

Annual Review 2023

New Waves of Japanese Domestic & Foreign Policies

8 articles have been selected for the Annual Review 2023 from the six issues of the past year.

- #249 May/June 2023 Issue
- #250 July/August 2023 Issue
- #251 September/October 2023 Issue
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Editorial Committee Members

(Listed in alphabetical order by surname as of April 2024)

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<p>Nobuo Iizuka Professor of Department of Economics, Kanagawa University Having worked for the <i>Nihon Keizai Shimbun (Nikkei)</i> and the Japan Center for Economic Research for more than 20 years as a journalist and an economist, Nobuo Iizuka is one of the most credible economists and commentators on the short-term outlook for Japanese business and economy. His economic analyses are always based upon his sharp, intuitive observations of business data. He is also working as a research director at the Tokyo Foundation for Policy Research.</p>	<p>Kazumasa Oguro Professor of Department of Economics, Hosei University Having worked for the Japanese Ministry of Finance for several years, Kazumasa Oguro became deeply interested in academic research on the macroeconomy and public finance. He joined the Faculty of the Institute of Economic Research at Hitotsubashi University and later moved to Hosei University. He is one of the most active advocates of fiscal reconstruction, including a consumption tax hike to reduce the cumulative budget debt of the Japanese government. He is a first-class analyst of Japanese monetary policy in the international context as well as the global economy overall.</p>
<p>Ken Karube Journalist & Professor of Teikyo University Ken Karube was a former executive writer for Tokyo-based wire service Jiji Press, which he joined in 1979 after graduating from Waseda University. From 1992 to 1996, he was a correspondent in Washington DC and from 2004 to 2009 he was chief of the Washington and New York bureaus. Before taking the executive writer's post, he was deputy managing editor at the Tokyo head office (2010-2013). Among his books are <i>Failure of Economic Policy Management</i> (1999), <i>The Bubble Economy</i> (2015) and <i>Japanese Bureaucrats with their Abenomics</i> (2018).</p>	<p>Sanjeev Sinha SBI Securities, Executive Officer - Shikkou Yakuin, Founder & President IIT Alumni Japan Graduating from India's top university, IIT, Sanjeev first came to Japan contributing to the formation of Mobileyeye, a world leading AI company. Subsequently working with Goldman Sachs, Mizuho, UBS and as CEO of Tata Asset Management and TATA Realty and Infra PE Fund in Japan, he specializes in AI and Finance. He has been a visiting faculty at the University of Tokyo, Member of AI Committee at GoJ and an advisor to Japan Railways, various Ministries and others. He has authored 4 books from leading publishers like Nikkei and Kodansha.</p>
<p>Sota Kato Research Director of the Tokyo Foundation for Policy Research After earning a law degree from the University of Tokyo, he joined the Ministry of International Trade and Industry (MITI, now the Ministry of Economy, Trade, and Industry, or METI) in 1991. At MITI and METI, he served as assistant director for the Aircraft and Defense Industries Division, deputy director for the International Economic Division, and senior fellow at the Research Institute of Economy, Trade, and Industry (RIETI). He also served as associate professor at Yokohama National University and professor at the International University of Japan (IUJ). He has an MBA (with honors) from Harvard Business School and a PhD in political science from the University of Michigan, and is concurrently a visiting professor at IUJ.</p>	<p>Mukesh Williams Professor, Soka University & Former Faculty member, Keio University University educator, media writer and poet. He has taught modern literatures, media studies and cultural history in Japan and India. He is presently distinguished professor at Shoolini University, advisor to the South Asia Research Center, Soka University and the Global Core Committee Member Alumni Association, St. Stephen's College. He has conducted seminars on global cultures and counseled Japanese universities on academic exchange and PR strategies.</p>
<p>Long Ke Project Professor of Global Center for Asian and Regional Research, University of Shizuoka & Senior Fellow of the Tokyo Foundation for Policy Research Born in China and having studied economics at Nagoya University in Japan, Long Ke is a distinguished economist and opinion leader on the Chinese economy in the Japanese policy research community. He has long been an advocate of political reform in China as a key to achieving economic reform in the country.</p>	<p>Nariyasu Yamasawa Professor of the Faculty of Management at Atomi University Nariyasu Yamasawa is a professor of the Faculty of Management at Atomi University. He worked for the Nihon Keizai Shimbun (Nikkei), the Japan Center for Economic Research, and is former director of the Statistics Commission Office, Ministry of Internal Affairs and Communications.</p>
<p>Keiichiro Kobayashi Professor of Department of Economics, Keio University Keiichiro Kobayashi has experience in the economic policy-making process as a former government official at the Ministry of Economy, Trade and Industry. His interest in economic research led him to join RIETI and pursue an academic career. He has been an active commentator on economic policy issues, in particular fiscal and monetary policies, such as how to eliminate non-performing loans after the bubble economy in Japan. His current interest covers areas such as innovation and income inequality.</p>	<p>Jillian Yorke Interpreter & Translator Co-author of several books, Jillian Yorke worked for the Public Relations Office, Minister's Secretariat of the Ministry of Economy, Trade and Industry in Tokyo as an English editor and checker for more than a decade. She now lives in New Zealand, where she is curator of the Japan Library: Pukapuka, as well as a freelance writer, translator, and interpreter, and often visits Japan.</p>

Introduction – New Waves of Japanese Domestic & Foreign Policies

We highlighted in FY 2023 the challenges for Japan's domestic economy and external relations, and possible solutions for them. Our survey has convinced us that Japan is a nation facing many challenges. If appropriate solutions can be found, Japan would have great potential as a leading country, and each solution could be a valuable contribution to global peace and prosperity.

Early in 2024, we see signs that the Japanese economy is getting out of deflation. Stock prices have soared and both price and wage increases will most likely follow. A wage-price virtuous cycle could soon be achieved. Japan's traditional economic system of lifetime employment and seniority-based salaries and promotion, which allegedly brought about the country's historically high economic growth era, has lost its dominance, though it still broadly exists. Many Japanese are now ready to change this old system. Structural reform on a national basis as well as a corporate basis is underway. Young people are now very keen on starting up their own businesses.

Looking abroad, geopolitical risks are rising. The continuing war in Ukraine and the Hamas-Israel conflict present numerous concerns, especially in the field of human rights. How to end these wars and build a new world order for peace and prosperity is a global challenge. And in the midst of the US-China confrontation, how Japan can contribute to the mitigation of such geopolitical risks is a critical issue for its foreign policy.

Against this backdrop, we selected the following articles published in FY 2023 as particularly deserving of being read and examined again.

I Issues on Japan's Domestic Economic Reform

1 Mr. Kuroda's unprecedented monetary easing – opening an exit from long-time deflation

■Exclusive Interview-Leaders in Japan No. 1 with Mr. Haruhiko Kuroda, Former Governor of the BOJ & Professor at the National Graduate Institute for Policy Studies
“Background of Japan's Unprecedented Monetary Easing & the Direction of Monetary Policy Hereafter”

By Sota Kato

(*Japan SPOTLIGHT* March/April 2024 Issue)

2) Human capital investment & raising labor mobility in Japan – key to raising Japanese industrial competitiveness

■Roundtable with Yuri Okina, Kazuhiko Toyama, Prof. Kotaro Tsuru & Masakazu Toyoda
“Labor Mobility & Human Capital Investment”

By *Japan SPOTLIGHT*

(Cover Story 1: *Japan SPOTLIGHT* May/June 2023 Issue)

3) Tourism as sources of Japanese growth potential

■Roundtable with Tomoko Okuda, David Atkinson, Mitsuki Hoshino & Masakazu Toyoda
“Opportunities & Challenges for Japan as a Tourism Powerhouse”

By *Japan SPOTLIGHT*

(Cover Story 1: *Japan SPOTLIGHT* July/August 2023 Issue)

4) How to stop depopulation in Japan – to maintain the presence of a leading nation

■“What Must Be Done to Maintain a Population of 100 Million in Japan?”

By the Working Group for Japan’s Population Challenges

(Cover Story 1: *Japan SPOTLIGHT* January/February 2024 Issue)

II Issues of Japanese Security & Foreign Policy

5) Japan’s national security faced with new challenges in the East Asia

■“Japan’s Foreign Diplomacy & Security Strategy, & Its External Economic Strategy in Relation to the Taiwan Crisis”

By Satoshi Morimoto (Special Article 1: *Japan SPOTLIGHT* September/October 2023 Issue)

6) Keeping friends with Asia

To complement the declining leadership of the United States, Japan needs to pursue its own foreign policy to secure its national security. Strengthening alliances with Southeast Asia and India must be a part of such a strategy.

■Roundtable with Prof. Naoyuki Yoshino, Prof. Mariko Watanabe, Prof. Shujiro Urata & Masakazu Toyoda

“Key Strategies for Raising Sustainability of Asian Economic Growth in the Age of a Disrupted World Economy”

By *Japan SPOTLIGHT* (Cover Story 1: *Japan SPOTLIGHT* November/December 2023 Issue)

■Roundtable with Amitabh Kant, Prof. Shujiro Urata, Prof. Yukiko Fukagawa & Masakazu Toyoda (Jan. 18, 2024)

“India – the Future of a Powerful Country”

By *Japan SPOTLIGHT* (Cover Story 1: *Japan SPOTLIGHT* March/April 2024 Issue)

■Interview with His Excellency Sibi George, Ambassador of India to Japan

“India-Japan: a 1,000-Year Relationship that Is Skyrocketing”

By *Japan SPOTLIGHT* with Mohan Gopal

(Cover Story 2: *Japan SPOTLIGHT* March/April 2024 Issue)

Naoyuki Haraoka is editor-in-chief of <i>Japan SPOTLIGHT</i> & executive managing director of the Japan Economic Foundation (JEF).
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Exclusive Interview

LEADERS IN JAPAN

No. 1

Former Governor of the BOJ
Professor, National Graduate Institute for Policy Studies

Haruhiko Kuroda



Background of Japan's Unprecedented Monetary Easing & the Direction of Monetary Policy Hereafter

By Sota Kato

Japan SPOTLIGHT starts from this issue a series of interviews with Japanese leaders attracting attention with their views on various issues. Our first interviewee for the March/April 2024 issue is Mr. Haruhiko Kuroda, former governor of the Bank of Japan (BOJ) and currently professor of the National Graduate Institute for Policy Studies, who has drawn attention worldwide for his monetary policy during his tenure (2013-2023). The interviewer is Dr. Sota Kato, principal researcher of the Tokyo Foundation for Policy Research and a member of *Japan SPOTLIGHT's* Editorial Committee. He inquires mainly about the background of the BOJ's unprecedented monetary easing and its possible future monetary policy. The big question is whether this monetary easing will continue hereafter.

(Interviewed on Dec. 20, 2023)

Lessons from “Magnificent Experiment”

Kato: The unprecedented monetary easing you adopted as governor of the BOJ was considered a “magnificent experiment” and attracted a great deal of attention around the world. I think it was a truly pioneering policy. Could you tell us what lessons you think there are from it for the rest of the world?

Kuroda: In the case of Japan, we had been in deflation for 15 years, from 1998 to 2012. The average CPI rate of increase during this deflationary period was a negative 0.3%, a mild degree of deflation. However, there were only four or five years during this period with a positive CPI rate of increase, and in all the other years it was negative. Such a period of deflation had never been experienced by other developed nations. During this period, the rate of wage increases had been on average a negative 0.9%, meaning roughly a 1% decline on average per year. Of these 15 years, there were more than 10 that marked a negative rate of increases in wages. It was extremely abnormal for such a situation to continue.

During this period, Japanese companies did not lay off permanent employees, but instead dismissed non-permanent ones. Thus, though the official unemployment rate during these 15 years had

been around 5%, in reality it was worse than that. Furthermore, the cost to companies of keeping their permanent employees was so high that they would not recruit new employees during that period, and it became known as the employment “ice age” – a hard time for job seekers.

At the BOJ we started quantitative and qualitative monetary easing in 2013 to get out of this 15-year period of extraordinary deflation and a worsening employment situation. The United States and European countries as well might not have had any other choice but to adopt such a monetary easing policy if they had found themselves in a similar situation. So I think there is no particular lesson for other nations, as this monetary easing was precisely a response to Japan's unique economic situation. We needed unprecedented monetary easing to cope with unprecedented deflation, and I think all the major policy authorities, central banks governors in the US and Europe, and distinguished economists such as Joseph Stiglitz, Paul Krugman and Larry Summers with whom I have talked, understand this very well.

Background of Unprecedented Deflation in Japan

Kato: Why do you think such extraordinary deflation occurred?

Kuroda: First of all, since 1990 we had been working hard for 10 years to deal with non-performing loans accumulated in our financial institutions due to the bursting of the bubble economy. Thanks to these efforts, in the 2000s Japanese financial institutions recovered their capital mobility, but due to their experience during the collapse of the economic bubble, they have been pursuing extremely modest business strategies and refraining from investing in or financing projects with any risks.

Companies in Japan then were not willing to invest in facilities after restructuring their business activities, and financial institutions had become extremely reluctant to take any risks with their finances. Also, the BOJ's monetary easing policy then was not sufficient, although a number of anti-deflationary measures were taken by each governor: a zero-interest policy and quantitative monetary easing were implemented by Governor Masaru Hayami (1998-2003) and an enormous expansion of quantitative easing was carried out by Governor Toshihiko Fukui (2003-2008), which contributed greatly to raising prices. Then with massive intervention in yen-selling and dollar-buying, which became a sort of non-sterilization policy, extraordinary yen appreciation was stopped and the yen rate stabilized. Then, there was a slight rise in price increases. Under Governor Masaaki Shirakawa (2008-2013), a variety of comprehensive monetary easing measures were adopted to respond to external shocks, such as the 2008 financial crisis and the Great East Japan Earthquake of 2011.

I think those governors implemented many anti-deflationary policies and they were necessary and appropriate, but not sufficient. We were then in a situation where corporate risk aversion continued and prices dropped, and wages also declined due to insufficient monetary easing by the BOJ during these 15 years.

I think there were three factors that caused the bubble economy in the second half of the 1980s. One was the tremendous increase in public construction projects following the recession of the early 1980s, which stimulated investment in local tourism industries as well. In Tokyo, investment in real estate had increased, with the Japanese government's enhanced incentive to make Tokyo into a global financial center. With these projects, real estate prices started to increase in the first half of the 1980s and stock prices started to rise in the second half. With such a solid background for inflation, since the beginning of the 1980s the Japan-US Yen Dollar Committee had been implementing financial deregulation. Banking transactions were liberalized and the short-term fund market was expanded under this initiative.

Furthermore, the extraordinary yen appreciation initiated by the Plaza Agreement had not been stopped in the late 1980s. The G7 tried to stop it with the Louvre Accord, but failed. Meanwhile, Japanese monetary and fiscal policies continued to be expansionary to cope with this yen appreciation. Japan's macroeconomic performance was at its best and realized 5% growth on average in the second half of the 1980s for five years with the inflation rate curbed at only 2.3% or 2.4 % per annum even at the end of the 1980s due to the strong yen. Business companies as well as financial institutions made large-scale investments and stock prices soared, with the Nikkei average having reached around 39,000 in 1989.

Against this background, the BOJ governor at the time, Yasushi Mieno, oversaw the collapse of the bubble economy, regretting that a loose monetary policy had caused it. With the burst of the bubble, share prices fell drastically, though real estate prices did not fall so easily. Since then, the BOJ remained concerned about loose monetary policy possibly triggering another bubble. As a result, through the 1990s monetary policy had been delayed in acting to stop deflation, whereas fiscal policy tended to work more actively. Then in 1998, with the new BOJ law, the bank became completely independent from the government, and since then this reluctance to take an active loose monetary policy has remained robustly in the BOJ policy mindset.

But under such changed economic and monetary situations, without a drastic loose monetary policy we cannot improve the shrinking economy. The three BOJ governors implemented appropriate policies, but they were insufficient, and this caused a vicious cycle of simultaneous declines in wages and prices and the worst employment situation in the postwar period.

To get out of this, I pursued quantitative easing that had been previously done and a zero interest policy, and also comprehensive monetary easing through bond purchases and expanding this policy by massive purchases of long-term government bonds. With such quantitative and qualitative monetary easing, we doubled the monetary base in two years and together with lowered interest rates as a whole we tried to activate the economy. Our policies were inevitable in responding to the unprecedented deflationary state. It was not me but Governor Shirakawa who decided to adopt a 2% inflation rate as a goal for price stability in January 2013. It was also integrated into the BOJ-Japanese government joint statement and thus they decided to conduct monetary easing to realize 2% inflation at the earliest time.

I was inaugurated as governor of the BOJ in March 2013. In the

first monetary policy decision meeting in April, we adopted quantitative and qualitative monetary easing. Prior to this decision, we received many views on monetary policy from a variety of experts, including members of the BOJ Policy Board and BOJ staff. There was a view that with the emerging two-year time lag in the effects of monetary policy, even an ultra-loose monetary policy would not bring us closer to the 2% goal any quicker. We discussed how much we should implement these policies by examining simulation outcomes based on various macroeconomic models.

There were two members of the Policy Board opposed to the 2% price goal at the January meeting, but in April we reached a unanimous consensus on this quantitative and qualitative monetary easing. This policy's scale was larger than the previous one and the quality was also different, but it basically remained a BOJ commitment to get the country out of 15 years of continuous deflation and realize 2% inflation as soon as possible.

Assessment of Global Economy & Japanese Economy

Kato: Next we move to current economic situations. At this moment, I think the global economy has changed from a deflationary state to an inflationary one, at least in the short run, and on the whole it is supposed to be moving in that direction a little more continuously. What is your view on this and also what is your outlook?

Kuroda: I have talked with many US and European economists and ex-governors of central banks, and their predominant view is that the age of loose monetary policy is over in general.

With the start of the Ukraine war in 2022, wheat and energy prices soared and that turned the deflationary state into an inflationary one at once, against the background of prices rising after the worst of the Covid-19 pandemic was over. Then developed nations all started tightening their monetary policies by raising interest rates in 2022. So, the perception that the phase of loose monetary policy over the past 10 years has ended now is commonly shared in the US and Europe. Meanwhile, high inflation rates are not likely to continue. So the majority's view in the US and Europe is that with the current monetary tightening, inflation rates in the US and Europe will be lowered and stabilized at around 2% in 2024 or 2025.

However, the situation in Japan is somewhat different. In Japan,

with the quantitative and qualitative monetary easing adopted in 2013, inflation reached around 2% but then dropped thereafter. This could be partly due to a last-minute surge in demand before the increase in the consumption tax and a reactionary decline after the increase, but more largely due to the fact that wages were raised only a little against price increases, resulting in a real wage decline. With declining wages and the inflation rate decreasing again, we could not help but expand quantitative and qualitative monetary easing.

One important development in monetary policy was the introduction of a negative interest rate in January 2016. The background of this policy was the continuing large decline in oil prices from around \$100 per barrel in 2014 to \$50 and eventually \$30 in January 2016, which had a significant deflationary impact on our economy. In addition, with the depreciation of the Chinese yuan, China started to export deflation to its trading partners.

Given these economic developments, we decided to further lower the overall interest rate in addition to expanding quantitative easing and we introduced a negative interest rate in January 2016, and in September adopted the so-called yield curve control with a negative 0.1% policy interest rate and 0% in 10-year government bond yields, and thus managed to realize this yield curve with a gradual slope.

During the pandemic, with the big fall in private consumption, prices dropped, but afterwards inflation started to return as the economy recovered from the pandemic's negative impact, and then with the outbreak the Ukraine war, wheat and energy prices started rising. Together with the yen's depreciation, in 2022 Japanese import prices increased by more than 40% from the previous year. This was naturally reflected in the CPI's rate of increase, which having once reached around 4% per annum is now around 3%. Unlike in the US and Europe, in Japan most imports prices rise are reflected in the CPI. The rate of increase in import prices is now negative and oil prices are not expected to rise under the current circumstances, and thus the CPI's rate of increase will be gradually stabilized.

In their Spring Labor Offensive in 2023 the unions decided to demand a 3.6% wage increase, the highest for 30 years. But the realized wage hike was around 2.5% and this means that real wages are still declining, given the 3% rise in the CPI. However, this trend seems likely to stop, as the unions will probably call for a 4-5% wage rate increase in 2024 and so the real wage rate increase would be around 3%. Assuming labor productivity increases around 1% per annum, we would need a 3% wage rate increase in order to achieve a 2% price rate increase in a sustainable and stable manner, and now we can see that possibility. If inflation is stabilized at 2%, we would

not have to continue with monetary easing any further. We could start normalizing finances and raise the policy interest rate gradually towards neutral, and with this, the interest rate on government bonds will start rising.

In the US and Europe in general, and also in Asia, monetary policy is now returning to normal and the majority view is that the loose monetary policy of the past 10 years or more will not be conducted in the coming years. However, in Japan the situation is different due to the bursting of the bubble economy and the long period of deflation since 1990. Whether our economy has completely escaped from this extraordinary situation will depend upon the Spring Labor Offensive in 2024.

Social Norms in Prices & Wages in Japan

Kato: In your press conference on the occasion of your leaving the BOJ in April 2023, you mentioned the robust and insistent norms in Japanese society in prices and wages as the reason for your having failed to achieve the 2% inflation target in a stable manner. You bravely tried a variety of policies to achieve this goal, but the triggers for the recent price increase were external shocks to the economy such as the pandemic and the Ukraine war. Do you think the policies you conducted will not be able to change these norms?

Kuroda: Yes, certainly the social norms in Japan that prices and wages would not increase cannot be easily changed. From 2013 until 2019 just before the pandemic, inflation had been around 1% and wage increases had been even lower than that. On the employment side, 40 million jobs were created and the unemployment rate was 2.5%. With such significant improvement in the employment situation, a price increase to a certain extent was achieved but it failed to reach 2%. It is true that this situation has been changed by those two shocks – the pandemic and the Ukraine war.

But we managed to prevent the Japanese economy from falling into stagflation in spite of the continuing pandemic and the Ukraine crisis, with corporate profits doubling and 4 million new jobs created, both achieved by a continued monetary easing policy. Without this improvement in the economic situation, the yen's depreciation due to price increases for wheat and energy from the Ukraine war would have provoked inflation and a significant negative growth rate at the

same time.

These norms that developed during the 15 years of deflation are not easily broken. However, it is not right to say that we should have set our inflation rate target at 1% instead of 2% under such insistent norms.

