way, global economic growth would benefit people in the form of enhanced affluence.

(Business Start-up Rate as High as Other Major Economies)

In order to stimulate the dynamism of industry, it is necessary to review and revise systems and frameworks that hamper new enterprises and allow inefficient established companies to remain. As a benchmark for efforts in this regard, it is desirable to boost the business start-up rate in Japan, currently at

around 5%, to the level similar to those seen in other major countries (around 10%).

Goal 3: Creation of Safety Net Assuring People Various Career

Japan should create a society that would give people various career and life options. In the envisioned society, people would be able to start a fresh business career or return to academic study whenever they like. For example, mothers are not forced to make the choice between having work and bearing child, people need not sacrifice their private life with an excessive workload or elderly workers are not forced to retire despite their willingness to continue their work. In order to create such a society, it is essential to establish comprehensive social infrastructure such as child-bearing support and to enable people to choose the working style that best suits them from a wide range of options, including part-time work and telework, without suffering undue treatment, so that gender equality in society and an appropriate work-life balance are ensured.

(Recovery of Birth Rate to 1.8)

It is essential for Japan to lay the social foundation which supports the life styles as described above on the assumption of a life expectancy of 90 years. A national minimum safety net should be put in place in order to ensure that all people may be given new opportunity if they fail on a certain career path. The social security system should be reformed quickly in ways to seriously tackle the issue of benefits, with due consideration of the concern of younger generations which are to support the ever-growing population of elderly people. It is also necessary to adjust the government's policy-making system so as to correct the inter-generational inequality that arises from the changing population structure.

In trying to see whether such a society is realized, it is desirable that the total fertility rate, currently 1.3, is raised to at least around 1.7-1.8.

Goal 4: Links between Japan's Regions and the World Economy

It is desirable that Japanese regions, each with a relatively wide geographic area, gain enhanced autonomy, develop their own unique features, and form their own links with the world economy, thereby creating a basis for their growth.

(Full Introduction of “Doshu” System)

To do the above, Japan should fully introduce the “doshu” system (a kind of federal system in which the existing prefectures would be integrated into larger administrative units (“do” and “shu”) with enhanced autonomy) within ten years. In doing so, much of the taxation power should be transferred to the expanded regions, enabling them to exercise their initiative in drawing up fiscal and economic plans.

It is necessary to design the form of regions facing the challenge of declining population. It is also essential to re-consider the desirable state of regions by conducting earnest deliberations on issues such as how to ensure comfortable life for the swelling population of elderly and how to concentrate in urban areas for securing service industries, in which accumulation of people is a key factor for the development.

(Rebuilding of Food-Related Industries)

Another important task is to rebuild the agriculture, forestry and fisheries industries and related ones. These industries are afflicted by the population ageing and the small scale of management. However, Japan could overcome this problem and enhance these industries if it takes advantage of consumers with preference for delicious meal and producers with strong commitment to quality. To this end, it is necessary to promote the separation of ownership and use of farmland and forests. It is also necessary to increase the scale of management and to enhance value added under the corporation management, and to introduce an advanced marketing method. If this goal is achieved, these industries would offer more attractive career opportunities for younger generations and would boost innovation. As a result, these industries could overcome the challenge of import liberalization and significantly increase exports to other countries.

Goal 5: Contribution to the Global Challenges

Japan should tackle global issues, such as environmental and energy problems as well as poverty and the protection of basic human rights in developing countries, in an earnest and active manner, and aims to provide not only financial support but also human resources and knowledge.

Also, Japan should aim to form an economic zone surrounding the Pacific Ocean by taking initiative in establishing a free trade area in the Asia-Pacific

region. It should promote the liberalization of trade and investment through the WTO and conclude economic partnership agreements with major markets such as the United States and the European Union, thereby ensuring people at home and abroad to have access to excellent goods and services. It should be noted that promotion of the liberalization of imports by a developed country like Japan could offer one of the best solutions to the problem of poverty in developing countries.

(Pioneer in the Creation of Environmentally Friendly Economy)

Japan, with its excellent technology and know-how related to the environment and energy, should contribute to the world economy by achieving sustainable economic growth harmonious with the environment. It should also contribute to efforts to transform the production and consumption activities of developing countries into environmentally-friendly ones.

Based on these achievements, Japan should take the initiative in establishing international frameworks and arrangements that would prevent the rise of resource nationalism and excessive regulations, thereby playing the leading role in maintaining a fair market-based economic system.

(Fostering of Young People Capable of Playing an Active Role in the International Community)

Japan can make the international contributions described above only if young Japanese actively advance into the international community and build their own human networks. This would mean that an increasing number of Japanese people will think about what Japan should be like in the future in light of the international situation. To this end, it is essential to foster a large number of young people capable of playing an active role in the international community, expressing opinions clearly and taking leadership as they communicate with foreign partners.

Concluding Remarks

In this report, we have seen that if Japan succeeds in establishing the economic system which enables Japan to grow with the world economy by exploiting the dynamism of the drastically changing world economy, it could achieve sustainable growth amid population decline and enhance the affluence of the people. The most important thing is that Japan should be open to the world and should co-exist with the world.

All Japanese people, particularly young people, should make self-improvement efforts without fearing globalization and work hard together with people around the world. With the emergence of new business, the economy as a whole should constantly undergo an active process of renewal. This would enable Japan to become an open “platform” for the creation of cutting-edge value,” to remain a leading player in the world economy and to make contributions to the world economic growth. In short, our goal is to constantly try to create value-added without fearing changes: that is, to rejuvenate the Japanese economy.

Therefore, the vision of Japanese economy presented by this report should be shared among the people. It is necessary to carry out reforms covering the whole economic system, including production/consumption, labor and finance, in a comprehensive manner and simultaneously, rather than implementing individual reform measures in a piecemeal way. These reforms should be carried out quickly and at the same time persistently. We hope that strong political leadership will make this reform possible.

(End)

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July 2, 2008