

JAPAN ECONOMIC CURRENTS

A COMMENTARY ON ECONOMIC AND BUSINESS TRENDS

The Keidanren Vision 2007 "Land of Hope, Japan"

Earlier this year, Nippon Keidanren (Japan Business Federation) released a vision for the Japan of 2015. The decade-long vision describes the basic policy direction which Keidanren is heading for — transforming Japan drastically into a "Land of Hope."

Introduction

The Japanese economy is regaining its strength. The real rate of growth has been positive for four consecutive years since fiscal year (FY) 2002, the employment situation has improved considerably, and the prolonged period of deflation is breathing its last. In the corporate sector, progress is being made in the efficient allocation of management resources, returns on assets are improving, and profit margins are also recovering. In the government sector, meanwhile, structural reforms such as the reforms of the financial system and pension system are making progress.

Nevertheless, to ensure that robust growth is sustained, Japan must inno-

vate itself ("Innovate Japan"). During the next decade, Japan is expected to experience further globalization and to face rapid aging and falling birthrate as its population declines. Keidanren will be resolute in pursuing not only technological innovation but also the innovation and reform of the economy and society and of the foundations that underlie them, including education and the relationship between central and local governments. Our aim is to transform Japan into a "Land of Hope" that is open to the countries and peoples of the world by 2015.

Below, we set out the shape that the Land of Hope should take, and the measures to be taken to achieve it.

The Shape of the Land of Hope

Characteristics of the Land of Hope

A nation of abundance and spiritual fulfillment

People who live in Japan will be able to lead their lives with peace of mind, supported by assured growth and by social bonds. In a social climate that appreciates diversity, people's

individual values will be respected. Safety and security of the community will be assured by means of mutual support and anti-crime measures.

Open opportunity and fair competition

People will have the opportunity to strive to achieve their own success depending solely on their ability and motivation. Opportunities to take up any challenge will be open to everyone, including people who come to Japan from overseas. Success achieved through competition will be duly and fairly rewarded. There should be no obstacles that hinder the comeback of people who have failed. And the reemployment of young people and women, active participation in society by elderly people, and reeducation and retraining for adults will be advanced. For people whose misfortune renders them unable to compete, a minimum safety net will be in place.

Respect and friendship from countries worldwide

To contribute actively to the peace and prosperity of the world, Japan will engage in strategic diplomacy in which its alliance with the United States

plays a pivotal role. It will contribute in particular to the strengthening of the international trade system and to the resolution of problems that are common to all of humanity, such as those in the fields of energy, the environment, and poverty. Japan should also make an effort to bring stability in the situation of international security.

Economic and financial structure of the Land of Hope (Japan in 2015)

After the bursting of bubble economy, Japan's growth rate remained low, hovering at an average real rate of just over 1%. However, by steadily implementing reforms aimed at enhancing potential growth, the Japanese economy will grow at an average rate of 2.2% annually during the period from 2006 to 2015 (Chart 1). National income per capita in 2015 is forecast to increase by some 30% from its level in 2005.

With respect to the current fiscal situation in Japan, the total public debt at national and local level stood at more than 150% of GDP in FY 2005, as a result of factors such as increased social security spending caused by the aging of the society, and tax cuts that were enacted to revive the sluggish economy. It is the worst level among the major industrialized countries. However, by advancing the reform of government revenue and expenditure, the total

public debt should be reduced by more than 20 percentage points by FY 2015, and should subsequently continue to decline in a stable manner (Chart 2).

In addition, a lean and efficient government will be created. The ratio of the sum of the social security burden, tax burden, and budget deficit to national income will remain at a level below 50%.

Next Steps: To Realize the Land of Hope

Achievement of sustained growth

Japan will devise a growth strategy that will enable the achievement of high economic growth despite the declining population, and with this strategy, Japan will contribute to global growth. On the supply side, it

Chart 1: Annual Average Real Growth Rate

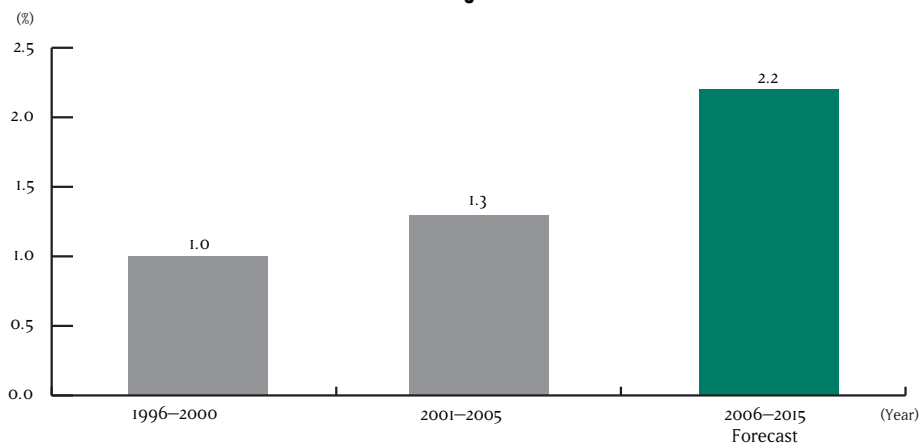
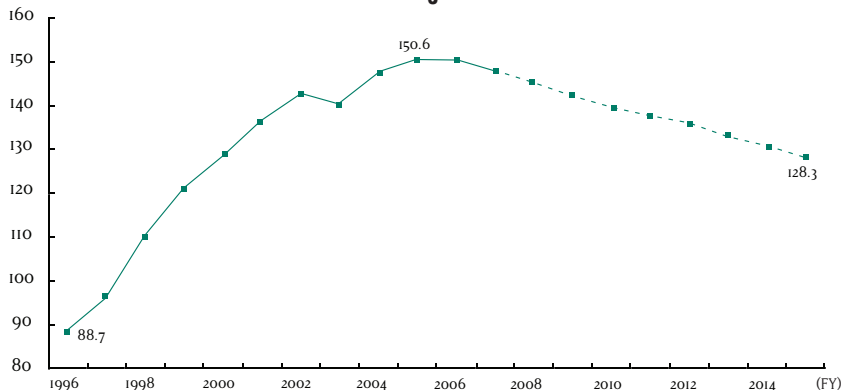