Kato: I think norms is a kind of Nash equilibrium in the academic sense, a situation where the mindset and behavior of all are in accord. In deflationary Japan, might this norm be a rational one simply reflecting the socio-economic situation? Individuals and companies alike are anxious about the future and falling into negative thinking about such issues as depopulation and feeling that nothing positive will happen to the Japanese economy, and that therefore it would be better to save as much money as possible rather than investing or consuming. Do you think such a view on contemporary society has a certain logic and rationale in accordance with the current economic situation in Japan?

Kuroda: No, that does not make sense at all. The population is also decreasing in South Korea and Taiwan. In Europe as well, apart from nations like Germany where immigrants now make up 25% of the total population, in many countries the population is decreasing, but they are not suffering from deflation. It is wrong to think that depopulation will lead to deflation. Depopulation would certainly reduce consumption but also supply capacity as well. With a decrease in both demand and supply, we cannot tell whether an economy would be inflationary or deflationary.

By coincidence, the Japanese working-age population started to decrease in 1995 and the total population started to decrease as well around 2001. This was noted against the background of 15 years of deflation. But after the introduction of quantitative and qualitative monetary easing, 4 million jobs were created. It is certainly true that population growth would significantly affect overall growth potential. For example, the US economic growth potential is 1.5 or 2 and the Japanese one is 0.5 or 1, and the difference between the two is 1%, corresponding to the difference in both nations' population growth, namely the US one is 0.5% and the Japanese one is a negative 0.5%. On the difference in growth potential between Germany and Japan, German growth potential is 1-1.5 with a 0.5 difference from the Japanese one, corresponding to the difference in population growth

between the two nations – that is, Germany is zero and Japan is a negative 0.5%. So it is true that population dynamics would affect the mid- or long-term growth potential significantly, but population growth is not the sole factor determining growth potential. Labor productivity growth is another factor. With labor productivity growth having been little different between the US and Japan during these 10-15 years, the difference in their growth potential can be mostly explained by the difference in population growth.

Kato: With a firmly established norm of not encouraging wage or price rises or investing, a person or a company diverging from it would be a loser.

Kuroda: Yes, financial institutions also may have found it better not to take risks. Business corporations with bad memories of the bursting of the bubble hesitated to make new investments. They only lower the prices of their products, not raise them, and employees found it crucial to secure jobs rather than gain higher wages, and thus they were getting into a vicious cycle with a nearly 1% annual decline in wages, mainly in bonus payments.

Kato: I think the government and the BOJ should intervene to move the economy from a bad norm to a good one. I have the impression that the BOJ was actively working on this in the monetary policy area under your leadership. However, the other two key policies needed to change a bad norm, namely fiscal policy and structural economic reform policy, do not seem to have caught up with the BOJ's efforts. Is it necessary to have collaboration between the BOJ and other public policy authorities to save the economy from a bad norm?

Kuroda: I do not think so. Under Abenomics, as you know, a wide range of policy measures have been made, such as encouraging women's social activities, expanding support for raising children, and expanding preferential tax treatment for GX or DX. Such policies worked well, and the majority of the 4 million newly created jobs were for women.

On the issue of raising wages, it was the ruling Liberal Democratic Party, not the opposition parties, that was working with the Japanese Trade Union Confederation in trying to do this. The administration of

Prime Minister Shinzo Abe on the whole worked hard on structural reform and fiscal support, as well as trying to save the Japanese economy from the continuing deflation, which resulted in a significant improvement in the employment situation and a certain degree of investment recovery. But our efforts were not successful in achieving a virtuous cycle of wages and prices. Prices increased to a certain extent but did not lead to wage hikes. The mindset behind this vicious cycle was not easily broken.

Kato: In Europe, there is a tradition of neo-corporatism, collaboration in policy making between labor unions, business, and government. Did such a collaborative mechanism exist in the Abe administration as well?

Kuroda: Yes. The Federation of Economic Organizations was also working with us. But even with collaboration among the three, we could not induce both labor unions and corporations to come back to a wage-price virtuous cycle after their 15-year experience of annual 0.9% wage declines and price falls, albeit little and gradual. At this moment, with a more than 40% import price rise due to the Ukraine war leading to a 4% CPI increase, the wage increase demand in the Spring Labor Offensive would reach 3.6% in 2024, and we should be able to break the last barrier to a virtuous cycle. In 2024, if we achieve a wage hike higher than the inflation rate, I expect that the bad norm will be completely broken and we will be able to realize the 2% inflation rate target in a stable, sustainable and continuous manner.

The Cause of the Yen's Depreciation

Kato: On the yen's current depreciation, there must be many factors behind it, such as the interest rate differential between Japan and some other countries, or the Japanese economy's growth potential. What do you think about these factors?

Kuroda: When I was governor of the BOJ for those 10 years, the exchange rate was miraculously stable within a range of 10 yen at about 110 yen to the dollar for nine of those years. Even after 15 years of deflation, the yen rate was more or less maintained. When the Ukraine crisis started on Feb. 24, 2022, the rate was 115 yen to the dollar. So it would be completely wrong to say that the yen is getting weak because the Japanese economy is losing its

international competitiveness. The exchange rate cannot be explained by such an argument. Of course, the mid- or long-term exchange rate is fixed by a nation's economic fundamentals. But the yen's depreciation that started in February 2022 cannot be appropriately explained by such fundamentals.

On the other hand, looking at Japan's current balance, often noted as a good indicator of foreign exchange demand and supply, its surplus has been expanding even with the trade balance in deficit. In spite of that, the yen has not appreciated because with the tremendous increase in external assets, the surplus in the primary income balance is largely increasing, even though there is deficit in the trade balance in goods and services.

Returns on FDI or indirect investment overseas are counted in the income balance, but it is another story whether such overseas earnings will come back to the mother nation. Even with a large current surplus, much of it will not necessarily come back to the foreign exchange market. Looking at the capital balance, there are FDI and indirect investments, and the largest fluctuations in capital movement are observed in the short term for indirect investments. So the expanding interest rate gap has been increasingly affecting these short-term investments. There was a narrative that although in 2022 in response to 8% inflation in the US and 11% in Europe, they all at once raised their policy interest rates widely, Japan did not change its yield curve control and then with the interest rate differential between Japan and those nations expanding, the yen's depreciation was triggered. I do not believe it, because it depends on exactly what interest rate differential is being referred to in this narrative – the short-term differential or the long-term one, or a covered interest rate parity or an uncovered one? It also depends on the exchange rate to only the dollar or to other currencies like the euro or Chinese yuan.

I would not predict any future exchange rate value. It is true that the Japanese economy is now performing extremely well. We will see economic growth in the 1% range continuously in 2022, 2023 and 2024, meaning continuous growth higher than Japan's growth potential of 0.5-1.0%. Japanese corporate business profits reached their highest in history, having exceeded those during the bubble economy. The labor market is tight and there is even a shortage of labor. In this light, the current yen rate is too depreciated and at some point it will return to the level of around 110 yen to the dollar. We cannot say when and how this will happen, since it will depend upon market situations.

I think it is easy to predict interest rates, as it is basically to predict



(From left to right): Interviewer Sota Kato, JEF Editor-in-Chief Naoyuki Haraoka, and former BOJ Governor Haruhiko Kuroda

the central bank's monetary policy. The central bank seems to control policy interest rates only in general, but it does so by assuming any rate change's impact on mid- and long-term interest rates. Thus we can have a correct prediction for either short-term or long-term interest rates by predicting what the central bank would do.

Share price predictions may appear more difficult, but this is basically equal to predicting corporate profits, and it would be easy to predict them either this year or next year. But you would not be able to correctly predict foreign exchange values, as it would need to be done by taking account of expectations or speculation. Also, government intervention in foreign exchange markets would need to be counted as a final factor that we cannot predict at all. So I think it better not to make any foreign exchange rate prediction.

Kato: Although we are not quite sure about achieving a stable 2% inflation rate, we can see a little hope for it at this moment.

Kuroda: Yes, it is true. What makes Japan different from the US and European countries is that they are now engaged in tightening monetary policy by making rapid and significant interest rate hikes to deal with inflation. Japan is not in such an inflationary state and is pursuing its 2% inflation goal in a stable manner. We need to raise the policy interest rate slowly to achieve it. The household sector in Japan has around 2,000 trillion yen in financial assets and it would benefit from the possible rise in saving deposit rates. Business

corporations owning great amounts of cash and deposits will not suffer much from a little interest rate rise. The government itself will be most affected by interest rate rises in Japan. With a gradual rise in the policy interest rate, the interest rate on national bonds would rise, and the government's refinancing bonds or newly issued bonds would be affected by such a rise. Assuming the average interest rate of all government bonds including short-term and long-term ones was a little less than 2% around 2000, government bond interest payments would amount to 30 trillion yen, which would create a much bigger government expenditure increase than the 5 trillion yen increase in defense expenditure or the 3.6 trillion yen increase in government support for child-raising.

Possibility of the BOJ Falling into Excessive Debt

Kato: As the interest rate continues to be raised, it has been pointed out that the BOJ could be in excessive debt due to increased interest payments on reserve deposits. By holding such big “unrealized losses” in government bonds not explicitly present in accounting, could the BOJ achieve its mission by maintaining market confidence?

Kuroda: The BOJ, the Federal Reserve Board and the European Central Bank do not have market evaluations and so there would be few occasions where they fall into excessive debt. But they could have deficits. At this moment, the FRB and ECB have deficits and they do not make payments to the treasury. The Australian Central Bank is now in excessive debt and in its case, all of its assets are subject to market evaluation and with the interest rate raised, government bonds would record a capital loss.

Although the BOJ, FRB and ECB do not have market evaluations for government bonds, with the rises in policy rates their interest payments on reserve deposits would increase. On the other hand, the interest rate on government bonds will increase by the same degree. Therefore, the difference in speed between reinvestment in government bonds with higher interest rates and interest payments on reserve deposits would determine whether the BOJ is in deficit.

If the interest rate on government bonds rises before the policy interest rate, the BOJ replaces the government bonds on due dates with ones with higher interest rates, so they would not be in deficit. But if the policy interest rate is raised prior to the rate on government

bonds, as the due dates of government bonds come around only slowly and if the speed of replacing them with new bonds with higher interest rates is slow, then there would be a deficit and the BOJ could not make payments to the national treasury. In the case of the FRB and ECB as well, they raised policy interest rates rapidly and their interest payments increased likewise. But if there was not enough time for them to quickly reinvest in new government bonds with higher interest rates, then they would have a deficit. In Japan, we have an allowance for credit losses reserved annually with half of the difference between interest payments on reserve deposits and operational income from government bonds. So even with a loss margin or deficit, we can use this allowance and the payments to the national treasury would not be easily erased, and even if this becomes zero, it would only be temporary.

Kato: According to the latest BIS report on excessive debt in central banks, they would not need to be so anxious about it. Rather too much concern about it on the part of central banks could provoke a loss of confidence in them, which would make the situation worst.

Kuroda: Yes. The Australian Central Bank is now in a deficit but it is maintaining a presence of mind and behaving firmly.

Relationship Between Government & BOJ

Kato: The Japanese government and the BOJ have occasionally been in conflict, but I have the impression that you managed this relationship very well. Did you pay particular attention to preventing conflicts with the government?

Kuroda: During my 10 years in office, I visited the Prime Minister's Office about twice a year and talked with the three premiers – Mr. Abe, Mr. Suga and Mr. Kishida. On those occasions, I gave detailed explanations of the BOJ's monetary policy. In particular, I often met informally with Mr. Taro Aso, deputy prime minister and finance minister, at various venues. I have never had any order or complaint regarding our monetary policy from them. Under the current BOJ law, the government does not have a way to apply pressure to the BOJ. Under the old Act, the minister of finance could give orders to the BOJ about policies, and he or she could dismiss the governor.

But the new Act eliminated such articles. Now, the BOJ is independent from the government in its monetary policy decision-making, as is the ECB or the Bank of England.

Also, in the old Act, the Policy Board of the BOJ could decide the official discount rate and open market operations, but on reserve ratio manipulation, government permission was needed. But now this permission system has been abolished. Of course, it is the Cabinet that appoints the governor, deputy governor and all the other Policy Board members with the Diet's agreement. During their five-year terms of office, the government cannot pressure any of those members to follow its own intentions, and thus it cannot force the BOJ to buy more government bonds. The BOJ has been easing monetary policy and purchasing lots of government bonds hitherto. This is to bring the Japanese economy out of deflation and not to help the government.

Kato: The BOJ's sharing of its 2% inflation target as a policy goal with the government seems to be one of the reasons for stable relations between the two. However, after this goal is achieved and the BOJ starts to exit from a loose monetary policy, might there be some conflict with the government, in particular on the question of public finances?

Kuroda: Yes. As you said, there is unlikely to be conflict in a situation where both the government and the BOJ must continue efforts to achieve their shared policy goal of a 2% inflation rate. I do not know yet whether any conflict between the two would arise over the question of increasing the government's burden with government bonds after this goal is realized and monetary policy becomes more normalized. Whatever happens, the BOJ would not need to get any instructions from the government and should not do so. I do not think the BOJ would purchase government bonds to expand its balance sheet and provoke serious inflation when prices and interest rates are normalized. As I said, the government has no means to pressure the BOJ and so I am not worried about the BOJ's policy. The concern is over the growing debt in public finances due to increasing interest payments after the rise in the interest rate. The government and the Diet must think about this question in depth.

Kato: If our inflation rate exceeds 2% and gets higher, people may expect the BOJ to have anti-inflationary countermeasures, contrary to the current situation. In

that case, the BOJ could be strongly criticized for its long-standing monetary easing policy. At such times, could the BOJ maintain what it believes to be a relevant policy without being influenced by outside views?

Kuroda: It should do so since it is written in the law. In sum, in monetary policy management, the BOJ's most important goal is to achieve healthy economic development through price stability. It should not do anything against this goal. The old BOJ Act did not have such a description of its mission, but this is clearly written in the new one. Its first primary goal is to achieve price stability and the second one is to achieve stability of the payment system. The BOJ is not responsible for achieving stability of the financial system. It is the Financial Services Agency that is responsible for that. The BOJ has had special finances for the banks exposed to crises that were a part of this payment system in order to stabilize it.

However, we have been trying to refrain from speaking about the whole financial system, as we are not responsible for stabilizing it. The FSA's representative and the BOJ's representative are members of Basel Committee on Banking Supervision. In the Basel Agreement, a nation's own government bonds should be risk-free and without risk weight. But after Greece went bankrupt with lots of risk weight, they discussed having a risk weight for each nation's own government bonds. This was not eventually realized, but anyway it is not an issue within the BOJ's jurisdiction. It would be meaningless for the BOJ, with no legal authority in financial regulations, to intervene in this issue. The BOJ must follow the rules of the BOJ Act and do what is defined in this Act.

Kato: Thank you so much for your valuable comments.

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Interviewer: Sota Kato is a research director of the Tokyo Foundation for Policy Research. After earning a law degree from the University of Tokyo, he joined the Ministry of International Trade and Industry (MITI, now the Ministry of Economy, Trade, and Industry, or METI) in 1991. At MITI and METI, he served as assistant director for the Aircraft and Defense Industries Division, deputy director for the International Economic Division, and senior fellow at the Research Institute of Economy, Trade, and Industry (RIETI). He also served as associate professor at Yokohama National University and professor at the International University of Japan (IUJ). He has an MBA (with honors) from Harvard Business School and a PhD in political science from the University of Michigan, and is concurrently a visiting professor at IUJ.

Roundtable with Yuri Okina, Kazuhiko Toyama, Prof. Kotaro Tsuru & Masakazu Toyoda

R oundtable on Labor Mobility & Human Capital Investment

By Japan SPOTLIGHT

Participants: Yuri Okina, Chairperson, Japan Research Institute
 Kazuhiko Toyama, Chairman of IGPI Group, Industrial Growth Platform, Inc.
 Kotaro Tsuru, Professor, Graduate School of Business & Commerce, Keio University
 Moderated by Masakazu Toyoda, Chairman & CEO, Japan Economic Foundation (JEF)
 (Online Roundtable on Feb. 20, 2023)

Participants



Yuri Okina



Kazuhiko Toyama



Prof. Kotaro Tsuru



Masakazu Toyoda

Stagnant Economy & Employment System in Japan

Toyoda: The Japanese economy has been stagnant for a very long time – referred to as “the three lost decades”. There has been increasingly strong criticism that this has prevented wages from rising. For example, in the early 1990s the GDP per capita of Japan was one of the highest in the world, but by 2021 it had fallen to 27th in the world and closer to the lowest among the G7 nations. It was not clear whether it was a macroeconomic or microeconomic issue. One certain thing is that the wide range of policies adopted since the beginning of the administration of late Prime Minister Shinzo Abe have not necessarily been successful.

Recently, I think there has emerged an increasingly prevailing view that one important factor behind this stagnant Japanese economy could be the limited capacity of the Japanese development model, as characterized by lifetime employment and its seniority wage and promotion system, which was dominant in the high-growth era, to adjust to the current low-growth economy. There seem to be stronger calls for labor market mobility as a key to achieving better

economic performance. Moreover, it is now being emphasized that human capital investment should not to be considered a cost but a future profit-earning activity.

Today, we have three distinguished experts to discuss these two issues of labor market mobility and human capital investment, namely Ms. Yuri Okina, chairperson of the Japan Research Institute and an expert on macroeconomic systems, Mr. Kotaro Tsuru, professor of Keio University and expert on employment systems, and Mr. Kazuhiko Toyama, chairman of Industrial Growth Platform Inc. and expert on business and local economy restoration.

First of all, I would like to start discussions with the argument that the post-World War II Japanese economic development model with its lifetime employment and seniority system has reached its limits. Many companies in Japan today are changing their general employment system, in which new recruits become long-term members of the organization, into job-specific employment, which evaluates workers based on their skills and competence to replace inefficient ones. Prof. Tsuru, will this become the new Japanese economic development model? There may be concerns that it could end up in increasing inequalities.

Tsuru: The importance of labor market mobility has been unchanged since we took the first step in employment system reform in discussions on regulatory reform under the Abe administration. Thinking about the impact of the labor force on economic growth, the continuing decline in the population will naturally mean a shrinking of the quantitative contribution of the labor force to growth. In this light, it is said that we will need to raise its qualitative contribution and for this purpose human capital management has been considered crucial. We will also need to expand an individual worker's capacity and skills in tandem with this.

We must not forget about another possible positive impact of labor mobility, that is, labor productivity being enhanced by relocations and resources being transferred to high labor productivity sectors. With closer matching between workers and their job type through improved labor mobility, both labor productivity and economic growth would be encouraged.

Many economists say that raising labor mobility would always lead to better economic performance and Japanese dismissal regulations could prevent labor mobility. But there seem to be fewer who talk about solutions specifically. I believe we should address this sensitive issue carefully.

On the effect of labor relocation on economic growth, among many different analyses, looking at data on economic growth by industrial sector or firm, we see rather less impact on economic growth since the 2000s. In international comparisons as well, its impact in Japan is today less than in the United States. In addition, looking at an individual company's labor mobility by turnover or mid-career recruitment, raising labor mobility a little more is expected to enhance a company's business performance but raising it too much could be detrimental to the company's performance, according to my econometric analysis.

I think what we need to do to improve our labor market situation is to change the general employment system that developed in the postwar era into a job-specific employment system. In my definition, job-specific employment is one which sets no limits on working duties, venues or hours. Japanese permanent workers are working under the general employment system without limits on any of these three conditions. Such a traditional employment system in Japan has resulted in high and stable economic growth, but with this condition starting to collapse, it cannot be maintained. The Japanese general employment system has worked very well with progressive innovation to improve quality. But when more disruptive innovation is needed, could the majority of a homogenous workforce under this system initiate such innovation?

I also believe that the Japanese seniority-based salary and general employment systems are closely connected, and that this prevents labor mobility, since a salary would likely decrease with a change in job-specific employment. So I think what is most important for raising labor mobility is to adopt job-specific employment instead of general employment.

On income inequality, I think there are two main reasons for this. One is that with too robust Japanese general employment, Japanese

companies have firmly protected the job specifics of middle-aged and elderly workers but have failed to raise their wages. The other is that they have been trying to employ non-permanent workers as much as possible instead of permanent ones to save on personnel costs. This has resulted in the income gap between permanent and non-permanent workers. So I think income inequality in Japan has been caused by Japanese general employment as well. The next question is how to reform general employment into job-specific employment.

Toyoda: A question for Ms. Okina. Innovation and increased productivity are needed in the Japanese economy. To achieve this, labor mobility is allegedly needed. But in reality, there are very few people in Japan changing their jobs, though many workers are not happy with their current job. There must be many people in Japan concerned about a possible decline in their wages in a more mobilized labor market. One of the reasons for such concern is the wage gap between permanent and non-permanent workers. Do you think this should be corrected? Saying that the same wages should be applied to the same job-specific workers is fine, but in reality there is a distinct difference in wages between permanent and non-permanent workers. What do you think about this situation?

Okina: Looking at Japan's economic growth potential, it has been flat or a little downward these past 10 years. Since around 2013, thanks to Abenomics, more women and elderly people have joined the labor force, which raised labor input a little and supported growth potential. Nonetheless, with a continuous decline in productivity growth, Japan's potential growth rate is only 0.6 %, with productivity growth at around 0.5%. This shows a severe reality compared with 30 years ago when the potential growth rate was around 4% and the productivity growth rate was around 2%.

In international comparisons of labor productivity among developed nations, not only the rate of increase but also its level is extremely low, indeed almost the lowest. Such stagnant labor productivity has resulted in the stagnant wages of today and the wage difference between Japan and other developed nations is enormous. Therefore, with such a low level of wages, large Japanese companies cannot recruit competent workers overseas in the global competition for competent human resources. This is another reason for Japan's stagnant economy due to its lifetime and general employment.

In addition, non-permanent employees are today drastically increasing, but investment in these human resources is not making good progress. This is another big issue.

Productivity growth is significantly affected by a changing business environment. Hereafter, industrial structural changes triggered by GX or DX will affect it in our great revolutionary period. On such occasions, without a system promoting the smooth transfer of labor into high-growth potential sectors, overall productivity will remain in an extremely serious situation. Failing to achieve labor mobility by transforming general and lifetime employment will be a

serious bottleneck for Japanese economic growth.

There may be psychological issues here, such as concerns about job-specific changes impeding labor mobility, but also I believe there are institutional issues affecting people's behavior and preventing employees from changing job-specifics. The government's providing of a safety net is not working in favor of promotion of labor mobility, and once you fail, you cannot start the next step.

The labor market in Japan is in a situation where a match-up between labor capacity and businesses striving for competency is not easily achieved. Retirement allowances are greater, the more years employees have worked for the same company. The Japanese tax system works in favor of such a retirement allowance system. An employee who quits job-specific employment for his or her own reasons will lose the provision of unemployment benefits for a short period. This is another institutional hindrance to job-specific changes or starting up new businesses. I think changing such systems is very important.

Though the legal institution of "the same salary for the same specific job" has been gradually introduced from FY 2020, the latest data still show around a 600-yen per hour wage difference between permanent and non-permanent workers. It is extremely important that we rigorously check corporate wage payments to prove "the same salary for the same specific job" principle is being strictly implemented equally among non-permanent employees who want to be permanent, along with provision of reskilling opportunities.

At this moment, non-permanent workers' wages are increasing due to labor demand. But with insufficient social insurance for them, they have concerns about the future and the risk of dismissal. Such concerns directly lead to a lower birthrate. We should reform a social insurance system that fails to meet the needs of an increasing number of people pursuing diversified working styles, and create a new one that meets a wide range of needs.

Toyoda: Do you think the Japanese government is aware of the need to reform the social insurance system and is working on it?

Okina: Discussions have already started, but what needs to be examined from now on is how it should cover non-permanent workers, freelance workers and other workers pursuing a diversified work style.

Toyoda: Mr. Toyama, do you think the countermeasures to deal with business stagnancy and business restoration will contribute to labor mobility? In recent media reports, the news of the dismissal of 100,000 IT engineers in the US technology industry was considered positive rather than negative. This is because there has been a steady demand for technology experts in the environment sector that has never been fulfilled due to their being in the IT business, but with these dismissals many of them will be able to join the environment sector. Could you tell us your story about business restoration and labor mobility?

Toyama: Working in the real world, I find there is an enormous gap between what the media talks about and actual business. Regarding business restoration, I do not think labor is so rigid in Japan and difficult to transfer. I think Japan is probably one of the best places for restructuring in the world. In particular, since the start of the second Abe administration, if you ask for 500 applicants for voluntary retirement you will get more than 1,000 applicants. In the case of companies in need of business restoration, more than half of the employees working for such companies would give up continuing to work for them. When seeking voluntary retirement with good conditions, there will be many more applicants than expected and many competent workers will apply. This is why Japan is in general a country with a labor shortage.

In this regard, I do not think changes in dismissal regulations will be important. In Japan, even the labor unions are ready to cooperate with companies on restructuring, which often surprises Americans and other non-Japanese. Japan has extremely high labor mobility in terms of business restoration. In Japan, labor mobility may be an issue among large companies' permanent employees, but apart from that the Japanese labor market is rather mobile.

For example, most of the employees of a bus transportation company are drivers and are working in job-specific employment. Their labor mobility is high. At this moment, as the Covid pandemic comes nearer to ending, 90% of the demand for bus transportation has returned to the pre-pandemic level. We see now in this situation a serious shortage of bus drivers, but it is much more expensive to employ freelance drivers using their own cars in service than an employed company driver. The labor market for drivers is mobile and their wages rise in accordance with demand and supply, as with all markets in Japan. If the market principle works in a mobile market, wages will always increase.

A tighter labor market is going to be brought about by aging and declining birth rate. With general employment, the cost of switching labor becomes extraordinarily high and that makes it difficult for an individual as well as a company to achieve labor mobility. In this system, in terms of the structure of a work contract, a permanent employee in a company does not need to have any skill set other than being a permanent member of the company.

When we work on supporting a person's job-specific change, what embarrasses us most is that half of the skill sets of those we are helping are connected to human relations within their company. Separated from such relations, the value of those people's working skills would be lost and their salary lowered.

General employment works well in the industrial sectors where progressive efforts to improve the quality of products among homogenous colleagues in a moderate transformation process leads to enhancing the competitiveness of the whole company. In the high economic growth era in Japan, this was effective in most of the mass production industries in Japan. However, at this moment, this does not work at all in sectors like electronics. Arguments about ethics and ideology concerning this issue are useless; this happened after the 1990s during the disruptive innovation era when the speed of an

industry's transformation exposed the failings of the general employment system.

This can be explained by the following figurative story. A company needs to set up its own football team but has always done only baseball. In general employment, they only have employees who play baseball, and the coach and manager know only about baseball. Would there be any young employees who could start playing football, if they are told to do so by their boss? Something like this happened to electronics, and Japanese electronics companies have been defeated by GAFA.

With the emergence of Chat GPT, I think this disruptive technology could achieve unprecedented social transformation, such as most job-specific vacancies at call centers being lost. Specific jobs at call centers are mostly for non-permanent labor and they will be gone. This would be a drastic change in the labor market. Some Japanese industrial people may worry about the survival of the traditional Japanese industrial model under GX, but I do not. Most likely, I suspect a brand-new company that we have never heard of or a US or European company purchasing such a company through M&A will dominate GX in Japan. Insisting on general employment will not result in winning in GX.

In this regard I fully agree with both Mr. Tsuru and Ms. Okina on the need for job-specific employment to be expanded in Japan. I would not say that sectors successful with general employment must be changed as well. Let them carry on as they do now. But so many legal systems and business customs, including retirement benefits and support systems for victims of unfair dismissal, encourage workers to remain in the same company. These institutions constitute a whole social system in Japan that evidently favors general employment rather than job-specific employment, and permanent workers rather than non-permanent ones, as the authentic employment system and this enforces most labor to be kept within this system. This works to the disadvantage of female employment and lowers the productivity of Japanese labor. We must neutralize all these systems that work against alternative ways of employment. Otherwise, productivity and wages will not rise, and nor will the birth rate.

Human Capital Investment

Toyoda: The three of you agreed that the traditional employment system needs to be corrected to raise labor mobility. On this issue, a key must surely be human capital investment. Ms. Okina is warning in her papers that the level of human capital investment in Japan is the lowest among developed nations. Companies are concerned about the high possibility of their human capital investment during increased labor mobility resulting in their employees' transfer to other companies. So they do not seem to be highly motivated and worry about their human capital investment being a waste. What about other nations? With high labor mobility, will there be less human capital investment? Companies may not have an incentive for human capital investment in non-permanent employees. Does the

classification of permanent and non-permanent employees hinder human capital investment?

Okina: Prof. Miyagawa at Gakushuin University and others made an international comparison of data on intangible asset investments such as data processing, IT software services and intellectual property rights in 2020. It showed that Japan and Germany are the lowest among the developed countries. Above all, Japan's score is overwhelmingly the worst in the domains of human capital investment and capacity for organizational reform. In this regard, I think low human capital investment level has affected Japan's competitiveness and productivity. The quality of labor made a rather high contribution to productivity growth until the 1970s, but now its contribution has become zero. In this light as well, I think efforts to enhance human competency will become extremely important. Human capital investment will be necessary at all levels for all people. Japan in particular has been ignoring until now the need for reskilling for data- and digital-related work.

This is commonly true of all sectors. In the case of job-specific employment, we need to define all the necessary skills for a certain specific job, and applicants for that job among a company's employees and from outside the company must be prepared to do it and there must be investment in human capital to meet the skill requirements for that job. This process could result in higher labor mobility. A company should provide reskilling opportunities for employees. This should be done not only to improve the value of the company but also to lead to an increase in wages and career development for the employees. I think companies should introduce job-specific employment as best they can and at the same time provide a reskilling program for their employees.

Providing reskilling opportunities should be a means of retaining those employees. If a company succeeds in convincing its employees that their wages match their capabilities produced by its reskilling program, their engagement with the company's mission and their incentive to work hard would be strengthened and would lead to a rise in productivity. And if a company's reputation for its good contribution to employees and its simultaneous growth are universally acknowledged, it would be able to attract high-quality human resources.

For example, AT&T did such reskilling and succeeded in attracting competent human resources.

Also, in Northern European nations, job-specific changing is common and the goal is to transfer labor from low-productivity sectors to higher ones. This is why their economic growth and productivity continue to increase, enabling them to overcome recession. Japan is expected to move in the same direction. In Northern European nations, labor unions and employers are working together on the smooth transfer of workers and reskilling. Japanese labor unions must also change their mindset.

The classification of permanent and non-permanent employees is problematic. We must think about this issue from a lifelong perspective. Both women and men must occasionally work for only a

short time due to family commitments. We must give up this mindset of measuring work performance by hours and instead choose the best work-life balance from a lifelong perspective and employ people who want to be permanent employees as permanent ones. This is how we can make the diversity of a work-life balance commonly accepted by society.

Toyoda: The idea you mentioned that reskilling must be aimed simply at retention of workers does not seem to be prevalent among Japanese companies. A question for Mr. Toyama. You are giving MBA lectures at university. What do you think about the relations between business restoration and human capital investment? In your view, in Japan how well does human capital investment achieve its goal and what role does this play?

Toyama: When I studied the MBA program at Stanford University in 1990, Japanese companies seemed to have sent most of their employees to US universities for MBA or other programs. They invested more in human resources then than they do now. But when those employees who earned MBAs after a couple of years' study at US universities came back to Japan to restart working for their mother companies, they were told by their bosses to "forget about what you learned in MBA programs". This was because the companies' sources of competitiveness were not especially management skills but progressive efforts for product quality improvement at production sites, namely Total Quality Control (TQC) and the Toyota Production System (TPS), as general employment with lifetime employment and seniority wage and promotion systems were predominant.

What we learned in MBA programs in the US was about strong leadership and taking the initiative in directing management strategies. However, we were all still very young, around 30 years old, and we could not be head of a division after coming back to our Japanese companies with their robust seniority systems. So we were told that we should conceal what we learned in our MBA programs for the next three decades until we became the president of our companies, as we would become unpopular if advocating for a revolutionary business strategy among our Japanese colleagues, who were used to only progressive process improvement under much less creative leadership. As a result, many MBA holders quit job-specific employment in response to these words. Thinking about why companies would be afraid of such employees leaving, as mentioned in my story of baseball and football, it is because Japanese business people have never thought in any logic but that of baseball. If you aim to maintain the competitiveness of a company only with baseball logic, you will have to invest in human resources to win a football game or a breakdance. And assuming that demand for baseball is decreasing, you would not be able to retain your human resources. If you live in a situation where the external labor market functions well without any barriers to job-specific changes, the more competent workers will move to a company where they can play football or breakdance. This is simply natural.

In this sense, human capital investment would naturally be a key to the retention of human resources. With an increasingly well-developed labor market, mobility is significantly enhanced, and in order to retain competent human resources you will need to raise salaries as well. Managers who worry about competent and skillful employees quitting are not qualified to run a company today.

At this moment, many young people are quitting job-specific employment easily, especially the more competent ones. The Japanese labor market is now seeing polarization. There is high labor mobility among the extremely competent students. They move from a large company to a consulting company or a start-up company. High labor mobility is seen among non-permanent employees as well. But there is a highly rigid labor market between those two, and with this market prevailing among existing large companies and large industries, unfortunately Japan as a whole nation is gradually declining.

Meanwhile, as in the reality of business restoration, we are facing labor shortages in general. This is true of management as well and there is a strong demand for well-trained human resources in management. There are lots of potential human resources among large companies, so if they adopt job-specific employment, labor mobility among industries or large companies and SMEs will be raised and the overall productivity of Japanese industries will be raised as well.

Strangely enough, while we are running seriously short of human resources among local service industries with job-specific employment, the large companies in Tokyo business districts are always restructuring. In other words, in large companies with general employment, there are always excess human resources among the middle-aged and elderly. With the emergence of Chat GPT, there will certainly be more excess labor. This is how we see a very distorted labor market in Japan.

Labor shortages made it difficult to achieve business restoration, as I mentioned. Restructuring would not be a solution for it. We need to build up a system with labor mobility under which each company pursues human capital investment, and unless we have job-specific employment we cannot achieve it. In this situation, if we seriously pursue job-specific employment, there will be a big opportunity for the Japanese economy. I believe that now, right after the serious stage of the pandemic is over, is the best time to achieve a large-scale reform of the labor market. Above all, business leaders must change their attitudes and those who insist on old-style thinking must be replaced. With such reforms, Japan would be reborn with a much improved business performance.

Toyoda: Three or four decades ago, large companies, especially large banks, sent many employees abroad to study. But now there are very few. The number of people going abroad to study from Japan has become much lower than those from China, and from South Korea as well. I am worried that young Japanese people are losing their ability to be "international". What do you think about this, given that human capital investment would be good for retaining

human resources? Many of the employees sent from Japanese companies did not return to their companies, or as you said the companies told them to forget about what they learned abroad.

Toyama: The easy answer to that question is that companies should not treat such employees merely as rank-and-file workers. With general employment, this happens. Japanese corporate culture in many organizations like government offices and banks would not allow a 30-year-old person with an MBA to be the boss of 50-year-old employees. In this culture, those with MBAs would quit, and the companies, having seen many such employees quitting, say they will give up their human capital investment programs for study abroad. They are not even aware of being wrong, and I think such companies or industries should disappear.

Meanwhile, consulting businesses are more active in sending employees overseas to study with a money loan system. This is same as in the US and Europe. They send more and more employees overseas with loans and the employees do not have to return the money if they stay in the company for three years after returning from abroad. Our consulting business believes that three years stay in the company after studying abroad would be good enough for a contribution to the business. This is how our consulting business, on the premise of mobility, approaches human capital investment. In the end, there will be many people with good potential joining a company actively engaged in human capital investment. Without making this virtuous cycle between labor mobility and human capital investment, the more competent workers would be more likely to switch from specific jobs, as the skill set is changing as time goes by and each specific job becomes more based on expertise.

Meanwhile, traditional Japanese management pursues slavery. It is used to the concept that your social status is fixed as a company's permanent employee and job-specific changes are out of the question. This Japanese "common sense" is wrong. We work in a flexible manner and do different specific jobs in different places in our life. We meet and work together temporarily in many places. This is the world's common sense. Young people in Japan will not follow Japanese common sense. We must change our mindset.

For example, we are now running a bus transportation company in local Japanese regions and around 5,000 employees are working for this company. We have also been purchasing a variety of local companies through M&A. Most of our management teams of those companies used to work for big Japanese companies such as trading houses, banks and various manufacturing firms. Their ages vary from the 30's to the 60's and all moved from those big companies, including the Certified Public Accountant (CPA). If they had remained at those companies, they would be rank-and-file employees, but in our companies they could be a president even while still in their 30's. This is how a traditional Japanese company wastes human resources.

Toyoda: A question for Prof. Tsuru. You also argue that the value of a company lies in human resources and intangible assets. What

human capital investment, including studying abroad, do you think should be pursued? I think large companies would like to retain human resources, while they cannot step into job-specific employment without assuming labor mobility.

Tsuru: I fully agree with both Ms. Okina and Mr. Toyama. I think "autonomy of career" is the main reason why we need to pursue job-specific employment. With general employment, an employee's life is in the hands of his or her organization, and not his or her own. There used to be a consensus between the company and its employees that nothing would be to their disadvantage regarding salary and promotion. But today it is not necessarily the case anymore, as our economy has been in low growth for many years.

It is extremely difficult for a large Japanese company's management in charge of personnel affairs to secure "autonomy of career" for an employee. They would have to start in-house recruitment. But without this, labor mobility cannot be achieved. I believe reskilling is indispensable to ensure "autonomy of career". It is often said that there are general skills and company-specific skills. A company cannot pay for a reskilling program for general skills in the US or Japan, as it would be a waste of money if the employees enrolled in it quit afterwards. An individual employee must pay for it. But a company can pay for a reskilling program for a company-specific skill, as this skill would only be used for the company.

In Japan, the main reskilling programs are on-the-job-specific ones. The company-initiated training programs are not for developing an expert's skill but for improving the skills of an already good employee. Reskilling is not done uniformly, as what is needed as a skill for each individual naturally differs among employees. Reskilling is limited to each specific job and thus, unless career autonomy is secured, we can have very little meaningful discussion about it.

Looking at examples of many companies' reskilling programs, I find the cafeteria method interesting. This gives employees a choice between all kinds of reskilling programs where they can learn about general skills – even those that prompt concern on the company side about employees changing job-specifics after learning those skills. Employees can choose freely whatever they want by considering their future career path and what skills are needed for it. Some people leave their companies with those general skills. But such a good opportunity for retraining and capacity-building attracts more people to these companies. Traditional Japanese companies do not have such ideas. But companies that appreciate the need for career autonomy and an individual employee's capacity for development and how to raise innovative human resources have already taken a step into a new stage.

The Japanese government does not understand this point very well. It is still thinking about policies on general employment and has wasted expenditure on training that has nothing to do with career autonomy. We must make reskilling programs that enable employees to choose for the sake of their career autonomy.

Toyoda: This cafeteria method sounds very interesting. Are such reskilling programs increasing in Europe and the US?

Tsuru: No, they employ people with such skills in the US and Europe. It is a very typical Japanese idea to develop skills *after* joining a company. Traditionally, Japanese companies recruit people without any skills, and so they need training. In the old days, Japanese companies had a long-term perspective on capacity building. But they have lost this now and their human resource development quality is much lower, I think. In the US and Europe, someone with an MBA can work at a managerial level from the beginning of their career. It is assumed that they already have the qualifications to be a manager. Those with such special skills will pursue a different career path from those without.

Strengthened Labor Mobility & Local Economy Restoration

Toyoda: Would raising labor mobility or consolidating human capital investment also be desirable in terms of local economy restoration and supporting start-ups? Or what do you think is lacking in Japan in these two areas? The Japanese government currently seems to be making great efforts to support start-ups. What do you think will be necessary to avoid Japan being a Tokyo- and Osaka-oriented nation as a result of these government policies?

Toyama: I have been working on start-up support mainly at the University of Tokyo for 25 years, starting with founding the first Technology Licensing Organization (TLO) in Japan. So far, unfortunately, these start-ups have been Tokyo-oriented, but start-ups have now become the first choice of specific jobs among graduates from the University of Tokyo and Keio University. They want to start up a business even while at university if they can find good seeds during their student days. And if they can't find such seeds while studying, they get job-specific employment tentatively at consulting companies or thinktanks or government offices and then whenever they find good seeds for a start-up, they quit. This is often seen now among young people in Japan. So even in Japan we see an ecosystem of start-ups growing, like that at Stanford 30 years ago, as there is a small market of experts who have founded ventures. They are not particularly insisting on working in Tokyo. They are rather liberal people. I think it is important to expand such a labor market. It is also important to diversify the university intake with more foreign students on campus to join the Japanese students.

Looking at the Asian and global political economy at this moment, Japan is an attractive nation and it will be important to create venues in prestigious universities such as the University of Tokyo, Waseda University, Keio University and the Tokyo Institute of Technology where liberal and confident diversified talents can come together, and then expand this to universities throughout Japan. This will be critical in expanding the start-up movement today.

One more thing that should not be ignored is that a start-up is still

regarded as a marginal existence by those in the large business establishment. They still believe large companies are the mainstream and tend to consider start-ups as "people doing something unusual". Yet it is the start-ups that have been driving economic growth in Europe and the US for the past 30 or 40 years, and so start-ups have now become a mega-industry. It is common sense that start-ups are the main engine of growth in our age of disruptive innovation, so for large enterprises to grow, a start-up's new technology would be the biggest engine for them.

In Japan, however, the government has committed the stupid mistake of supporting existing pharmaceutical makers to develop a vaccine for Covid-19. Pfizer's vaccine was not developed by itself: it was the German venture BioNTech that developed the vaccine and Pfizer applied it for general use. BioNTech was founded by a German-Turkish immigrant couple and the technology itself was invented by Dr. Kariko Katalin, who was born in Hungary and moved to the US. In this light, I think it is better to stop providing finance for large companies. The current boom in Japanese start-ups will be a very important development for economic growth and Japanese universities may as well strengthen their efforts to raise human resources for start-ups. It would be better if we made education on start-ups an obligatory subject in liberal arts course at universities.

On the issue of local economies, there has been no lifetime employment in local labor markets for a long time, since there were no industries assuming general employment in local economies. There are instead many job-specific employment opportunities in local economies that need to be restored. Tourism is based on job-specific employment and health care and caregiving are also a type of job-specific employment. These are the core industries in local economies and this trend cannot be reversed.

In this regard, young people in local Japan regions have already started building their career paths on their own. They cannot maintain their lives by continuing to work for a single company and it is common for them to have a side business, and also many are working in agriculture as well as their principal specific job. The Japanese education system seems to fail to adapt to this reality. Professional training or junior high-school, senior high-school and university education are all part of a system for educating students to join companies with general employment. We should change a large part of education in Japan into technology college education, corresponding to community colleges in the US and professional and vocational universities in Germany. Good local universities and in particular private ones are mostly shifting to become such schools and we should encourage this further and provide a variety of recurrent education to create local societies where young people without much interest in working in Tokyo can enjoy their life.

In local Japanese economies there are many middle-scale companies and SMEs and it would be rather difficult to expect them to invest much in human resources development. It would be better to have human resources investment with public support, as human resources are a kind of public commons and we had better think about strengthening it as a whole society.

The government may as well stop its subsidies for companies investing in education like reskilling. With these subsidies, enterprises would always fail to catch up with changes in industries, because they would have an existing industry bias. Therefore, we must have a system of subsidizing an individual directly or providing options for everyone. With subsidies for an automobile company, the money should not be used for investment in education for individuals but for reform of the existing model of the automobile industry. In the US and especially in Europe, subsidizing individual workers is the trend. This is crucial for local economy restoration and particularly important for the tourism industry. The number of employees in the automobile sector and in the tourism sector are almost the same in Japan. The Japanese tourism industry currently does seem to be providing a minimum wage for the labor market, but if we can achieve a middle-class income in the tourism industry it would herald a real transformation.

Employment in the automobile sector in Japan will definitely decline. If the tourism industry can absorb this decrease in employment and workers in this sector earn wages close to those in the automobile sector, the Japanese economy will be wholly changed. This is what happened in Europe. The tourism sector there is providing middle-class employment. In particular, in Switzerland and Austria tourism is evidently a high-income industry. They have many professional schools for experts in tourism, even graduate schools. Graduates from these graduate schools can earn the equivalent of around 20 million yen in the tourism sector. Japan is very rich in touristic resources and boosting tourism would be a solution for the restoration of our economy.

Toyoda: I would like to ask Prof. Tsuru about the role of provincial universities in promoting start-ups to help restore local economies, as well as the role of human capital investment and what is most needed for such investment.

Tsuru: I think it would be extremely difficult to achieve fundamental reform of a university compared with other institutions. Universities are exactly the opposite of a world dominated by general employment. Each professor is an independent business owner and they do as they like. When any of them exercises a veto in decision-making, nothing can be achieved. So I think it would be difficult for universities to respond quickly to any developments in society at large. There would be no need for it.