Chart 2: Public Debt (National and Local Combined) as a Percentage of GDP



Note: Figures for FY2008 onwards are estimates

will maintain total factor productivity at an annual rate of increase averaging over 1.5% by fostering innovation, the driving force of growth. To that end, the government and private sector will take steps such as strengthening intellectual property policy. High-quality human resources will also be nurtured by promoting industry-academia collaboration and by accepting foreign students to study in Japan. Productivity will be raised through regulatory reforms and the use of ICT. Additionally, to generate and augment demand, Japan will take full advantage of the products that enjoy strong competitiveness, and will ensure the expansion of markets with further growth potential, such as housing, digital content, tourism, and household support services.

In parallel with the above, Japan will overcome factors that may otherwise constrain its growth, for example, energy and environmental issues, through foreign policy efforts and technological strength.

Giving full play to Asia's dynamism

Japan will further invigorate the economy of Asia and assist to enhance the global economic growth. Based on the fact that Asia has realized its economic growth through dynamic trade and investment activity, Japan will demonstrate leadership for a successful

and ambitious outcome of the WTO Doha Development Agenda and the conclusion of an economic partnership agreement (EPA) that encompasses the whole of East Asia. This EPA will create a seamless economic environment within Asia and guarantee free economic activity, at the same time giving rise to a massive market. Japan will also contribute to raising the base level of the Asian economy by sharing its technologies and experience in the fields of the environmental protection and energy conservation, by increasing access to its domestic markets including agriculture, and by extending economic cooperation to vitalize trade and investment.

Japan will play the role of a gateway through these efforts and become a conduit between Asia and the rest of the world. Furthermore, the creation of an open, regional "East Asian community" that shares economic prosperity while embracing diversity will be in the foreseeable future.

The conclusion of EPAs with the United States and other strategically important nations such as the GCC countries and Central and South American countries is also essential. Furthermore, the importance of economic cooperation is not confined to Asia. Japan will continue to engage actively in economic cooperation, and will maintain its status as the world's second largest donor country.

Building a robust fiscal structure

To achieve fiscal consolidation, Japan will give first priority to the reform of government spending. In order to achieve this goal, the review of the bureaucratic system and the administrative structure and the rationalization of the public sector through regulatory reforms and public-private partnership should be advanced. With respect to the rapid expansion of social security spending resulting from the aging of the population, the increase in benefit payments will be restrained by introducing social security numbers which lead to more efficient social security system and cutting the overloaded benefits, so that the sustainability of the system is assured.

A tax system that encourages sound economic activity will be created at the same time. The present tax system that relies heavily on direct taxation should be amended. To assure international equal footing, the effective corporate tax rate will be reduced to a level of around 30% from its current level of approximately 40%. In regard to personal income tax, the graduation of the tax rates will become more moderate. Consumption tax, currently 5%, which is one of the lowest levels worldwide, will be increased by approximately 2 percentage points by FY 2011.

Enhancing the autonomy of local government and reforming the labor market

By 2015, steps will be taken to shift the population and industry from central to local by consolidating and reducing the number of local government bodies and by decentralizing central-government powers and funds. It will enable local government bodies to manage local issues more efficiently and effectively, and to develop their local areas by enhancing distinctive regional characteristics.

Japan is approaching the period when its baby boomers born between 1947 and 1949 are to retire. However, by developing systems of remuneration in accordance with job role and

performance and by promoting the introduction of human resources from overseas, the estimated reduction in the labor force of 4 million people by 2015 will be held at only 1 million. The fact that at present the average number of births per woman in Japan is only 1.26 will be lifted to 1.5 by 2015, by means of comprehensive measures, including the provision of support for women to enable them to hold jobs while raising children.

Strengthening social bonds

For resource-poor Japan, the development of human resources is important. To this end, public education will be further improved and the level of scholastic achievement in primary and secondary education will be maintained at the highest level in the world.

In order to build a sound, vibrant society, every citizen will share a charitable attitude that motivates them to help promote the nation's welfare. To nurture such an attitude, education will be enhanced accordingly not only in schools, but also in the home and in the community. Companies, too, as members of society, will devote their energies to corporate social responsibility.

Publisher & Editor: Hideaki Tanaka,
Keizai Koho Center

WASHINGTON, DC
1150 Connecticut Avenue, NW, Suite 1050
Washington D.C., 20036
(202) 293-8430

TOKYO
Otemachi Building 7th floor,
6-1 Otemachi 1-chome,
Chiyoda-ku, Tokyo 100-0004 Japan
Phone. 81-3-3201-1415
Fax. 81-3-3201-1418

www.keidanren-usa.org/kkc-usa.org
<http://www.kkc.or.jp/english/index.html>

Keizai Koho Center (KCC) is an independent, non-profit organization designed to promote the understanding of Japan's economy and society at home and abroad. Its financial resources are derived entirely from the private sector.

KCC fosters a deeper understanding of Japan's basic social structure. Furthermore, it conducts public affairs activities to improve the Japanese people's recognition of Japan's global role.

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