Young people in Japan today, even if they do not start up a business, are more interested in consulting businesses or other ventures than large enterprises. Although the Japanese education system is good for producing well-behaved people in a large traditional company, people who are not well suited to that system are the ones leading the ventures. The current Japanese education system at all levels – elementary school, junior high-school, senior high-school, and universities – does not aim at producing such people. It is true, though, that for students in humanities as well, some Japanese companies have started job-specific recruitment and

in some mega-banks professional recruitment has also started for college graduates. As this process continues, I guess students' thinking about job-specific employment will gradually change.

Toyoda: A question for Ms. Okina. I think the one merit of the pandemic is that remote working has become fixed as a business practice. Will this lead to local economy restoration or start-up support, and will it also encourage more women to work?

Okina: Around 30% of the nation's workers have been forced to stay and work at home. Most of them have been drastically changing their thoughts about work styles and work-life balance. They are now fundamentally skeptical about the utility of their previous work style, such as commuting by crowded train every day, and have come to acknowledge the importance of work-life balance after having worked with their spouses in raising their children or doing domestic chores. A hybrid style of working remotely and working at the office has now become customary and a more flexible working style is now considered important. Companies failing to provide such a working style are losing their attractiveness. Consequently we now have a big change in our business world, and it is important not to reverse the direction of such progress.

This must of course contribute to the restoration of local economies and we now have more business opportunities online and more online education opportunities, so we can both work and rest simultaneously at home. This is how an increasing number of people living in regional towns are engaged in a wide range of work. Meanwhile, it is also possible to help local companies as a side business while living in Tokyo. People in their 40's or 50's working for a large company who could not fully take advantage of their potential capacity are now given an opportunity to use it with the help of DX. This has enormous implications. The moment has finally come to think about how to take advantage of DX for the restoration of local economies in alliance with universities, business firms and local governments.

Working at home could have certainly a positive impact on start-ups or working women, and this is good news for people obliged to stay at home to raise children or support their family or who wish they could do housework and office work at the same time. There are an increasing number of women engaged in regional start-ups, but start-ups by women still account for only 34% of all start-ups. Of this figure, incorporated ones account for 14% , and in terms of procured capital, only 2% of the companies have women as top management. This is how women initiating start-ups are facing challenges such as limited access to funds and lack of a supportive community.

However, young people, in particular women, are very keen on resolving social issues and they have their own unique ideas. I think it is a very good idea for women to take a leading role in start-up businesses. Young people are flexible in their thinking and working, and more of them can become role models.

Final Words

Toyoda: Lastly, I would like each of you to give your final words on what you would most want to emphasize.

Tsuru: Without breaking the solid Japanese employment system and general employment, the wide range of economic challenges facing Japan cannot be resolved. Reskilling and raising labor mobility, as the Japanese government is promoting, cannot be achieved without the realization of job-specific employment. I would also recommend promoting work on side businesses. This should also be achieved on the premises of job-specific employment and career autonomy. The government must do its utmost to realize this, but the key is a change in business management and labor union policies.

Both management and labor unions advocate for the current unbound permanent employee system or general employment. With the introduction of job-specific employment, for management, the existing simplified personnel policy decision should be given up. For labor unions, though there may be many who enjoy a more comfortable working environment with it, they do not like taking any risk with any member's specific job. In return for keeping the existing employment system, they would not ask for any rise in wages. This has continued for several decades and has been binding the whole Japanese economy.

In talking about employment of senior people until the age of 70, whether they stay in the same company or go out of it, there would be nothing but job-specific employment for them. So we must introduce job-specific employment at an earlier stage of life. As society is aging, our economy will hit a stumbling block if we do not convert our employment system into a job-specific one. This pressure from the aging of society in Japan could be a trigger for fundamental reform.

Okina: First, we must introduce more creativity and the capacity for problem solving in the early stages of education at elementary schools or junior high schools. This should lead to entrepreneurship. Correcting our uniform education system and uniform human resources management would lead to the creation of added value.

My second point is that we must have an employment system in which individuals can choose from a variety of options for their working life until around 70 years old. With reskilling or recurrent education in this employment system, we could overhaul our existing seniority system and achieve high labor mobility. That would lead to the restoration of the Japanese economy.

Lastly, we should build up a safety net for non-permanent employees so that they can have opportunities for reskilling and get better job-specific employment.

Toyama: More than 150 years have passed since the Meiji Restoration in 1867. At the beginning of our modernization, we pursued a wealthy state and strong military. The pursuit of a strong military led to failure in World War II, but pursuit of a wealthy state

has been continuing. In our industrialization in this pursuit, we adopted a system in which men were bound to their companies as permanent employees and their lifetime security was assured until retirement age as long as they were bound to it and their wives were bound to home. This was the standard model in which progressive product reform was conducted stably and which worked particularly well in the Showa period.

This model, however, has recently reached its limits. There is a perfect mismatch with the current Japanese social and industrial structure. This is the fundamental reason behind our three decades of depression. Without changing the old system, Japan will have another three lost decades. It is now that we must start thinking seriously about reforming it.

Meanwhile, people are living around 30 years more after retirement in our now aging society. To ensure a happy life for our elderly people, we must take advantage of the current labor shortage and take the opportunity to introduce job-specific-type employment replacing general employment that does not cover people beyond retirement age. Without leaving this general employment system behind, we cannot achieve renewal of our industries or business corporations. Our safety net has been dependent on companies and homes up to now. With the collapse of this dependency, there could be a risk of social collapse in Japan, and this is why we may have been trying to avoid drastic reform. But our productivity has not been rising and wages have been decreasing. The percentage of permanent employees covered by general employment has been declining and the percentage of unionized labor is now less than 20%, meaning around 80% of the nation are now not covered by the old system. Therefore, as the authentic majority are the people outside permanent general employment, politically speaking the nation must change direction to include individuals in the safety net, without depending upon intermediary organizations or homes. This would be possible for the first time with the introduction of job-specific employment. Now is our opportunity for social transformation.

Toyoda: Thank you all so much and we sincerely hope you are playing leadership roles in our social reform. We are happy to support your initiatives.

JS

Written by Naoyuki Haraoka, editor-in-chief of *Japan SPOTLIGHT*, with the assistance of TapeRewrite Corporation.

What Must Be Done to Maintain a Population of 100 Million in Japan? (Nov. 7, 2023)

By the Working Group for Japan's Population Challenges

1. The Current State & Challenges of Our Country's Declining Population

(1) Current situation

The decline of birth rates and the aging of the population in Japan have been particularly prominent compared to that of other countries. This has resulted in projections of a drastic population decrease in the years to come. As of 2022, Japan's population was 124.95 million, according to projections by the National Institute of Population and Social Security Research and the Ministry of Internal Affairs and Communications. However, the population is forecast to drop to 105.1 million in 2055, fall below 100 million in 2056, and further drop to 87 million by 2070. In 1970, the birth rate was over 2.1, but by 2022 it had fallen to 1.25. Not only did the actual birth rate decline, the number of children that people desire to have also dropped from 1.83 in 2010 to 1.55 in 2020. In tandem with the overall population decline, the working-age population (15-64 years old), which is currently around 75 million, is expected to fall below 50 million in the early 2050s. Similar declines are projected in the working-age population and labor force participation rate (Chart 1).

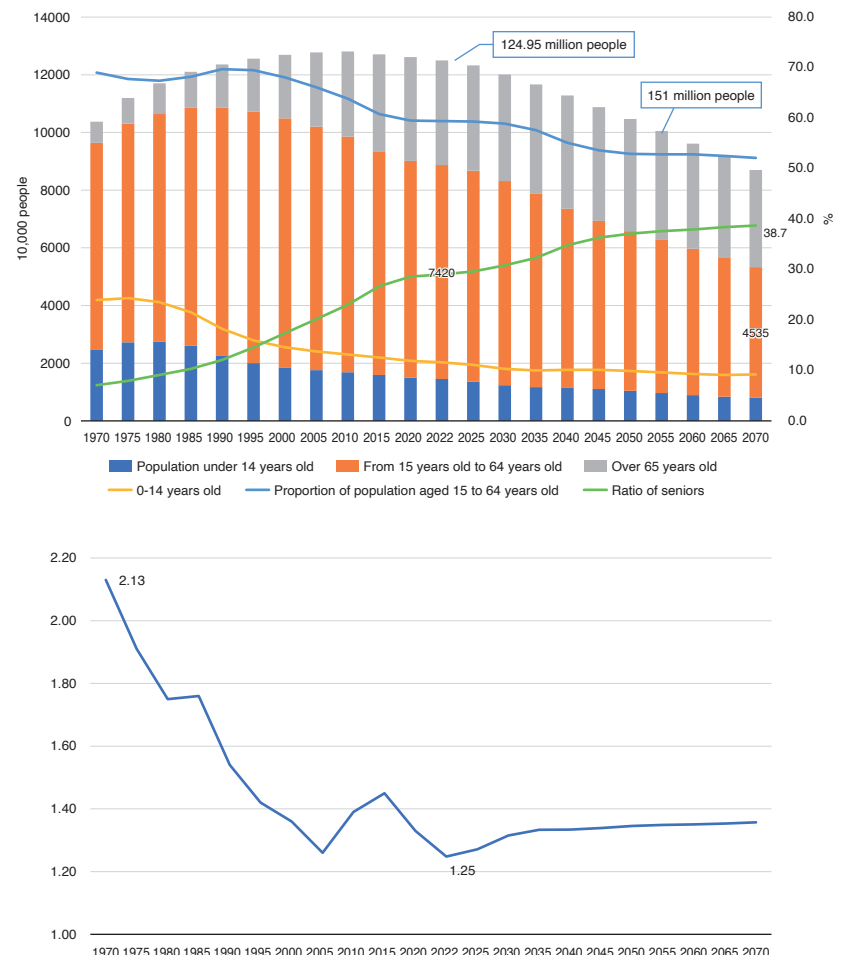
The underlying context is that a significant portion of the population choose not to get married. The 2022 edition of the Gender Equality White Paper by the Cabinet Office indicates that 40% of men and 50% of women opt out of marriage because they want freedom and independence. At the same time, there are worsening economic and employment landscapes symbolized by economic uncertainty and stagnant wages. Yet, despite these economic pressures, educational costs, including expenses beyond school tuition (such as cram schools on top of regular school fees), continue to rise. In addition, the rigid work culture places a premium on the number of

hours spent in the workplace. This presents an obstacle for balancing work and childrearing responsibilities.

With the restriction on time and income, an increasing number of households want children but either cannot have them or have fewer than they want. Japan is a notable case study in this dynamic. Many young people migrate to major metropolitan areas like Tokyo. They leave behind a rural economy that struggles in the wake of urban

CHART 1

Japan's population trend, total fertility rate



Source: Created by research group members using statistics from the National Institute of Population and Social Security Research, Ministry of Internal Affairs and Communications, and United Nations

concentration and economic stagnation. The resulting decline in rural vitality has become a major issue. This manifests itself as a crisis in the form of severe strains on local finances.

Furthermore, Japanese society as a whole lacks the collective spirit of nurturing and watching over children. It is essential for the nation to cultivate such a consciousness on the national level.

(2) Challenge

The biggest adverse impact of the population decline lies in the stunting of economic development due to the shrinking labor force. That, in turn, leads to a loss of vitality in society, deteriorating social security foundations, and other issues. Additionally, the reduction of domestic consumption will manifest as a shrinking domestic market.

This trend is likely to negatively affect corporate capital investments. Although it may seem desirable to relocate business operations overseas, there are limits given the current rise in geopolitical risks.

Japan is also a global frontrunner in aging. According to UN projections, the proportion of the population aged 65 and above will be around 38% in 2065, placing Japan second after South Korea (*Chart 1*).

a) Decline in national power and economic strength

Supply side economic growth is driven by three forces: capital, labor, and technological progress. A useful method to analyze these factors is “growth accounting”, which reveals how much technology (total factor productivity), capital, and labor each contributes to economic growth. It is clear that with a reduced workforce due to an aging society and population decline, supply-side growth will be negatively impacted.

Opinions differ on how population decline will affect aggregate demand, and there is no clear-cut answer. However, surveys show the elderly tend to spend less than working-age families, possibly leading to a drop in overall demand for goods. This decrease in consumption could signify a contraction in domestic demand for producers, which in turn could dampen demand for capital investments by companies. Corporations then would have reduced financial leeway to innovate technologically, potentially leading to a negative impact on total factor productivity.

On the flip side, an aging demographic might actually fuel demand in sectors like health care, nursing care, and medical services. Moreover, a surge in investments from businesses has the potential to drive technological advancements. This could be spurred by a growing global interest in Japanese products, a rise in tourism, and more women entering the job market, all of which could offset the dip in consumer spending typically associated with an older population.

As more seniors remain active, there could be a growing demand for robots that assist them at work. This need may spur the development of new technologies and escalate investments aimed at supporting older workers, fueling economic expansion. If Japan can thrive in the senior care technology and export their expertise to other rapidly aging countries, it might mitigate any decline in Japan’s national power.

b) Increased fiscal burden

Increases in fiscal expenditures, such as growing social security costs that arise from an older population, will pose significant challenges (*Chart 2*). If technological innovation fails to progress and international competitiveness remains low, the current account balance will fall into the red from a decline in earning power. Coupled with fiscal deficits arising from an increased financial burden, this could result in twin deficits, potentially reducing the creditworthiness of Japanese government bonds. This, in turn, could trigger a plunge in bond prices, and national bankruptcy could become an imminent reality.

Some research also suggests that aging affects the efficacy of fiscal and monetary policies. In the DSGE model where two groups of working and elderly people coexist, it is pointed out that as the proportion of the elderly increases, the effectiveness of monetary and fiscal policy decreases (Naoyuki Yoshino and Hiroaki Miyamoto, “Declined Effectiveness of Fiscal and Monetary Policies Faced with Aging Population in Japan”, *Japan and the World Economy*, Vol. 42, 2017). The intuitive reasoning is explained as follows:

In the realm of monetary policy, reducing interest rates typically encourages corporate investment, which in turn can boost company revenues. This often leads to higher wages for employees, who then have more to spend, further propelling consumption and aiding economic recovery. However, in an aging society where retirees do not directly benefit from wage increases, the stimulative impact of low interest rates may be diminished.

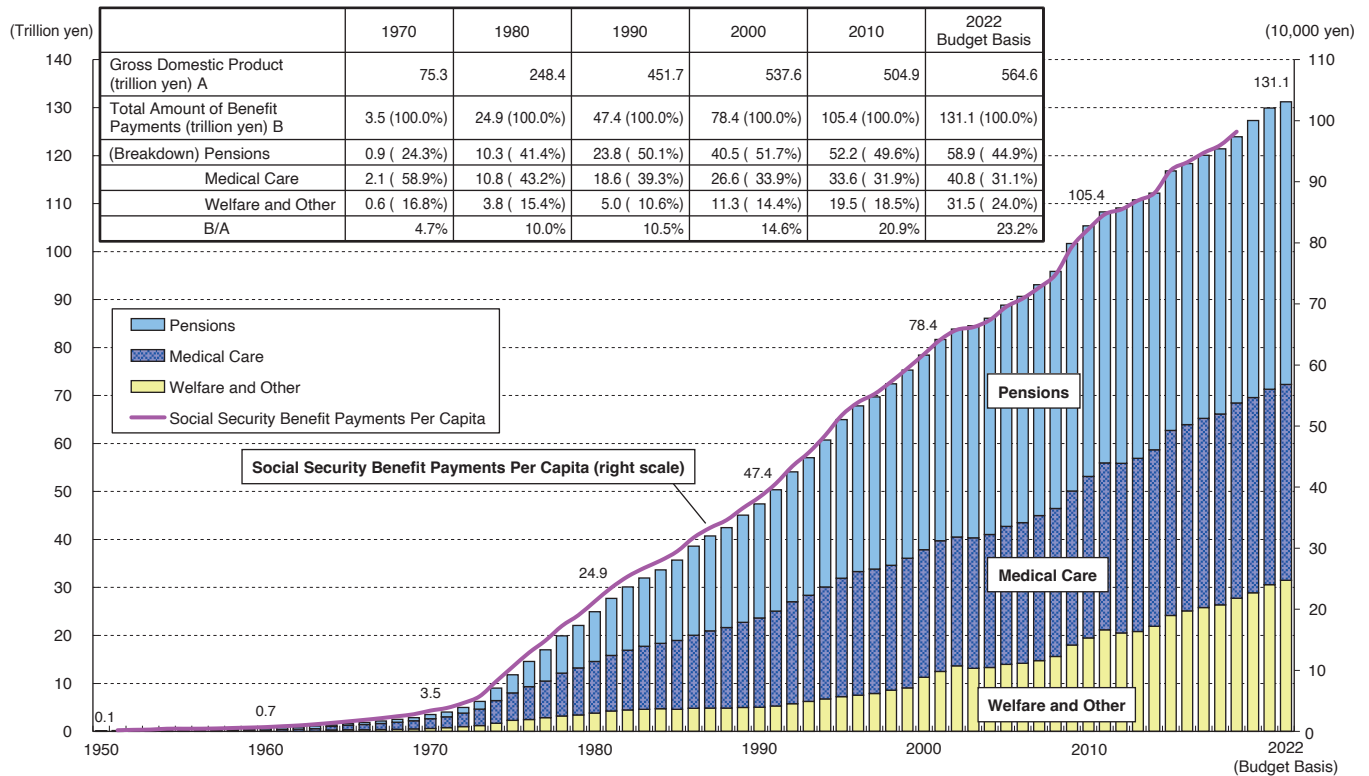
Fiscal policy is also less effective in an aging society. Keynesian fiscal policy argues that increased income through the promotion of employment leads to a recovery in total consumption, which, through the multiplier effect, leads to economic recovery.

However, as the number of retirees increases, fewer people will be looking for new employment opportunities, thus reducing the policy’s effectiveness (Hiroaki Miyamoto and Naoyuki Yoshino, “Effectiveness of Fiscal Policy in Aging Economies”, *Policy Research Institute, Ministry of Finance, Japan Public Policy Review*, Vol. 17, 2021).

In summary, the prospect of sustaining economic growth in the face of an aging and declining population hinges on technological innovation that nurtures emerging senior-focused markets.

CHART 2

Trends in social security benefit payments



Note: The numerical values in the figure represent social security benefit payments (trillion yen) for the fiscal years 1950, 1960, 1970, 1980, 1990, 2000 and 2010 as well as FY2022 (budget basis).

Source: Ministry of Health, Labor and Welfare estimates for FY2020 – FY2022 social security benefit payments (budget basis) based on the “FY2019 Social Security Cost Statistics” from the National Institute of Population and Social Security Research; FY2022 GDP is according to the “Economic Outlook and Basic Stance for Economic and Fiscal Management for FY2022” (Cabinet Decision on Jan. 17, 2022)

Additionally, it relies on establishing social systems and norms that encourage the ongoing engagement of seniors in society and promote an “active life expectancy”.

c) Security implications

Japan is experiencing a population decline driven by fewer births and an aging population. The consequent decrease in GDP can alter power dynamics in international politics and affect national security. Countries with smaller economic power and fewer resources need to boost their diplomatic efforts to secure their influence and impact on international discourse and security. In particular, they must strengthen their alliances to enhance their deterrence capabilities. To offset the shrinking pool of young men who traditionally underpin military strength, it is vital to invest in new military technology.

Japan had historically leveraged its technological and economic advantages to attract top international students from across Asia and

beyond. Many of these students attained prominent positions once they returned to their respective countries. Their strong educational ties to Japan enhanced economic and diplomatic relationships with their countries. However, with the waning of Japan’s national power, international students are choosing other destinations, such as Europe, the United States, and China. Regrettably, this trend erodes the strength of Japan’s foreign policy. The weaker yen has also diminished Japan’s status as a “high-wage” country, which results in a smaller number of aspiring nurses immigrating from other parts of Asia. Japan’s image as a hub for talented professionals from Asia is undergoing major changes.

We must mitigate Japan’s national security risks in Asia that arise from a population decline and shrinking economy. The following are some considerations we must bear in mind.

In 2005, Japan became the first “super-aged society” with over 20.2% of the population aged over 65. More than 20% of the

population are now classified as seniors. South Korea and Taiwan are not too far behind, with China and Russia close on their heels. By 2035, these nations are projected to have average ages ranging from the mid-40s to mid-50s. In contrast, countries like India, Indonesia, the Philippines, Vietnam, and Malaysia anticipate a growing youth population with average ages expected to remain below 40.

This shift in demographics could mean a reduction in Japan's Self-Defense Forces. They may well face serious problems in recruiting personnel. However, Japan's defense spending is actually increasing. The administration of Prime Minister Fumio Kishida aims to raise it to 2% of GDP by 2027. Japan's fiscal deficit is already the largest among developed countries created by an imbalance between the tax burden on citizens and government expenditure. Increased defense spending could exacerbate this trend.

In the context of Asian regional security, Japan faces not only longstanding threats but also newer ones. These include cyber-attacks, space security, pandemics, and climate change. China's growing military assertiveness and potential conflicts over Taiwan are issues as well. There are also territorial disputes in the East and South China Seas, North Korea's nuclear ambitions, the divided Korean Peninsula, damage from piracy, and the proliferation of weapons. These diverse threats mean that we must closely examine how demographic challenges may influence the strategic perceptions and reactions of the countries involved.

For cyber countermeasures, we must also address how Article 21, Section 2 of Japan's Constitution severely limits intelligence gathering and reconnaissance. This constrains information sharing between Japan and the US. Among developed nations, the US stands out in its resilience to the impact of population decline. It will no doubt remain a central player in the regional security policies of its Asian allies.

Furthermore, when evaluating security frameworks, it is increasingly important to factor in shifting population trends in regions like Africa. As there are changes in the economic scale of the US and China, it is critical to take into account the international situation in regions outside of Asia.

2. Policy Direction & Measures to Sustain a Population of 100 Million

The combined forces of a falling birth rate and an aging population are expected to have a severe negative impact on economic vitality. A contraction of the domestic market is likely, and as a result, consumption and investment may stagnate. This could then diminish international competitiveness, potentially leading to a current account deficit.

Concurrently, in an era of meager economic growth, the fiscal

burden heightened by an aging population may lead to chronic fiscal deficits. Such circumstances could precipitate a situation known as "twin deficits". Prices of government bonds plummet and trigger the flight of capital, which then endangers fiscal management. In the face of such a crisis, sustaining the social security system will pose an increasing challenge. As the population continues to age, ensuring equitable distribution will become increasingly complicated. Moreover, there will be significant difficulties in averting the downturn of local economies.

Within the international arena, this shrinking of economic scale will result in diminished clout. In the current climate of escalating geopolitical challenges, such a contraction poses significant security risks.

Some take the view that as long as per capita GDP does not decrease, it will feel as if the economy is prospering. But the fact of the matter is that as the work force shrinks, the working-age population will bear an increasingly heavier social security burden for their elders. This brings to surface the inequality between generations. Therefore, per capita GDP divided across the total population is no longer a significant way to gauge the nation's prosperity.

When you take these factors into consideration, the national goal that the Cabinet of late Prime Minister Shinzo Abe put forth in June 2014 seems appropriate. His administration formulated a basic policy (also known as the "Grand Design") for economic and fiscal management reform. Projecting 50 years into the future, the aim was to sustain a population of approximately 100 million people in the 2060s. To achieve this goal, this policy needs to be carried out across different areas.

(1) Policies to increase birth rate

It is not enough to simply implement economic strategies to boost the birth rate. It requires cultivation of a national mindset that recognizes children as treasures of society. The government should strive to foster this perspective beyond merely providing family allowances. To address the root cause of low birth rates, the underlying economic structure that leads to static wages must be targeted. To enable the younger demographic to earn more, we must at least implement the policies enumerated below.

a) Review of Japanese employment practices and policies to increase labor market flexibility

The labor market should increase its flexibility so that individuals can work in a way that suits their lifestyle, while also increasing their productivity.

In a dynamic labor market where jobs, workers, and resources can

move more easily in response to market demands, workers are more likely to be matched with jobs that suit them well. That should increase individual productivity. Also, as the industrial structure changes, labor is redistributed smoothly. This leads to a vibrant and dynamic economy that fosters high labor productivity, resulting in higher wages.

At the same time, Japan should shift away from its traditional lifetime employment and seniority-based systems. We should instead adopt a system where employment is based on job roles coupled with objective performance evaluations, thereby enabling a performance-based pay structure. Currently, there is a significant wage gap between regular and non-regular employees, which is a key factor in Japan's low wages. To rectify this issue, Japan needs to enforce the principle of equal pay for equal work.

In concrete terms, this means overhauling the evaluation systems across the public and private sectors. This entails transitioning away from wages based on seniority rather than performance. It is crucial to abolish mandatory retirement. In point of fact, discrimination based on age is not allowed in the US. For example, it is not unusual to see academics actively contributing well into their 80s.

Furthermore, it is important to establish severance packages for employees who have been dismissed. We must also reevaluate the "income wall" which effectively reduces a family's yearly income if the housewife obtains part-time work. Under current law, a homemaker earning part-time income could increase the family tax burden because her wages are excluded from her husband's income tax deduction for spouses.

The government is currently considering a temporary system that will allow the homemaker to be covered under her husband's social insurance without having to pay for her own even if her annual part-time wages exceed 1.3 million yen. This is meant to be a provisional measure in place for about three years. More effective solutions are being considered. For example, the government might provide subsidies to companies that give their employees bonuses to increase their income or help with their insurance costs.

Developing personal skills is a vital task. It is important to support this by introducing tax incentives. A "self-development preferential tax system" would allow individuals to deduct some of their self-development expenses from their income taxes. This could replace the "Special Deductions for Learning and Relearning Expenses Provisions" that are currently in effect. Right now, the employer has to provide proof of such expenses. Under the new system, a certification from a career counselor would be enough to qualify for the tax deduction.

Skill development seminars can be very costly. It is essential to expand remote education opportunities not only for students but for working adults as well so that anyone can tap into the expertise of

Japan's top instructors at any time, from anywhere, 24 hours a day, throughout the year.

The current system and policies that disadvantage labor mobility must be phased out. These include the Retirement Allowance Preferential Tax System and Employment Adjustment Subsidies, which hinder labor mobility. The tax incentive for retirement allowances works to keep lifetime employment in place, while employment adjustment subsidies are meant to offset the costs companies have to bear when employees have to take time off or require training. Because of these subsidies, employees' wages often remain unchanged, which can lead to less motivation to work. At the same time, companies become more dependent on these subsidies.

Finally, to ensure equal pay for equal work, the Ministry of Health, Labor, and Welfare is expanding coverage for employees' pensions by making it easier for part-time and other short-time workers to qualify. These policies are vital for enhancing labor market flexibility.

b) Creating attractive employment opportunities in rural areas

The population is concentrated in major metropolitan areas. While rural regions face a larger decline in residents, their abundant tourist resources give them a great potential for growth. It is therefore crucial to create attractive employment opportunities, such as in the tourism industry. Innovative approaches to shore up the tourism sector are gaining attention. These include eco-tourism initiatives that blend agricultural experiences, tours of renewable energy industries, and educational programs to inform tourists about environmental issues. Focusing on these approaches and actualizing potential growth industries like tourism can help generate appealing job prospects and increase the rural population.

Before the Covid-19 pandemic, tourism was a major source of foreign income for Japan, second only to the automobile industry. (In 2019, tourist spending came in second only to car exports.) Looking to the future, international tourism is expected to rebound. It is vital to promote travel across Japan's diverse regions. The government is actively working to stimulate tourism in these areas by providing incentives for foreign tourists to spend two nights in more remote districts. Support is also being channeled into new infrastructure like hotels and transportation networks. The government will also back training programs for local tour guides and service staff, which include English language lessons. In addition, it is crucial to enhance productivity in service sectors beyond tourism, such as restaurants and hospitals. This effort should extend to constructing universities that appeal to young people, like Ritsumeikan Asia Pacific University in Oita Prefecture and Kochi University of Technology in Kochi Prefecture.

Creating enticing employment prospects in the countryside will

give youth the financial means to raise children. Life away from the urban rush will also give them more personal time. These factors should encourage young people, particularly those living in Tokyo, to migrate to rural regions, potentially leading to a rise in birth rates.

It has been noted that lower birth rates tend to correspond with higher population densities, where it is also typically more expensive to raise children. Thus, if more young adults choose to settle in less populated regions, it could lead to an increase in fertility rates.

The population decline in rural areas not only reduces resident tax revenues, but it could also trigger a drop in property tax revenue through falling land prices, which are affected by both the decreasing working age population and long-term diminished expectations. With social security costs expected to surge, alleviating the strain on local finances becomes crucial. It is therefore extremely important to create attractive employment opportunities in these regions.

As the trend of retiring to rural areas grows and remote work becomes more popular, it is likely that an increasing number of people will be living in two locations. This raises the possibility of a mismatch between where residents receive government services and where they pay taxes. It is therefore essential to develop a tax system that supports such a dual-region living arrangement to fortify local finances.

c) Enhancing remote learning and work

Expanding remote learning and integrating EdTech (Educational Technology, a system that uses technology to support education) more efficiently will provide people in rural communities, regardless of their income levels, access to top-tier knowledge and hone their skills. This is expected to boost productivity and, as a result, increase earnings. Teachers can then offer individual guidance in person only on sections that students find difficult to understand just from online lessons.

EdTech allows each student to learn at his or her own pace and level and creates personalized education accessible from anywhere, anytime, according to the individual's interests and proficiency. By harnessing EdTech, we can cut the cost of meeting various educational needs and ease the burden of on-site teachers.

For example, as pilot programs for proof of concept, we could initially consider programming, where there is a severe shortage of specialized teachers, and Japanese language lessons for children of foreign descent who experience considerable regional discrepancies in the accessibility and quality of language education. Yet another benefit is that introducing individualized instruction through remote learning and EdTech could prevent the downsizing of traditional educational institutes in rural areas.

Incidentally, to avert a feared escalation in educational inequalities in the era of widespread remote learning, it is critical to quickly tackle

the digital divide (information disparity) among educators. This situation came to light at the time of the Covid outbreak.

During this pandemic, touch screens were given to all children in Japan. This meant that no matter where in Japan the children lived, they had access to education that enhanced their motivation to learn through remote means. It is believed that when taught by the best instructors in their fields, the lessons are easier to understand, and students' comprehension increases accordingly. If students can access these videos on demand any time, there will be no need to attend cram schools. The hope is that this will eliminate the impact of income disparities on education.

If remote work, which expanded during the Covid-19 pandemic, becomes more entrenched, people will have more options for where to live, commuting times will be cut, leisure time expanded, and a greater variety of lifestyles possible. Single people will have more opportunities to meet others, and married people more time at home. These changes, it is hoped, will result in a higher birth rate. Long commuting times were one of the major barriers to employment and full-time work for working parents. Remote work could make better work-life balance possible. Relocating away from city centers can help individuals avoid soaring housing costs and encounter shorter waiting lists for childcare and afterschool services.

The pandemic made remote work possible for many jobs. In traditional Japanese work culture, there was a perception that being seen at the office was equivalent to being productive. But if we promote remote work and switch to a system that measures each individual's actual productivity rather than time put in at the office, people could move to rural areas. They could commute only a few times a month to their workplaces in the city. This cultural shift could act as the catalyst for enhancing the skills of the workforce in rural regions.

During the pandemic, it became apparent that, even doing remote work, women bore a larger share of domestic duties and child care. It is vital that we move away from the male approach to work centering around the number of hours spent. The focus should instead be on performance. Also critical is proper education to modernize outdated gender norms.

d) Policies for reducing educational disparities

Public schooling alone cannot ensure that students master basic academic skills. Currently, higher-income families spend three times as much on education compared to lower-earning ones, causing an educational disparity. To tackle this issue, one idea is to give families "education vouchers". These are coupons that can only be used for educational expenses. Another point Japan must recognize is that because its education has been too uniform, it has failed to unleash individual talent through innovative education. Every effort should be

made to shape creative thinkers who can tackle new technologies like generative AI.

As stated earlier, remote education allows students, no matter where in the country they live, to attend classes at no cost, and to listen to lectures taught by the top instructors. Students are also free to review any materials as many times as they want to clarify concepts they personally struggle with.

Touchscreen rollout during the pandemic enabled nationwide access for students. The advantage of remote education is that it provides access to websites for different subjects that any student can listen to any day of the year, regardless of income differences. Another benefit of remote education is that students can revisit challenging topics as often as needed.

e) Policies to change gender norms by correcting women's underrepresentation in politics

The scarcity of women in electoral races can lead to the neglect of concerns such as falling birth rates. Male politicians aren't typically faulted for overlooking issues like shrinking family sizes. However, there is an expectation for female politicians to have a stronger grasp on matters related to family demographics.

Women make up half of the population, yet they account for only about 15% of Japan's parliament members. It is crucial that we increase the percentage of women in politics. To do so, we can introduce quota systems and use proportional representation. At the same time, local politics should establish systems that encourage the recruiting of female candidates, thus removing psychological barriers to women becoming politicians. These should reform systems that keep birth rates stalled, and in particular change gender norms.

(2) Policies to increase the workforce

Innovations centered around digitization should enable greater labor productivity. This is critical for support of all willing workers, including women and the elderly, so that they can achieve their potential.

The fact is that some seniors feel pressured because the age at which they can draw a pension has been raised. Women, for their part, feel that they are forced to work while juggling the triple burden of child care, housework, and employment. To relieve such individuals from their pressures, allow them to fully realize their potential, and achieve fulfillment in work, the following measures should be expanded:

a) Policies to encourage the elderly to stay active for life

We should move towards eliminating mandatory retirement and seniority-based pay systems, shifting instead to a pay system based

on productivity. This would encourage older people to continue working as long as possible. Since Japan's pension payout duration exceeds that of other countries by an average of five to 10 years, raising the starting age could be considered. Incidentally, the US has been working to eliminate age-based employment discrimination. It is important to create workplaces that fully utilize the abilities of older workers. For instance, the tourism industry in Japan's regional cities has a high growth potential. They are expecting an increase in inbound tourism, where we hope that the experience and knowledge of retired managers from large corporations can be utilized.

b) Promoting women in the workforce

Changing the gender norms mentioned earlier will empower women to participate more fully in society. There must be new standards so that both men and women can balance work and child-rearing. The "income wall" previously discussed must be also reviewed in terms of promoting women's participation in the workforce.

The deep-rooted assumption in Japan is that the woman handles housework, childrearing, and caregiving. This societal expectation effectively limits job opportunities for women, who are unable to use their skills and abilities fully. Fundamental changes are crucial in this situation. In general, women who aim for managerial positions find the prospect of overseas transfer a significant obstacle to their corporate ambitions. While it's common practice for a wife to accompany her husband when he is transferred abroad, the reverse situation is not met with a similar understanding. Instead, the wife may be forced to resign or change jobs. Adopting more flexible work practices where both spouses continue to work, the family chooses a place to live together, and partners are able to adjust their workstyles, would make it easier for people to have and raise children. This could contribute to solving the issue of declining birth rates.

c) The active participation of foreign workers: introducing a points-based system

The active participation of more foreign workers can compensate for a shrinking population and lead to greater diversification of the workforce. This diversity is the key to making Japan more competitive in the era of globalization.

The direct investment in Japan (Invest Japan) policy that the Japanese government has been implementing up to now sought to bring in more skilled workers from abroad by making it easier for international companies to set up branches, factories, sales offices, and research and development centers in Japan. Moreover, boosting tourism was expected to raise Japan's profile, potentially leading to a surge in international business activities within the country.

This raised a question, would adding foreign workers offset the drop in population?

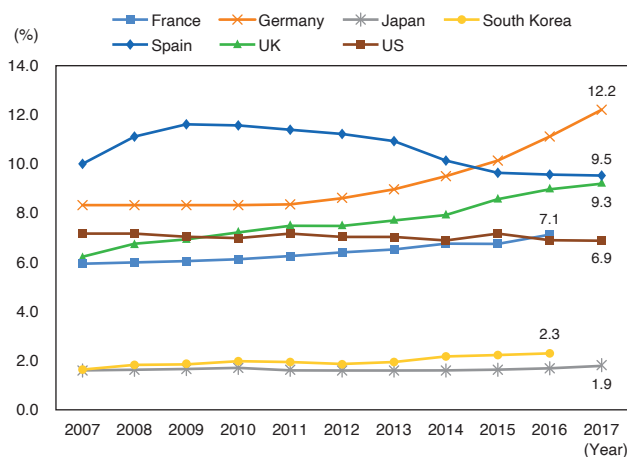
Foreign workers have a more significant presence now. Across all industries, the number of workers from other countries rose from 1.17% in 2010 to 3% in 2020. The National Institute of Population and Social Security Research forecasts that by 2070, foreigners will make up 10.8%, or 8.8 million, of Japan's total population. (The estimated average is based on the net number of foreign workers entering Japan from 2016 to 2019, with the assumption that this trend will continue. Because of the impact of Covid-19, the year 2020 was excluded from the calculation.) This figure is relatively high in comparison to Germany's data. According to Eurostat, from 2014 to 2019, Germany's foreign-born residents comprised 16.2% of the population, the largest share in Europe. It is important therefore to have a system that accepts foreign workers and helps them integrate (Chart 3 & Table 1).

Some problems have been associated with the existing Technical Intern Training Program, which was created so that "foreign technical intern trainees in Japan could enter into an employment

CHART 3

Ratio of resident foreigners to total population in major countries

Refer to JETRO HP General Overview: "The Reality and Significance of Accepting Foreign Talent as Seen Through Data, March 2, 2019".



Note: No data for the year 2017 for France and South Korea.
Source: Created from (OECD) "International Migration Outlook 2018"

TABLE 1

Foreign population stock

Refer to the website of the Independent Administrative Institution of Labor Policies Research and Training Organization. Data Book: International Labor Comparison 2022 (PDF) 2 Population Labor Force Population P. 089 Tables 2-14 Foreign Population (Stock)

	2005	2010	2015	2016	2017	2018	2019	2020
Per 1,000, % (lower row, ratio to population)								
Japan	1,974	2,185	2,122	2,232	2,383	2,562	2,731	2,933
	1.6	1.7	1.7	1.7	1.9	2.0	2.2	—
US	19,858	21,641	22,263	22,426	22,415	—	22,519	—
	6.7	7.0	6.9	7.0	—	—	—	—
Canada	—	—	—	2,405	—	—	—	—
	—	—	—	6.6	—	—	—	—
UK	2,857	4,524	5,592	5,951	6,137	5,991	6,227	—
	4.7	7.2	8.6	9.0	9.3	9.0	—	—
Germany	6,717	6,695	8,153	9,108	10,039	10,624	10,915	11,228
	8.3	8.3	10.1	11.1	12.2	12.9	13.1	—
France	—	3,821	4,335	4,542	4,704	4,617	4,763	—
	—	6.1	6.7	6.8	7.0	7.1	7.3	—
Italy	2,402	3,648	5,014	5,027	5,047	5,144	4,996	5,040
	4.1	6.1	8.4	8.5	8.5	8.7	8.7	—
The Netherlands	699	735	847	901	972	1,041	1,111	1,192
	4.3	4.4	5.0	5.3	5.7	6.1	6.5	—
Sweden	481	603	739	783	852	897	932	941
	5.3	6.4	7.6	8.0	8.6	9.0	9.3	—
South Korea	491	921	1,092	1,143	1,162	1,172	1,951	2,025
	1.1	2.0	2.3	2.3	2.3	2.3	2.4	—

Note: Persons with foreign nationality. Precise definitions vary by country (see OECD database for details).
Source: OECD International Migration Database (<http://stats.oecd.org/>) (as of February 2022)

relationship with their trainers for the purpose of acquiring, utilizing, and mastering skills and knowledge that are difficult to obtain in their home countries.” But the unintended consequence was that the program was at times used to fill jobs with low-waged foreign labor, as well as create a dependency on that labor. It has also been linked with human rights abuses and missing trainees. Therefore, the decision was made to transition to a system focused on securing and developing human resources. Under the new system, workers will be allowed to transfer to a different employer, where before they were, in principle, forbidden to do so. More jobs from different industries would also be added to the program. The new rules and regulations will be reviewed by the fall of 2023. We hope to have as flexible a system as possible.

More than ever, Japanese companies are searching for foreign experts with specialized skills and knowledge. A new system now allows foreigners with a master’s degree and an annual income of over 20 million yen to acquire the residence status of Highly Skilled Professionals (Type 2). They can acquire this after just one year of stay, with no renewal requirements. Thus, Japan is transitioning from a country that merely accepts “foreigners” to more actively and strategically attracting them. We need to push this agenda further.

It is important to consider adopting a “points-based system” similar to what the United Kingdom and other countries use. Because the UK system has only been introduced recently, we need to see how it unfolds. But it seems to be well-suited for giving priority to highly skilled foreign talent. Under the system, points would be assigned and calculated for skill level, Japanese proficiency, and possession of specialized knowledge. Workers with high scores are prioritized. We would like to make this our working group’s basic recommendation for promoting the introduction of foreign workers. Furthermore, we need to recognize that Japan’s employment environment and acceptance of workers’ families do not compare favorably to other OECD countries.

These are the reasons why Japan is a challenging place for skilled foreign professionals to settle: (1) career advancement is difficult; (2) Japan has certain unique employment practices, such as the mass hiring of new graduates; (3) integration and assimilation into the workplace is difficult; (4) schools are not multicultural; (5) there is no work-life balance; (6) salary level may be inadequate; (7) need for high proficiency in Japanese.

There is an urgent need to correct these issues and build an economic and social system that does not discriminate against foreigners.

To make settling into Japan easier for foreign nationals, it is important to create and promote policies that: (1) support the family (unite the family and educate children) (2) improve the work environment (ban discrimination, ensure transparency in career

development, and offer Japanese language lessons).

Whether the foreign talent is unskilled or highly skilled, it is important to build an adequate infrastructure for supporting them. First, the government should set up a central hub to oversee and facilitate the integration and coordination of data-related activities. This should involve the use of DX (digital transformation) for immigration and residency management tasks. For example, entry and exit procedures at immigration can be made digital, and residency application procedures can be streamlined through further digitization.

Furthermore, we must work towards mid-to-long-term social integration. To establish improved living conditions, we will: (1) use digital technology to provide multilingual support at government offices and hospitals, including implementation of measures to promote the spread of “Easy Japanese”; (2) set up systems for Japanese language schools and teachers; (3) streamline procedures related to children’s education and for caregiving, insurance, and pensions; (4) allow people who have lived in Japan for five years to be eligible for permanent residency; (5) accelerate initiatives of the accepting companies, such as performing due diligence (DD) with respect to human rights, ensuring that management respects diverse values.

For foreign workers, the first generation can continue to live in Japan based on their individual skills. But if we look at examples from Europe (such as France and Germany), considerable monetary investment will have to be spent in order to improve education for the second generation. When parents speak imperfect Japanese, it is harder for their children to learn kanji and Japanese grammar in their early years. And once they start elementary school, they have a hard time keeping up with the curriculum. To make it easier for foreign workers to integrate into society, we must continue to support their children’s education through public funding. In addition, we need to have community-based activities to make sure that foreign children are not bullied at school. The recent unrest in France and the Netherlands, along with the UK’s Brexit decision, underscores the complexities of assimilating foreign workers into the societal fabric. Stable, well-thought-out measures are essential for successful integration.

Of concern is the effect of yen depreciation. Foreign workers find that their income is reduced when converted to dollars. There are reports that the number of applicants from overseas, such as nurses, has drastically decreased. It has become necessary to consider measures to ensure that excellent talent from abroad continues to see Japan as an attractive choice for employment.

d) People-to-people exchange

We must continue welcoming international students and technical

interns. The goal is to allow these individuals to learn about Japan and acquire skills that they can take back to their home countries to support economic development. To achieve this, it is important to make sure that they have a fruitful stay in Japan. We need to implement policies that encourage as many people as possible in Asia and all around the world to entertain a favorable view of Japan.

(3) Minimizing Japan's security risk in Asia from population decline and economic contraction

To reduce the risk to Japan's security in Asia, two main strategies are considered.

a) Utilizing high technology

We may use unmanned systems, including robots and artificial intelligence (AI), to maintain military strength despite having fewer troops. Or we may place Self-Defense Forces personnel in more labor-saving positions. However, new types of responses are needed when bringing in such high-tech solutions. Technologies such as AI, cyber warfare, and swarms (groups of drones used in combat) are changing the nature of regional security measures.

Moreover, mastery of these new technologies will require new and longer periods of training. New personnel capable of designing, assembling, and using such complex technologies will be necessary.

As the population grows older and the demand for new types of weapons systems increases, countries that are already struggling to pay for their defense because of a decreasing population will have to consider taking on even more financial responsibility to come up with the money needed for these costs.

Moreover, when private companies become involved in developing new technologies with allies like the US, implementing thorough security clearances will be vital, considering the potential conversion of such technologies for military use.

b) New regional economic security cooperation

We must deepen relationships with nearby nations like South Korea and the Philippines. At the same time, we must fortify our bond with the aforementioned highly populated Asian countries, as well as reinforce mini-lateral cooperation, like the Quadrilateral Strategic Dialogue involving Japan, the US, Australia, and India. Populous countries like India and Indonesia are not threatened by shrinking demographics. Their military budgets have room to grow. Security partnerships with such nations are expected to play a bigger role.

(4) Population trends in Africa and other areas outside of Asia; changes in scale in the economies of the US and China

Looking ahead, it is vital to consider security with international

relationships outside of Asia in mind. For example, in the context of the Indo-Pacific initiative, which is a vital pillar of security in the Asia-Pacific region, it will become important to collaborate with the African region, where population growth is anticipated. Moreover, because of China's declining birth rates and aging population, it seems increasingly unlikely that China will overtake the US in economic size. Even if that were to somehow occur, the situation will probably reverse itself again. The US shares Japan's democratic values and is likely to remain a long-term security partner.

3. Policies that Should Be Referenced in Countermeasures for Declining Birth Rate & Aging Population in Other Countries

Although there are differences in degree, other developed countries, like Japan, face an aging society and are likely at risk of future population decline. We will refer to and introduce policies from these countries (*Table 2*).

(1) France

a) Policies regarding fertility rate

In 2020, France's fertility rate was 1.82, which is considerably higher than Japan's 1.35. The following five policies can be cited as reasons:

- 1) A stable, long-term birth promotion policy – family allowances (benefits) are linked to the cost of living, not GDP.
- 2) Tax policy rules (N-fraction N-power method)

First add up the total income of the family. Then divide it by the computed family coefficient (where adults count as one, the first two children as 0.5 each, and the third and subsequent children as one to get the total) to determine the tax amount per coefficient of 1. With this method of calculating the tax amount by applying a family coefficient, the more children in a family, the less tax they have to pay.

Numerical example: the husband earns 30,000 euros; the wife, 20,000 euros, for a combined family income of 50,000 euros.

For one child, the family coefficient is 2.5. When you divide 50,000 euros by 2.5, the result is 20,000 euros.

For three children, the family coefficient is 4 ($1+1+0.5+0.5+1=4$). Dividing 50,000 euros by 4 gives you 12,500 euros.

Before adjusting for family coefficient, the tax rates are:

- 0% for income up to 11,000 euros
- 11% for income from 11,000 to 27,000 euros
- 30% for income from 27,000 to 79,000 euros

For one child, with a family coefficient of 2.5, income up to 27,500 euros ($11,000 \times 2.5 = 27,500$) will be taxed at 0%. The remaining income of $50,000 - 27,500 = 22,500$ euros will be taxed at 11%.

TABLE 2

Overview of policies from various countries addressing low birthrates & aging population that should be referenced

	Reforms regarding birth rate			Addressing the aging population	Foreign labor policies
	Childcare assistance	Education cost support	Housing policies		
France	Family allowance payments indexed to cost of living, N-power tax rules. Inclusive family policies supporting all types of families (children born out of wedlock, low income, single parent, etc.)	Free public education including university	Priority housing benefits for families with children	Prohibition of age discrimination	Policies such as birth promotion policies and other social policies are applied equally to foreign workers. The education provided to the children of foreign workers is more substantial than that for the general population. For the children of highly educated foreign talent in particular, there have been efforts to prioritize their admission to elite educational facilities. As a result, there has been some backlash from the general citizenry.
UK	Paid parental leave for both parents until child is 6 years old. Allow flexible work arrangements. Full coverage of childbirth costs, 80% of childcare expenses tax deductible	Free public education until age 16	Generous housing cost support for families with children	Prohibition of age discrimination	The UK: Brexit ended the free movement of Britons within the EU. A "points-based system" was introduced to issue a new "Skilled Worker Visa" to people of all nationalities. Priority is given to higher-skilled workers, while lower-skilled workers are not issued visas unless they reach a certain number of points. In principle, 50% of occupations are open to foreign workers. The majority welcome foreign workers as supporting economic recovery.
Sweden	Strong paid leave support for both parents, generous childcare subsidies	Free public education including university	Housing finance system that favors married couples	Mandatory retirement age of 67 years old	Previously, the policy on foreign workers was close to free flow, but recently, due to the rise of right-wing forces, there has been a notable movement to reduce the numbers of refugees and foreign workers. As a social integration policy, significant weight is given to language education. However, the presence of many foreign workers in impoverished areas tends to exacerbate disparities and increase social unrest. Therefore, an inclusive economic policy is required.
Singapore	Increased Baby Bonus cash gifts; expanded government-paid paternity leave	Childcare and parenting subsidies can be used for education and medical costs	Support for childcare and parenting assistance funds that can be used for educational and medical expenses	Retirement at age 63 but can work until 68 if able to	The provision of long-term stay visas is limited (for those who have a spouse or parent who is a Singaporean citizen or permanent resident, about 10% of the total visas granted). There are strengthened measures to acquire highly skilled foreign workers. It is characteristic that about 40% of the labor population are foreign, of which approximately one-quarter are permanent visa holders.

Source: Prepared by the Working Group for Japan's Population Challenges Secretariat

Therefore, income tax due will be: $0 \times 27,500 + 0.11 \times 22,500 = 2,475$ euros.

In contrast, for three children, the family coefficient is 4. Therefore, income up to 44,000 euros ($11,000 \times 4 = 44,000$) will be taxed at 0%. The remaining 6,000 euros ($50,000 - 44,000 = 6,000$) will be taxed at 11%. Therefore, income tax due will be: $0 \times 44,000 + 0.11 \times 6,000 = 660$ euros.

3) Education policy – Provide free public education, including at the university level.

4) Housing policy – Policies take family size into account. Includes public housing provided preferentially to families with children.

5) Inclusive family policy implementation (achieving equality of opportunity and inclusive social security policies that cover poor

families, single-parent families, children born out of wedlock, etc. A social security system that does not discriminate against children born inside or outside of legal marriage). Measures include special benefits to single-parent households.

The policies above give everyone the choice to have children under different conditions. In this way, anyone in a variety of situations – for example, after completing certain job experiences, and whether they are married or not – can have the option to have children. All such policies will play a role in a higher birth rate.

b) Measures against age discrimination

The EU's General Employment Equality Directive prohibits direct and indirect discrimination based on age. In France, a provision in

the Labor Code prohibits discriminatory treatment based on age.

c) Policy regarding foreign workers

Since 2000, the number of foreign workers in France has increased by 36%. Integrating them into society presents a challenge.

1. Application of social policies to promote fertility

Among adults between the ages of 18 and 60, 31% have at least one grandparent born abroad, which makes them eligible for social policy benefits including housing allowances, back-to-school funding, and subsidies for expenses such as babysitting. Whether or not the worker is a foreign worker is irrelevant to the application.

2. Education

Educational policies are implemented to save children from failing academically, regardless of whether they are the children of foreign workers or French citizens. The reality is that the children of foreign workers are better educated than those of the average French citizen. There is also a system in place that gives highly educated foreign professionals preferential admission to special higher education facilities. But this can result in animosity and backlash from the general public in France.

(2) United Kingdom

a) Birth rate policy

The birth rate was 1.6 in 2020, down from 1.93 in 2010.

The ratio of seniors to the working-age population was just under 30% in 2020 and is projected to be about 50% in 2070. (In Japan, the numbers are just below 50% and around 75% respectively. Both are estimates by the United Nations.)

Thirteen weeks of childcare leave are guaranteed for employees until their child turns one year old. Mothers are entitled to nine months of leave benefits and up to 12 months of maternity leave. Fathers can take 26 weeks of paid leave if they apply within eight weeks of the birth of their child. Parents with children under the age of six have the right to request flexible working arrangements from their employers. Regarding maternity and childcare services, there is full financial support for childbirth costs and, starting with the first child, child allowances are provided until the age of 16 without any income restrictions. 80% of childcare costs, such as the use of daycare centers, are tax deductible. Public-school tuition and related fees are free for children up to the age of 16.

These policies make it easier for both men and women to raise children, and additionally allow men to participate in housework at a relatively high level.

b) Policy regarding foreign workers

The issue of foreign workers was a significant issue just before

Brexit, which signaled opposition to the free movement of workers within the EU. After Brexit, Britons could not travel quite as freely as before within the EU states.

The UK introduced a “points system”, started giving out “Skilled Laborer Visa” (work visa) to people of all nationalities, and lowered the minimum yearly income required for skilled foreign workers from 30,000 pounds to 25,600 pounds. The skill requirements have been lowered from a university graduate level to a high school graduate level. The cap on the number of skilled workers that can be accepted has also been lifted. Also abolished was the so-called “resident labor market test” which prevented foreign workers from being admitted if they were thought to hurt the domestic labor market. Workers need more than 70 points based on criteria such as English proficiency and the appropriate skill level for the proposed job. However, the requirement is lower for a doctoral degree holder. Workers with higher skills can get visas without a job offer, but for lower-skilled workers, visas will not be issued unless the above points are met. In principle, therefore, approximately 50% of jobs have been opened up to foreign workers.

This has impacted public opinion; 10 years ago the issue of foreign workers in the UK was a source of economic stress for most Britons. Now 59% of people believe that foreign labor and skills are needed to help the economy recover.

(3) Sweden

a) Birth rate policy

The current birth rate is around 1.5, which has been higher than Japan’s for the past 40 years. This is partly due to higher birth rates among foreign workers. In addition, the relative youthfulness of foreign workers has helped forestall aging of the population. All children under 18 receive a universal allowance, a generous income compensation during parental leave (80% of salary paid for one year), and substantial childcare subsidies (\$150 per month per child). The government strongly enforces gender equality norms. Financial measures are also in place to help couples secure housing.

b) Foreign worker policy

Sweden has long been concerned about labor shortages and the country’s future as the population trends downwards. It recognized the need for a policy that allows for the acceptance of foreign workers and for utilizing refugees as a strategic labor force.

It is especially noteworthy that in 2008 the government stopped its labor market testing when bringing in non-resident workers. (A check was required to see if there actually was a domestic labor shortage before accepting applicants from abroad.) However, far-right parties who advocated against foreign labor grew more influential. As a result, refugee acceptance became more restrictive

with bans on permanent residency and strict visa requirements. Meanwhile, to promote social integration, non-EU foreign workers are required to receive union-approved wages. There are no limitations on the kinds of jobs that can be held. There are regulations to prevent the cost of housing from being prohibitive for immigrant employees.

Meanwhile, as part of a policy for integrating foreign workers, Sweden emphasizes language education, as well as adult education for those who have not received schooling. Given that a large number of them live outside major urban areas, support for finding housing is stressed. Many live in poverty. Female foreign workers with children are less likely to be employed compared to Swedish women. Stark income disparities exist in large urban areas, while poorer areas are turning into a breeding ground for crime. These and other significant challenges remain. The smooth integration of foreign workers into society is a major task.

(4) Singapore

a) Birth rate policy

Singapore's birth rate was 1.03 in 2022, lower than Japan's 1.3.

Attention has been drawn to the negative effects of low birth rates since the mid-1980s. A variety of incentives were introduced to counter the declining birth rates, but the rates continued to fall despite a temporary increase. Marriage and Childcare Support packages were introduced in 2004, 2008, and 2013. They granted significant subsidies for married couples to purchase houses, substantial subsidies for families with children, extension of paternity leave, assistance for childcare, matchmaking support programs, and tax deductions for households with children.

By 2030, one in four people is projected to be elderly (an aging rate of 25%, the proportion of the population aged 65 and older.) Although the official retirement age is 63, to promote the employment of elderly people, employers are mandated to offer re-employment opportunities up to the age of 68. Part-time re-employment subsidies will be extended until 2025.

b) Foreign worker policy

Approximately 40% of the labor force consists of foreigners (combining just under 10% who are permanent residents and just over 30% who are non-residents). Policies are strengthened to attract highly skilled foreign workers. The Expert Pass is issued to non-residents who earn a fixed monthly salary of 30,000 Singapore dollars (1 SGD = 100 yen) or more, which places them in the top 5% among Employment Pass holders. The pass is valid for five years and allows holders to work for multiple companies simultaneously.

4. Conclusion

Japan's declining birth rates and an aging population are long-term trends that highlight the need to correct underlying structural problems. It is essential to correct this structure over the medium-to-long term by setting population targets. "Maintaining a population of around 100 million people in 50 years (2060)" was set out in the Basic Policies for Economic and Fiscal Management and Reform (the Grand Design), a target set by the Abe administration in June 2014. These are suitable goals to prevent negative economic growth due to population decline, avoid further devastation of regional economies, maintain the social security system, and ensure security in the face of rising geopolitical risks. Social and economic systems such as lifetime employment and seniority systems, previously predicated on population growth and a large number of young people, must fundamentally change to accommodate the shrinking and aging population.

To halt the trend of population decline, it is critical to both improve the birth rate and expand the intake of foreign workers. From a medium-to-long term perspective, we must implement policies that provide incentives for having children and allow people to appreciate the benefits of accepting a global workforce, while also encouraging foreign workers to see the benefits of immigrating to Japan and working here.

The current Kishida administration's extraordinary measures against declining birth rates are based on the medium-to-long term perspective: 1. Increase the income of the younger generation; 2. Change the structure and consciousness of society as a whole to support childrearing with the participation of companies, men, and the community; and 3. provide seamless support regardless of parents' employment or family situation, aligned with life stages. While this is the right direction to take, Japan is still only halfway to achieving these goals, compared to other countries.

Furthermore, Japan should promote 1. Structural income growth through a more flexible labor market; 2. Creation of attractive job opportunities in regional areas through the stimulation of tourism and other industries; and 3. Improvements to work-life balance through enhanced remote education and work. Japan should also consider implementing other measures such as tax rules (N-fraction N-Power) adopted by France, policy support that includes children born out of wedlock, and expansion of free public education, including university studies.

According to the 2021 version of the White Paper on Measures to Cope with the Declining Birth Rate, Japan's child-related budget is relatively low at 1.65% of GNP, compared to around 3% for family-related expenditures in the UK and France. There is room for significant expansion. It is important to form a national consensus

TABLE 3

Policies not covered in Prime Minister Fumio Kishida's unprecedented countermeasures for the declining birth rate & foreign talent recruitment strategies

①	<p>Spread of remote education & remote work</p> <p>Spreading remote education means that whether people live in rural areas or belong to low-income groups, they can access the best knowledge to improve their skills. This raises productivity and income so that people can better afford having children. Additionally, more options for remote work give people more choice over where they live. Saving commuting times and having more leisure time means people can afford to have children. For women with children commuting times had been an obstacle to working or working full-time, but remote work allows them to avoid expensive big cities and work in areas with shorter daycare waiting lists.</p>
②	<p>Labor market reforms</p> <p>Making the labor market more flexible creates better matches between workers and jobs, consequently improving worker productivity and raising wages. This gives people the economic means to have children.</p>
③	<p>Promoting industries like tourism to create attractive employment opportunities in rural areas</p> <p>Japan's rural areas have abundant untapped tourism resources. Developing the tourism industry could create many jobs for youths and accelerate young people settling in or moving to rural areas. An affluent life in the countryside with few time constraints would make child rearing possible.</p>
④	<p>Raising children born out of wedlock</p> <p>In France, 61% of total births are to unmarried parents, while in Japan the rate is just 2.4% (both 2020). France offers the same subsidies from the government to assist in raising children, whether the parents are married or not.</p>
⑤	<p>N-fraction N-power tax rules</p> <p>France's tax rules sum up all family income, divide that by a family coefficient (1 for each adult, 0.5 for the first two children, 1 for each child thereafter) to determine the tax amount per coefficient of 1, then multiply by the family coefficient for total tax amount owed. More children means less taxes owed overall.</p>
⑥	<p>Accelerate the acceptance of highly skilled foreign workers</p> <ul style="list-style-type: none"> • Singapore's Specialist Pass System • The UK's "points-based system" • France's social integration education for foreign workers' children

Source: Prepared by the Working Group for Japan's Population Challenges Secretariat

on funding sources, recognizing that Japan's consumption tax is relatively low.

The expansion of foreign labor, which is another measure to stop population reduction, involves transitioning the current Technical Intern Training Program into a new system driven by the need to "secure and nurture talent". Japan should commit to a full-scale expansion of highly skilled international talent and to support this, improve the environment for welcoming their families. They should have ready access to Japanese language lessons and quality education for their children. Additionally, job discrimination should be prohibited in the workplace. Japanese society as a whole should create an environment that is more open to foreign workers (Table 3).

According to the National Institute of Population and Social Security Research, the birth rate for maintaining the current population should be 2.07. This is a much higher rate than 1.26, which was the figure the Ministry of Health, Labor and Welfare announced on June 2, 2023. Birth rates under 1.50 are considered

"ultra-low", a situation for concern. We might assume that the reason for the current low birth rate is that fewer people were getting married during the Covid-19 crisis. But even if the pandemic impact eases, and the current measures to raise the birth rate gradually begin to work, the Research Institute still predicts a low birth rate of 1.64. According to its calculation, by 2070 there will be just under 100 million people – 95.49 million, of which 8.8 million will be from other countries. Therefore, to ensure a long-term population of 100 million, it is necessary to implement all policies, including those aimed at foreign workers. Raising national awareness of the issue through large-scale social mobilization will be an important step towards Japan becoming a "child-friendly society".

Article translated from the original Japanese by Cheryl Chow. JS

The Japan Economic Foundation (JEF) initiated the Working Group for Japan's Population Challenges with prominent Japanese experts in January 2023 and published policy recommendations in Japanese in November 2023.

Roundtable with Tomoko Okuda, David Atkinson, Mitsuaki Hoshino & Masakazu Toyoda

Opportunities & Challenges for Japan as a Tourism Powerhouse

By Japan SPOTLIGHT

For the *Japan SPOTLIGHT* July/August 2023 issue highlighting tourism's recovery from the pandemic crisis, we held the following roundtable showcasing Japan as a tourism powerhouse.

Participants: Tomoko Okuda, Proprietor of Kyoto Cuisine Ryokan (Inn) Shiraume
 David Atkinson, President of Konishi Decorative Arts and Crafts Co., Ltd. and Special Advisor to the Japan National Tourism Organization (JNTO)
 Mitsuaki Hoshino, Director of International Tourism Department of the Japan Tourism Agency
 Moderated by Masakazu Toyoda, Chairman & CEO, Japan Economic Foundation (JEF).
 (Online Roundtable on May 29, 2023)

Participants



Tomoko Okuda



David Atkinson



Mitsuaki Hoshino



Masakazu Toyoda

Introduction

Toyoda: At the beginning of this roundtable discussion, I would like to speak about today's themes. As the Japanese economy is faced with the challenge of depopulation, the idea has emerged that tourism could be a driving force of growth to compensate for the possible economic decline due to depopulation, and especially so in the process of recovery from the pandemic disaster.

Japan has rich natural tourism resources, such as landscapes with mountains, rivers, and coastal areas, as well as a variety of plants and animals. The climate is generally mild and the four seasons regular and predictable. Japan also has a distinctive culture, and Japanese cuisine was registered as a World Intangible Cultural Heritage by UNESCO in 2013. But in spite of such great potential for tourism, the number of foreign tourists visiting Japan has not reached even the top 10 among nations.

Today, we have invited three experts on tourism to discuss three different questions. What are the most attractive aspects of Japan for visitors from abroad? Can Japan's tourism industry be internationally competitive and a key industry for supporting the Japanese economy? And how can we attract many more visitors to fill the gap between the reputation and the reality of foreign tourism in Japan?

Our three experts are, first, Ms. Tomoko Okuda, proprietor of Cuisine Ryokan Shiraume, number one in Kyoto's hotel rankings, and also president of Gion Shinbashi Townscape Community Planning Council; second, Mr. David Atkinson, who has inspired Japanese people by saying that Japan should be number one in inbound tourism revenue as it enjoys the highest reputation as a tourist destination in his numerous books on it; and third, Mr. Mitsuaki Hoshino, director of the International Tourism Department of the Japan Tourism Agency, responsible for the Japanese

government's tourism promotion strategy, and the Tourism Nation Promotion Basic Plan that he has been working on has just been approved by the Cabinet at the end of March 2023.

We would like to start the discussion with the question of what is most attractive to foreign tourists about Japan. Ms. Okuda, you are working in Kyoto, considered to be the most attractive tourist spot in Japan. Could you tell us your thoughts about this question? Even in Kyoto, tourist numbers have been falling due to the pandemic these past couple of years up until 2022. What was the situation in Kyoto and are tourists returning now?

Japan's Attraction for Tourists from Abroad

Okuda: Japan has many points of attraction for tourists, such as natural scenery, cultural customs and artifacts, and historical sites. Although Japan is a small country, it has an unusual diversity of cultures within it, from the north to the south – from Hokkaido to Okinawa. But the big issue now is that we cannot take full advantage of these attractions for tourism promotion.

In Kyoto for example, there are many wonderful hotels with luxury rooms and many public spaces, but I think one of the issues is the quality of service of the staff.

Gion Shinbashi Townscape Community Planning Council was started in 2015. We established this because the uniqueness of Kyoto was gradually being lost and it looked all too similar to any other tourist spot. In this area, as a landscape preservation district, we have many rules to be rigorously observed. But as the young generation succeeds in business in this district, new businesses try to attract tourists only to their own business regardless of the harmony of the town community.

We Kyoto people respect the custom of working hard together to enhance the community as a whole and attract tourists to Kyoto. But many young entrepreneurs today do not hesitate to break this custom and the rules, such as the color of a shop curtain or the shape of the architecture. If this situation continues, we cannot preserve our unique culture.

I believe that our culture must be passed on to the future generations. Of course, Gion today is different from what it was 200 years ago, and I think that good ideas, though new to us, can well be adopted. But we founded this Council for the preservation of our own culture in this district and made it a rule to have prior consultations with new shops and discuss with them the nature of their business, their management of it, and their appearance – and thus without our permission, they cannot apply for the Kyoto city government's official permission to open a new business.

It is true that due to the pandemic there have been very few tourists in Gion these past two or three years. It was, however, shocking for me that all the tourists that did visit us during the

pandemic, mostly Japanese, were saying the same thing – namely that Kyoto had lost its unique charm before the pandemic, but only now with Covid-19 was the ancient Kyoto coming back.

Bearing these views in mind, we must think about how to develop tourism in Kyoto while preserving its unique traditional townscape. This is our future challenge.

Tourists from abroad have recently been returning too. I was walking around Hanamikoji and Shijou-Dori yesterday and found that 99% of those walking in these areas were from abroad and I could not hear Japanese at all. The serious problem is that they were just walking and not spending money. This presents a very tough situation for the shops on the streets.

Toyoda: What do you think are the acknowledged attractions of Japan, Mr. Atkinson?

Atkinson: I think it is wrong to think about what we think of as Japan's tourist attractions, though there seem to be many people who think like that. The key question is what travelers are looking for when they visit Japan. It is not a question just of which heritage sites or beautiful scenery you can list; the point is the diversity of attractions.

For example, it is not true that so many tourists visit Kyoto just because of its many temples and shrines. Kyoto offers a rich diversity, such as Gion, cuisine, hiking, shopping venues, all concentrated in a relatively small area. Tourists don't come only for history and culture. So it does not make sense at all to try to define a limited list of the attractions of Japan as a possible tourist destination for all 8 billion people in the world. You cannot enjoy looking at temples and shrines all day and night over a two-week stay. There are also many tourists who want to go to the beach or the mountains or walk in a national park. Japan has many beautiful national parks and it loses out on a much larger market if it does not fully utilize these unique resources.

Look at Kamakura, for example. It is certainly true that without its cultural properties, Kamakura would not attract as many tourists as it does, but it cannot attract as many people as it does only with its cultural properties. The Enoshima Electric Railway, the beach, good food, and many other factors all contribute to the number of tourists visiting. History and culture are not the only or even main decisive factors in the success of a tourist spot, though they are certainly important.

Thus how many world-beating tourist attractions a country has is not the real question. In fact, there are not that many world-beating tourist attractions in the world. It is often said in Japan that more tourists visit a country with the most world-beating tourist attractions, but it is not true that we travel to any given country only for that reason. It is human nature to choose a new place to visit. In

this regard, the key questions in a tourism strategy are whether a nation has tourism assets that people want to visit at least once in their lifetime, whether those resources have been invested in properly to be attractive to tourists, and whether the infrastructure has been put in place to earn the revenues to make tourism sustainable.

It is fundamental to a tourism strategy to invest in and create such resources and venues. The Japanese idea that there is no need to invest in tourism development is extremely irresponsible. Tourism assets rarely exist; they are created by investment. Without investment in tourism promotion, nowhere can become a good tourist spot. In my opinion, investment to make such venues attractive is the key to a successful tourism strategy.

Toyoda: Mr. Hoshino, what would you say are the main appeals of Japan's tourist resources, as a member of the Japanese government section in charge of tourism promotion? Due to the pandemic, inbound tourism has largely decreased these last couple of years. Could you also tell us whether it is now rebounding to its former levels?

Hoshino: Inbound tourism is certainly returning now. According to a questionnaire survey among tourists worldwide, Japan is fortunately referred to as "the country which they definitely want to visit after the pandemic". There could be an argument about which aspects of Japan they value, such as food, culture, or seasonal elements, but I imagine people value Japan by taking a comprehensive view of these factors.

Before the pandemic, in 2019, foreign tourists visiting Japan totaled around 32 million, the highest level ever. But with the pandemic's impact, this declined to 4.12 million in 2020 when there were still many foreign tourists until February, and then continued to decline to 0.25 million in 2021. In accordance with the decrease in infections, the Japanese government has been relaxing its border measures against entrants into the nation, even after June 2022 when the ban on group tours was lifted. More importantly, since Oct. 11, 2022, it has lifted the ban on visits by individuals on condition they have a vaccination certificate.

With these new policies in place, the number of foreign tourists visiting Japan has been increasing steadily again.

In February 2023, there were around 1.5 million foreign tourists, in March around 1.8 million, and in April around 1.95 million. The number for February indicates a recovery to 67% of the level prior to the pandemic. China still maintains its ban on group tourism, but if that is disregarded the level would be back to 82% of the level prior to the pandemic. As you know, the Japanese government lifted all border measures at the end of April, and on May 8, Covid-19 was considered to be at level 5 – the same level as influenza – from level

2 in terms of severity. Restrictions on people's lives in Japan were widely modified with these new policies, and so we expect many more tourists from now on.

Tourism as an Industry

Toyoda: Let's discuss tourism as an industry. What do you think needs to be improved in the Japanese tourism sector in comparison with other nations? Do we need more investment in the tourism business, as Mr. Atkinson mentioned? He mentioned in his book that we need to attract tourists from abroad who would not hesitate to pay a high cost for tourism, in particular those coming from nations far from Japan, such as in Europe. Failure to attract such high-class guests is an issue that needs to be solved. What is your advice, Mr. Atkinson?

Atkinson: A destination has to find a way to earn sufficient revenue to cover the inconvenience of having tourists visiting. Only when there is sufficient revenue being generated does tourism become a business, and without those revenues, the number of tourists visiting is simply an empty boast.

According to the United Nations World Tourism Organization, 70% of tourism in a country on average comes from intra-regional tourism. Thus it makes sense that most inbound tourists coming to Japan are from Asia. Likewise, in Europe, most of the tourists are from Europe; and the same in America. Intra-regional tourism is the mainstay of tourism everywhere.

Initially, Japan's tourism strategy was focused primarily on Asia and the number of tourists coming from Asia rapidly increased. Once Japan had reached critical mass from Asia, I suggested changing the strategy from a mainly Asian-oriented one to attract tourists from all over the world.

My point was that long-haul tourists stay longer because of the higher cost and longer travelling time. They not only stay longer but also stay in more expensive hotels, because the higher investment required to visit Japan attracts more affluent travelers.

Japanese tourists will tend to stay at hotels and inns mainly at weekends and during the major holiday seasons. However, on weekdays their occupancy rate is relatively low. Tourism from overseas will help to raise occupancy rates over the year since holiday periods globally are different and especially because overseas visitors will travel for a longer period than is true for Japanese tourists. I have also argued that Japan needs to attract more wealthy tourists, but one of the challenges for the Japanese tourism industry here is the lack of hotels to accommodate them. As a rule, hotels and restaurants account for roughly half of tourism revenue, so Japan cannot attract this market even if it can compete on the basis of heritage or nature unless it invests more in its hotel

infrastructure. This is not just the right hotel buildings. More needs to be invested in the right human resources, and that means higher salaries which also creates an additional boost to the local economy.

Such investment in better hotels and more qualified human resources has to come first, after which a destination can be promoted. Spending a lot of money on promotion without such investment is a waste of money. No matter how much a restaurant with bad food may spend on promotion, customers may come once but afterwards it would get bad reviews on SNS. In the Internet age, if your product is not good, a lack of investment quickly results in bad reviews on the Internet.

In order that foreign tourists from abroad can enjoy staying in Japan, good signage in English and other languages is a necessity. Obviously, most people cannot understand Japanese on their first visit to Japan. Museums and heritage sites need multi-language ear-phone guides and Wi-Fi needs to be widely available. With the right infrastructure investment, Japan can become a major tourist destination, and its reputation will spread via the Internet. The source of any industry's profitability is investment and the same is true for the tourism industry. People working in the tourism industry need to understand this essential point.

Toyoda: A question to Mr. Hoshino. Tourism is considered as a pillar of Japan's growth strategy in the Tourism Nation Promotion Basic Plan. I am interested in this plan from three perspectives: raising or maintaining growth against depopulation, the vitalization of local economies, and the promotion of Japan's soft power. Could you briefly explain about these three perspectives? And could we also have your views on what Mr. Atkinson has said about the need for investment in tourism facilities and in particular his view on long-haul visitors? How is the Japanese government trying to address this issue?

Hoshino: We consider tourism an important pillar of our growth strategy and thus it means effectively considering tourism as an industry. At this moment, the Japanese population is around 126 million and annual consumption per person is around 1.3 million yen. Hereafter, depopulation will progress and there will be only 100 million people around 2052, according to one estimate. So annual consumption will decrease as well. Can this consumption decrease be compensated for by an increase in consumption by inbound tourists?

According to the statistics in 2019, visiting foreign tourist numbers were about 32 million and their consumption for travel was 4.8 trillion yen. So expenditure on travel per person by foreign tourists is calculated to be around 158,000 yen. This means that with just eight foreign tourists, the annual consumption per person in Japan of 1.3 million yen will be compensated for.

For domestic tourists, this amount corresponds to 23 tourists staying in hotels and 75 making day trips. So in this light, it would be more effective for us to have foreign tourists. The 4.8 trillion yen in expenditure on travel by foreign tourists can be considered as exports of services in trade, and this was the third-largest figure among industries, following automobiles at 12 trillion yen and chemicals at 8.7 trillion yen.

There is a secondary impact of tourist consumption on other industries and on transportation. Total consumption for travel in 2019 including both Japanese domestic and outbound tourists and foreign inbound tourists was around 29.2 trillion yen. This produced 55.8 trillion yen in additional production and 4.56 million additional jobs. This is how we can see that tourism will play an extremely important role in the economy.

So we must consider the tourism industry as a rising one and try to restore a strong economy using its strength. I believe in particular that this would play a pivotal role in revitalizing local economies suffering from a decline in their resident population.

It should be noted that we changed our policy from one focused on visitor numbers to one focused on quality in this basic plan. Above all, we are aiming for high consumption by foreign tourists and also at developing local tourism industries. In this plan, we consider long-haul customers staying longer in Japan as well as wealthy ones as important elements in tourism promotion.

Toyoda: Ms. Okuda, your inn has five rooms in the main building and two rooms in a separate building and super high-class inn. In Japan, we would tend to think an egalitarian society is better, but looking at the rest of the world there are not a few super-wealthy people. Do you think an inn or a hotel that could attract such very rich tourists would produce added value?

Okuda: I think consumption per tourist would be a more important goal in tourism promotion than the number of visitors. Our customers would be ready to pay whatever is needed to have a wonderful experience. We have only seven rooms and it is an old inn, almost 160 years old. We must follow unique restrictions regarding landscape preservation and we neither have any outdoor open-air bath nor a vast garden. Given these conditions, why do customers choose our inn? I believe the reason is the invaluable experience we offer – namely, experiencing traditional Japanese customs. For example, today there are some young Japanese who have never slept on a futon or have never seen *fusuma* or *tatami* or have never had a special sake drink to celebrate New Year's Day. We welcome those young Japanese and foreign tourists to experience traditional Japanese customs in our facilities. Therefore, our customers do not say "stay" but "experience" in referring to their being with us. Their experience with us is worth the extra cost. A

cheap hotel would be good enough just for staying, as even cheap hotels are well appointed today. So the focus of tourism promotion must be on how much money tourists have spent rather than the number of foreign visitors.

Investment in tourism facilities is of course important. Even though they can have a good experience, if a toilet has to be shared by customers in a hotel, wealthy customers would not come. There needs to be minimum facilities for good customers, and even more, investment in human resources. In a small inn like ours, there are lots of occasions when our staff communicate with the customers and their skills strongly affect the customers' satisfaction. How much knowledge and experience staff members have is crucial and thus education for the staff is indispensable. Such education is limited in small businesses and this will be a future issue for tourism promotion.

Assuming that foreign tourists are increasing, local people would not be convinced of the benefits of tourism unless they could earn money. They would consider it a nuisance. In particular, Kyoto people, even only those in the Gion area, would feel this strongly and consider it tourism pollution, since it would be more difficult to ride on a bus and go to shops often due to excessive tourism. You cannot gain locals' support for tourism promotion if this situation continues.

I hope there will be a local system for local residents to gain the benefits. For example, we could have a different fee for public transportation to be applied for local residents and tourists. Other facilities like museums could apply such a system as well. This is how municipal governments could gain money, and this money could eventually be to the benefit of the locals.

Toyoda: Are there many foreign tourists coming to your inn?

Okuda: Yes. Around May, half of our customers are foreigners. But we are restricting the number of foreign customers, because they tend to plan their trips a long time in advance and if we accepted reservations so far in advance, our customers would all be foreigners. However, most of these foreigners come to our inn, such a small place in Gion, to enjoy experiencing a traditional Japanese lifestyle. If they find themselves surrounded by all foreign customers, they would be disappointed. In this light, we try to avoid having all the customers being foreigners at any given moment and create an environment where the majority of customers are Japanese.

Toyoda: Is there such a strong demand around the world for staying at your inn?

Okuda: Yes. There are now 60 to 70 inquiries per day from abroad. We have to turn down most of the requests for reservations because

we have such a strong demand from overseas.

Enhancing Tourism Industry's International Competitiveness

Toyoda: The last subject for discussion is what to do to improve the Japanese tourism industry's international competitiveness. First, I would like to ask Mr. Hoshino. The goal for the number of visiting foreign tourists in 2025 set in the Fourth Tourism Nation Promotion Basic Plan is to exceed the number in 2019 and it looks rather modest. But it may be reasonable because of the remaining threat of the pandemic. Anyway, you would need to have an ambitious goal and a policy to realize it. Could you explain the essential points of the policy support adopted in this basic plan? I think most importantly the industry must maintain business profitability by itself rather than depending on government subsidies. In this sense, the issue of the Integrated Resort (IR) is very important. Could you give your view on this as well?

Hoshino: The Basic Plan was revised on March 31, 2023. The points of this revised plan are to aim at building up sustainable tourism spots nationwide, restoring inbound tourism and expanding domestic tourism. These three goals are expressed with three key phrases: "sustainable tourism", "consumption expansion" and "promotion of tourism in local regions". As goals for 2025, aiming at raising the quality of tourism, we set up new goals such as increasing the number of regions engaged in building up sustainable tourism spots to 100, increasing a foreign tourist's consumption for travel to 200,000 yen, and also two-night stays in local regions of Japan per foreign tourist. Of course, we set up a numerical target for foreign tourists visiting Japan as one that exceeds the level in 2019, but the core of this plan is to establish goals for the improvement of quality.

The first goal, building up of sustainable tourism spots, will be promoted in the belief that we need a framework to create a virtuous cycle in local communities and economies through tourism promotion. In particular, on the issue of business profitability, we are aiming to link increased profitability or productivity with improvement in the working conditions of employees.

We will subsidize investments for the restoration of tourism spots by enhancing added-value, such as large-scale reforms of banquet rooms into something else, given less demand for them under the pandemic, and also promote digital transformation (DX) in tourism. We will help the tourism business in replacing a wide range of manual work with digital technology and thus reduce human labor. But we will also promote a policy of raising and keeping human resources in tourism.

As Ms. Okuda mentioned, we want to create a firm consistency

between preserving local nature and culture and developing tourism, while maintaining the local residents' sympathy with our plans. We want to pursue a policy for such consistency between the two.

As for restoration of inbound tourism, we want to achieve the goal of the number of foreign tourists visiting Japan exceeding the level of 2019 as quickly as possible. In doing so, expansion of inbound tourists' consumption and promotion of visits by foreign tourists to Japanese regions are very important goals, and we reflect these key concepts in our basic plan with new numerical targets such as 200,000 yen in consumption per foreign tourist and two-night stays in local regions per foreign tourist. More specifically, we will promote a "restarting tourism movement" to publicize Japan's attractions by creating special experience for foreign tourists all over the nation. We are working hard now on the contents of these special experiences.

On the issue of attracting wealthy foreign tourists, with Mr. Atkinson's guidance, we came up with five concepts for this. The first is "sell" – meaning how to create potential value to meet the needs of high-end tourists. The second is "lodge" – meaning how to prepare high-class lodging facilities for those wealthy tourists. The third is "human resources" – meaning how to assign the right staff for such lodging venues and how to develop the hospitality shown by tour guides. The fourth is "connection" – meaning how to communicate in particular with potentially wealthy foreign customers. And the fifth is "transportation" – meaning how to develop new transportation means for these wealthy people, such as those visiting by private jet, to create added value for them. In March 2023, we chose 10 regions as models and are ready to discuss how these concepts can be specifically achieved.

Our strategy for expansion of Japanese domestic tourism is important as well, and this is the third goal defined in our basic plan. We aim to spread demand for tourism across the months and develop a new demand for domestic travel that will lead to the expansion of employment in tourism-related sectors. More specifically, we are planning to promote new practices for holidays and create second hometowns.

In talking about investor relations, casinos are always mentioned, but I think it should be emphasized that an IR could attract not only casinos but also international conventions and business customers. Business customers are good customers, as consumption per individual is high. Furthermore, they spend time not only working but also on tourism and they would stay longer at such resorts. I think it would be important to meet various people's needs in thinking about a future tourism promotion policy.

Toyoda: Ms. Okuda, could you talk about what you expect the Japanese government to do, on behalf of people engaged in tourism in Japan? Also, if you have any advice for local tourism industry

people, could you tell us?

Okuda: Among many things I would like the Japanese government to do, human resources development for tourism that I mentioned cannot be accomplished in a short time. In Kyoto, there are not only big hotels but also small ones and inns. Those small ones in particular cannot afford to spend money for education of their staff or human resources development. They cannot spend much time either on that in the midst of Covid-19 and they also suffer from a labor shortage. We will need public support in this area. I would like the government to start working on creating a system for support by which we can send our staff to public education schools for a certain period to help raise the quality of services. Another thing I would like the government to do is to improve the quality of tour guides, who are the important links between tourists and the destination sites.

For people in the local tourism industry, I suggest they come up with some creative ideas. A good example often mentioned is the hot springs in Kurokawa in Kumamoto Prefecture. They were once almost deserted and at a certain stage they found they could not continue business, and so all the hot spring village people got together and decided to issue a certificate for bathing to be used in any hot spring among all the lodging facilities in Kurokawa, and this eventually led to explosive popularity.

However, no matter how creative the ideas may be to attract foreign tourists, they will be difficult to attract if the area has bad traffic access. Convenient transportation, at least to some extent, will be necessary.

Toyoda: Mr. Atkinson, if Japan aims to be the top tourist destination in the world, I think government-private sector collaboration will be necessary to boost the tourism industry's competitiveness. Could you tell us more specifically what kind of private business efforts and public policies are desirable in this light? Please also tell us what is lacking in government and private business efforts at this moment.

Atkinson: Japan's tourism strategy has been successful mainly because it has a both a target to increase the number of inbound tourists balanced by a revenue target. The quantitative goal is tempered by the qualitative goal.

No major car company produces just one car. To serve a global population of 8 billion, there is a wide variety of options available to answer to the very wide range of demand. Some people prefer to drive a small car, while others prefer SUVs, and yet other demographics own expensive sports cars. Toyota has many kinds of vehicles to meet such diverse needs, and tourism is no different. Increasing the number of tourists visiting the prefectures, towns and villages can be achieved relatively easily, if aimed at tourists who do not spend much money. But this does not boost the local

economy and above all imposes a heavy burden on local communities.

During the administration of late prime minister Shinzo Abe I argued passionately for the establishment of a number and a revenue target to address the issue of over-tourism. Japan's traditional tourism business model was not focused on increasing revenues per traveler. As a result, the industry under-invested and simply focused on increasing the number of people visiting in order to increase revenues. The strategy now is to raise the spend by tourist while increasing the numbers. Obviously, it is preferable to have 30 million tourists spend 10,000 yen each, than 50 million people spending only 1,000 yen each. There needs to be more capital investment and investment in human resources in order to raise the average spend. This is vital to attract wealthier tourists.

The three basic forms of investment – in R&D, facilities, and human resources – are the keys to raising revenues anywhere in the whole economy. Tourism is no exception. In order to raise the average spend, we need to raise both the quality and the salaries of the people working in tourism. You cannot earn a high salary only by bowing. Staff need to be knowledgeable, to be able to communicate effectively with customers, which may require foreign language ability, and to be able to resolve issues. Staff may need to be able to respond to questions about history if in Kyoto, or if in a national park about activities or questions about the local flora and fauna. It is thus inappropriate for a hotel to expect guests to pay a higher room rate and then to pay most of its staff the minimum wage. A tourism strategy must aim to raise wages in the industry, and for that there needs to be investment in the appropriate hotel infrastructure.

The restaurant industry is one of the only sectors in Japan that has successfully met the great diversity of consumer needs, ranging from Western cuisines and ethnic cuisines to Japanese cuisine, and running from the expensive all the way to the very cheap. Sushi, for example ranges from the cheap conveyor-belt sushi restaurants to the very expensive high-class ones in Ginza. Many of the people working in Japan's restaurant industry have excellent language skills.

One of the greatest attractions for tourists in Japan is that you can enjoy such a variety of global cuisines at such a high level in a single country. Among the many tourism resources in Japan, food is the most highly evaluated by overseas tourists. And not just for Japanese cuisine. Japan has perhaps the broadest range of international food at the highest level of any country in the world. It is thus wrong to promote only Japanese cuisine to the rest of the world. There are amazing coffee shops and also excellent curry restaurants in Japan. In Kyoto, there are so many excellent bakeries.

The hotel industry in Japan is not on the same level as the restaurant and pubs; nor are Japanese tour guides. Japan needs to redouble its efforts to achieve high profitability, as there is a huge world population out there. There is more than enough global

demand to support more profitable businesses.

Finally, there is the question of local government and over-tourism. If residents of Kyoto cannot get on a city bus because there are so many tourists from abroad, then why doesn't Kyoto city simply increase the number of buses? Over-tourism, in my view, is caused by a lack of investment in infrastructure, mainly by local authorities. In Italy, 20 million people visited Venice every year. Venice has a population of around 60,000. In Kyoto, before Covid the number of overseas tourists was probably around 4 or 5 million at peak, and there are many more than 60,000 residents. Relative to Venice or London or Barcelona, Kyoto was absolutely not suffering from over-tourism. Kyoto rather was suffering from a lack of infrastructure investment and an insufficient response to bottlenecks highlighted by tourism. The local government was the cause of any inconvenience suffered by Kyoto residents when the number of tourists increased.

Concluding Remarks

Toyoda: In conclusion, could you all please give a key phrase or concept for promoting Japanese tourism?

Okuda: Human resources, facilities and a virtuous cycle between them.

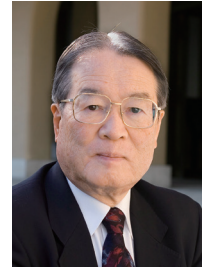
Atkinson: Let's make money.

Hoshino: I would strongly recommend to people all over the world to see the changing landscape of tourism in Japan as the result of our efforts to resolve the challenges we face.

Toyoda: Thank you very much, all of you. Tourism is undoubtedly a rising industry in Japan and an important industry for Japanese people. I would like all of you to continue your valuable efforts to promote it. **JS**

Written and translated by Naoyuki Haraoka, editor-in-chief of *Japan SPOTLIGHT*, with the cooperation of Tape Rewrite Co.

Japan's Foreign Diplomacy & Security Strategy, & Its External Economic Strategy in Relation to the Taiwan Crisis



Author Satoshi Morimoto

By Satoshi Morimoto

Conflicts & the International Order

The peace and security of international society is maintained by order based on international law. In regard to such international law, in order to prevent the recurrence of a global-scale war, after World War I the League of Nations Convention was concluded and the League of Nations (LON) established. However, since the LON Convention had not formulated effective sanction measures against countries that violated the Convention and waged war, it is thought that Adolf Hitler found loopholes in it and was emboldened to dissolve Czechoslovakia and proceed with his invasion of Poland, the latter step sparking World War II.

The Charter of the United Nations, concluded after WWII, focused on compensating for this defect in the LON Charter and established necessary measures based on the Resolutions of the UN Security Council (UNSC) in regard to acts that ran the risk of disturbing the maintenance of the peace and security of international society. However, in these UNSC Resolutions, the right to veto by permanent member countries was recognized. In his recent invasion of Ukraine, Russian President Vladimir Putin, aware that sanctions based on the UN Charter do not have efficacy, determined to use force. This defect in international law for the purpose of maintaining the peace and security of international society was clarified also in the Soviet Union's military invasion of many countries in Eastern Europe during the Cold War period, and this loophole was revealed once again in the Ukraine war.

There was an interval of 39 years between the Napoleonic Wars and the Crimean War, and one of 57 years between the Crimean War and World War I, totaling 96 years. Thereafter, there were 21 years between WWI and WWII, and 77 years between WWII and the current Ukraine war, giving a total of 98 years. As shown in both these examples, a war with the characteristic of demarcating global order occurs around once every 100 years, centered on Europe.

In Europe, there is a growing feeling of concern about the risk that the Ukraine conflict could develop into a world war. Reform of the UNSC is not progressing, and as the probability of the use of nuclear weapons increases, this risk is becoming a more realistic possibility. From around the time when one year had passed since the start of the Ukraine war, with this growing sense of risk, the public desire for the reopening of peace negotiations has been increasingly expressed. Moreover, recently in the United States, in regard to its support for Ukraine, since the US has become embroiled in

disastrous wars in the past such as the Iraq War and the Afghanistan War, there have been concerns that it might again fall into the same kind of situation in Ukraine. Meanwhile, there are also concerns that, although US support for Ukraine might be understandable, the realities of the US economy suggest that financial reconstruction should be carried out instead, and there should be more emphasis on national interests such as preventing the flow of immigration. In this regard, victory in the Ukraine war, along with responses to the Taiwan crisis, would be taken as an indication of the US commitment to its allies; but at the same time many people object to this stance, holding the view that efforts to maintain international order through strong engagement by the US simply match US national interests.

In any event, in the present war, there are fundamental discrepancies in the stances of Russia and Ukraine in talks aimed at a ceasefire. Even if the time comes for a reopening of ceasefire talks, it will be the state that dominates militarily that will have the advantage in such talks, and so both Ukraine and Russia feel they must first win the war to be in the superior position. This is the background to whether the fighting continues or even worsens in intensity.

Maintaining International Order by Rule of Law

The Cold War began after WWII, around 1947, and continued for almost half a century until it came to an end in 1990-1991. For about 15 years after the end of the East-West Cold War, a US-led unipolar world continued. However, from 2006 to 2008, this unipolarity started to change, in particular due to situations in the Middle East. During this time, Russia continued to experience suffering in its attempts to rebuild the state post-Cold War, but brought two Chechnya wars to an end in about 2009 and slowly regained its position as a major nation. In 2010, China overtook Japan to become the No. 2 global economy, and since then its dramatic progress and national ambitions have come to be seen as a threat to the US.

In 2014, the annexation of Crimea by Russia and China's incursions into the South China Sea occurred at the same time, and since this time there has been a strategic battle between the US and China/Russia, focusing on differing values and national systems. Although the US, which emphasizes democratic values, along with its allies and friendly nations comprise slightly less than half the world's countries, the countries of the global south, comprising China and Russia along with emerging and developing economies,

with their authoritarian or hegemonic regimes, now make up slightly more than half of the world's countries. The battle between these two groups of nations has been brought into the Ukraine conflict, and their strategic confrontation has become even more obvious. Although the Ukraine war has not yet become a global conflict, it is steadily developing the character of a proxy war in the fight between these two groups.

At the same time, no matter what happens in Ukraine, the Indo-Pacific region is facing another crisis, namely the realization of the Taiwan crisis scenario. If a war is sparked by China's attempt to reunite with Taiwan, it would not only have historical significance but would also bring the major powers to a crossroads, possibly resulting in the end of the battle between them. In any case, whether it be the Ukraine war or the Taiwan crisis, power-based domination spreads confusion and does not alter the fact that a world will arise in which international order does not hold.

For us to maintain an international order that strictly follows the rule of law, we should reconfirm that this is the key to bringing peace and stability to international society.¹ In a society based on the rule of law, the values of freedom and democracy are the themes that should be most emphasized, but it is not possible for such values to become the standard for building an international order.

Meanwhile, in countries that implement control based on authoritarianism or despotism, there is disgust at seeing freedom and democracy used as justifications for conducting interference in the domestic affairs of other countries. Moreover, it must not be forgotten that since the Cold War era these countries have received some kind of support from Russia or China, while in contrast they have had no support at all from countries in the West. A certain African diplomat is said to have remarked at the UN, "If Ukraine was an African country, I wonder if there would have been this level of support from countries in the West." After the invasion of Ukraine, in the implementation of the UNSC Resolution to condemn Russia, 52 countries of the world did not agree, including 26 of the African countries, about half of them (141 countries agreed).

In fact, from the second half of the 2010s on, there has been a gradual reduction in the number of countries with democratic systems, and it is no exaggeration to say that democratic systems are facing a crisis.² The US has held two democracy summits, inviting more than 100 global leaders to promote the importance of democracy.³ But simply claiming the importance of democracy does not by itself enable the building of international order.

Authoritarian and despotic countries such as China and Russia

exert pressure on other nations of the global south, criticize power-based changes in present conditions such as the Ukraine war and the development of nuclear missiles by North Korea, and do not agree with the UNSC Resolutions to impose sanctions. Furthermore, China and Russia, in order to continue the Ukraine conflict, provide mutual support, expand military access and infrastructure in the countries of the Middle East, the Gulf, Africa and Central and South America, and use political and economic intimidation and pressure against democratic countries. This is further increasing the instability of not only Ukraine but also the balance within various regions of the world. However, this is neither a new Cold War nor an increasingly multi-polarized world. Multinationalism based on the rule of law is a concept that expresses reality. With this multinationalism as a background, we must further develop the recovery of order based on the rule of law for international peace and prosperity.

For the time being, there is no sign of any country or organ that could take the lead in mediating ceasefire discussions for the Ukraine war. The UN, Turkey, NATO, etc. cannot fill this role. Looking at the Russia-China summit meeting that took place in March, even though its results may be unclear, there are now more countries that think China itself is a major nation that could influence Russia, and visits to China by Western leaders have started. From this viewpoint, we should pin our hopes on China and have it be a mediator. This could bring about a separation for the advanced Western-side countries (decoupling). Firming up the unity and cohesiveness of Western countries was the biggest topic of discussion at the Hiroshima Summit in May 2023 of the G7 advanced nations (including, apart from the members, seven participants from eight outreach countries and organizations that were also invited). However, although it may depend on the course of future battles, in the end it is likely that there will be no other method than having the US act as a mediator to resolve matters.

In any case, in addition to efforts by the G7, it is encouraging that countries that respect the rule of law, and cooperative relationships such as alliances and relationships based on security concerns, typified by NATO and the US-Japan and the US-Japan-South Korea relationships (and also by other groups such as the four-country QUAD group of the US, Japan, Australia, and India, and the 12U2 Group of India, Israel, the United Arab Emirates, and the US) are advancing. There should be greater emphasis on closely advancing these kinds of alliance relationships and relationships of like-minded countries as a whole.

Further, in regard to reform of the UNSC, while genuinely

accepting the necessity for this, there is a need to deepen discussions on concrete measures, including electing member countries from Africa and Central and South America. However, until a new composition of these types of international relationships can be constructed, for some time we must first safely overcome both the Ukraine war, which exerts a decisive influence on multinationalism, and a Taiwan emergency that might occur after that. We are living in a period when facing these issues is our historical destiny.

Rivalry Among Superpowers Provoked by Ukraine War

I would like to briefly touch on the impact the Ukraine war is having on relationships among major nations, without delving into details. While it is clear that the war was initiated by Putin, there are various perspectives and no consensus on the background and reasons behind it. Putin's true motives remain unclear, but some argue that, at the least, it is not Russia that is in the wrong and that instead the responsibility lies with the US, the European Union, and NATO.

To summarize the arguments mentioned in the introduction: (1) Putin harbors deep resentment akin to a delusion that the US conspired to bring down the Soviet Union during the Cold War, leaving Russia as just an ordinary major nation afterward, (2) Russia has a motive to overcome its one-sided territorial crisis perception, fueled by the expansion of NATO towards Russia's borders, leading to a sense of threat from the West, and (3) Russia's actions are based on a distorted historical perspective, suggesting that Ukraine is historically and ethnically under Russian dominion. In particular, it is a misconception that the cause of the Ukraine conflict can be attributed to the US; this is a delusion arising from Russia's anti-American worldview and historical perspective.

The outcome of the Ukraine war is unpredictable, but certain aspects are clear at the moment: 1) Major power relations have turned into a strategic confrontation between the US and China/Russia, with the war serving as a proxy conflict for this struggle. 2) Diplomatic relations between the US-Russia and the US-China have reached a state of near-rupture, with little meaningful dialogue taking place. 3) China attempted to persuade Russia to engage in peace negotiations, but Russia insisted that the US bears all responsibility and requested support and assistance from China, which China declined, citing the need to avoid becoming a target of economic

sanctions. 4) In other words, China finds itself in a dilemma where it does not wish to see Russia lose the Ukraine war, but also does not want to provide support that could lead to economic sanctions against itself, as Russia's defeat would allow the US to withdraw from Europe and potentially create a disadvantageous situation for China regarding the Taiwan issue. 5) In any event, the global-scale conflict situation, involving a mix of military and non-military aspects, is becoming increasingly intense.

If proceedings in the China-Russia summit held on March 20-21, 2023 took place as described above, both Chinese and Russian leaders seem to be solitary dictators without appropriate domestic advisors to offer sound counsel. It is also possible that China engaged in the summit merely to probe Russia's actual intentions. Some speculate that China might have pretended to recommend peace talks with Russia, knowing Russia's true intentions, in order to receive positive international recognition. This would raise questions about why a Chinese Foreign Ministry spokesperson publicly stated that President Xi Jinping intended to promote peace talks with Russia from a fair standpoint. Considering the subsequent visits of European leaders to China after the China-Russia summit, one cannot entirely dismiss these speculations as incorrect.

Impact of Ukraine War

Returning to the course of the Ukraine war, it is natural that the US, with the cooperation of its European allies, is focusing on the conflict and seeking to bring victory to Ukraine. That is, one of the aims of the war is to lower Russia's military capability to the extent that it cannot invade neighboring European countries again. For China, it is desirable to exhaust the US as much as possible in the Ukraine war. China seeks to avoid becoming a common enemy of the US along with Russia and so opposes Russia's use of nuclear weapons, while also wanting to prevent Russia from losing the Ukraine war. Consequently, even though it is difficult for China to secure the sovereignty of Ukraine or the withdrawal of Russian forces, while it advocates for peace talks and seeks international empathy, including from developing countries, it also provides dual-use components that can be used in the private sector as well as militarily, semiconductors, major equipment, drones, and other generic goods to Russia, within the scope not subject to economic sanctions, sometimes via a third country. Simultaneously, China purchases large quantities of cheap oil and natural gas from Russia and finds profits by exporting a substantial amount of consumer

goods to Russia. As a result, it can be said that, regardless of the outcome of the Ukraine conflict, without its heavy dependence on China, Russia would now be unable to exist.

Meanwhile, the Ukraine war is seeing greater changes in combat dynamics and surrounding circumstances. Serious issues are growing, including domestic social unrest in areas such as Georgia, Moldova, and Belarus; tactical nuclear deployments by Russia in Belarus; grain export restrictions imposed by Russia on Ukraine; international crimes such as abuse of Ukrainians (including child abduction and mistreatment of prisoners); and attacks on Ukraine's nuclear and electricity facilities, and destruction of dam facilities. Particularly alarming is the tactical nuclear deployment in Belarus.

These escalating factors are triggering cautious responses from Western countries regarding ongoing support for Ukraine, expectations for the resumption of peace negotiations, concerns over Russia's inhumane and criminal acts, efforts for postwar reconstruction, and deep apprehensions about the potential use of nuclear weapons. In particular, as the likelihood of Russia's losing the war grows, the fear of nuclear weapon usage has intensified, leading to growing calls for the resumption of peace talks. However, at the same time this has also become a divisive factor among Western countries.

In any case, the international community must first achieve an end to the Ukraine war. Russia's intentions are strong, and as long as they remain a significant factor behind the conflict, bringing an end to the war will not be an easy task. Some believe that the outcome hinges on Putin's course of action, but the situation is not that straightforward. However, our efforts should be focused not only on ending the war and preventing a major European conflict, but also on reconstruction and advancing the process towards building stability for Europe's future. As a consequence of the Ukraine war, the world's weapon systems have rapidly developed, and Eastern and Central European countries, including Ukraine, have been stockpiling arms.

Furthermore, the economic conditions in these countries are undergoing immense harm due to such factors as the damage wrought by the war, an influx of refugees, and increased military spending. Meanwhile, state relations in Europe are showing signs of complexity and if there is reduced international involvement, the threshold for the use of force may be lowered, making the concentrated stockpiling of military assets and weapons in itself a potential destabilizing factor that needs to be carefully considered. We must try to ensure that such large-scale wars do not recur in

Europe, and achieve conclusions to this end.

Implications of Taiwan Crisis Scenarios

The next concern is the potential crisis surrounding Taiwan and scenarios that may lead to it. If China's attempts to reunify with Taiwan involve the use of force, the consequences would undoubtedly have a profound impact on the international order on a level far surpassing that of the Ukraine war. If China were to lose, it could result in the collapse of both the Chinese Communist Party system and the Xi regime simultaneously. If China nevertheless does not give up on this goal, the question becomes how it plans to achieve it. China would certainly want to avoid disruptions to its economy during any actions related to reunification with Taiwan. China cannot sustain a prolonged operation like the Ukraine war, so it would likely seek a short-term decisive conflict within the limits of its economy to avoid economic sanctions.

At the same time, if the US were to lose, the balance of power in the Indo-Pacific region would undergo a significant shift, and the US sphere of influence would retreat to the Second Island Chain in the east, which includes Hawaii and Guam. The US Indo-Pacific strategy would collapse, and not only the regional but also the global credibility of US commitments would be undermined. This would pose a serious threat to the southwest region for Japan, and a unipolar world led by China might emerge.

The most serious implication of a Taiwan crisis is that it would not be a proxy war in the way that the Ukraine conflict can be considered a proxy war between the US and Russia, but rather a full-scale war between the US and China, with the high possibility of Russia supporting China and providing military power in the Far East. This means that a war involving three major global powers – the US, China, and Russia – would occur in the East Asian region including the Far East, with Taiwan at the center. In such a scenario, as a US ally Japan would need to provide full support and cooperation for the activities undertaken by the US, or it would be challenging for Japan and the US to achieve a favorable outcome in the Taiwan crisis.⁴

Furthermore, even if the war ultimately ended in a short decisive battle, the years-long preparatory period leading up to that moment could be an unprecedented period of intense hybrid warfare, encompassing information warfare, cyber warfare, space warfare, cognitive warfare, and the utilization of information technology and new cutting-edge technologies. If the lessons from the Ukraine war were utilized to the maximum, the importance of combat capability

and the industrial capacity to support it would no doubt be fully recognized.⁵ The conflict would assume a three-dimensional nature, maximizing the use of land, sea, and air areas. The key factor determining success could well be the ability to conduct complex integrated operations, which would necessitate advanced command and communication capabilities. The results of the conflict would have a significant impact not only on the Indo-Pacific region but also on a wide range of national state relations, diplomatic relations, and the economic development of countries across Europe, the Middle East, Africa, island regions, and Central and South America.

Considering the above, the ongoing Ukraine war and a potential Taiwan crisis in the future could lead to situations that reshape the course of modern human history. I would like to stress that, in the midst of this potentially major transformative period, this article offers a comprehensive analysis and discussion of the diverse perspectives of experts in numerous fields in order to discover what path we should take and the optimum means of doing so.

References

1. On Jan. 12, 2023, Japanese Foreign Minister Yoshimasa Hayashi hosted a ministerial-level debate on the rule of law at the UNSC (Japan held the presidency). Representatives from 77 countries, including UN Secretary-General António Guterres, participated. In the debate, Hayashi called for solidarity in upholding the rule of law.
2. According to the annual report released by Swedish research institute V-Dem (Varieties of Democracy) in March 2023, for the year 2022: a) 32 countries with liberal democratic systems accounted for a population of 1 billion people (13%), and b) 58 countries with democratic systems that have electoral mechanisms accounted for a population of 1.3 billion people (16%) – a total of 90 countries with either liberal democratic or democratic systems with electoral mechanisms accounting for a total population of 2.3 billion people (total: 29%); c) 33 countries have autocratic systems with a population of 2.2 billion people (28%), while d) 56 countries have autocratic systems with electoral mechanisms, with a population of 3.5 billion people (44%) – a total of 89 countries with autocratic systems (representing a total population of 5.7 billion people, 72%), showing an increase in the number of countries with autocratic systems.
3. The Democracy Summit was one of President Joe Biden's

election pledges. The first summit was held on Dec. 9-10, 2021, while the second summit took place on March 29-30, 2023, both online. Approximately 110 countries participated in the first summit, and about 120 countries participated in the second. Biden's Democracy Summit Declaration presented during the second summit received support from 73 countries (around 60%). While the US and European countries emphasized the importance of democratic outcomes, there were divisions within the region of the Association of Southeast Asian Nations (ASEAN). Although the Philippines, Malaysia, and Indonesia were invited to the summit, other countries such as Thailand and Singapore were not. Furthermore, there were discrepancies between the views of the global south countries and the summit's objectives, with the president of Indonesia, for example, expressing concerns that democracy should not be used as a tool of containment.

4. In *The Real China Hands: What Washington Can Learn from its Asian Allies* by Michael Green, chief executive officer at the United States Studies Centre at the University of Sydney, the author points out that Japan's options in response to the deteriorating power balance with China are as follows: a) aligning with the emerging power dynamics, b) strengthening national capabilities in response to threats, and c) enhancing alliance relationships. Green suggests that former Prime Minister Shinzo Abe's choice of the third option resulted in retaining significant influence in Japan's policies towards China. This observation was made on Nov. 3, 2022, on the website of the US Studies Centre.
5. During his testimony before the Senate Armed Services Committee, Roger Zakheim, Washington director of the Ronald Reagan Presidential Foundation and Institute, highlighted some lessons from the Ukraine war, such as a) that combat force capability remains crucial, and b) that industrial capacity could become a vulnerability for the US. This testimony took place on Feb. 15, 2023, as part of discussions on "Global Security Challenges and Strategies".

Article translated from the original Japanese by Jillian Yorke. **JS**

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Roundtable with Prof. Naoyuki Yoshino, Prof. Mariko Watanabe, Prof. Shujiro Urata & Masakazu Toyoda

Key Strategies for Raising Sustainability of Asian Economic Growth in the Age of a Disrupted World Economy

By Japan SPOTLIGHT

Prof. Naoyuki Yoshino, professor emeritus at Keio University

Prof. Mariko Watanabe, professor at Gakushuin University

Prof. Shujiro Urata, professor emeritus at Waseda University

Moderator: Masakazu Toyoda, chairman & CEO of the Japan Economic Foundation (JEF)

(Roundtable on Sept. 4, 2023)

Participants



Prof. Naoyuki Yoshino



Prof. Mariko Watanabe



Prof. Shujiro Urata



Masakazu Toyoda

World Economic Outlook

Toyoda: The Covid pandemic that has damaged the world economy and human life so deeply seems to be calming down today, and expectations are high for the global economy to recover. But given the rise in fuel and food prices as a result of the Ukraine war, major economies' tightening monetary policy to curb inflation and the difficulties of the Chinese economy, most economists predict only modest growth for the world economy. According to the IMF World Economic Outlook published in July 2023, global growth is predicted to be around 3% both in 2023 and 2024. Since its average annual growth rate from 2000 until 2019 was 3.8%, this predicted growth indicates a considerable slowdown.

Meanwhile, expectations are focused on Asia. Looking at China, the ASEAN5 (Indonesia, Malaysia, the Philippines, Thailand and Singapore) and India, high economic growth is to be seen in India, China and ASEAN, in that order. Earlier this year, JEF completed research in collaboration with ERIA on "Asia-wide industrial policy" and METI published a White Paper on International Economy &

Trade 2023 in June. On both research outcomes, I would like to raise the following three issues for discussion.

First, on the issue of what the White Paper pointed out, namely, "the world is in transition to the age of disruption from the age of harmony achieved by free trade", what must Japan do as a nation that has been pursuing trade liberalization?

Secondly, on the question of declining Chinese economic growth, why is this happening and how serious is it?

And thirdly, what should Japan do to achieve resilience in global supply chains against the background of rising geopolitical risks? Is it reshoring or building up an Asia-wide supply chain through strengthened relations with ASEAN or India?

We have three distinguished Japanese economists for these discussions. Prof. Naoyuki Yoshino is a professor emeritus at Keio University, knowledgeable on the structural economic issues of the global economy. Prof. Mariko Watanabe is a professor at Gakushuin University, an expert on the Asian economy including China. And Prof. Shujiro Urata is a professor emeritus at Waseda University, a leading economist in Japan on issues of the international economy

including the WTO.

First, on the question of “transition to disruption”, the White Paper pointed out that we are entering an age where geopolitical risks and economic security risks are prevalent. In general, its background is the confrontation between the West and China, and also Russia, as revealed by the Ukraine crisis. In addition, the Global South, supporting neither of them, makes this situation more complex.

Prof. Yoshino, could you please express your view first on the current world economy and the role of Japan?

Yoshino: I think this White Paper covers all the key issues. One is the issue of restructuring of accumulated debt following a series of fiscal stimulus steps to cope with the pandemic. Global climate change, the rapid depreciation of the yen, whether temporary or structural, the direction of FDI and domestic investment, SMEs and start-ups, as well as the need to accept skilled foreign labor – all are mentioned in this White Paper. It is a very comprehensive and extremely good paper.

Among these issues, I would like to mention inflation in Japan, caused by rising oil and food prices, and touch upon the role of Japan in the world economy from my standpoint. Monetary policy in ordinary times is not effective in curbing inflation caused by rising import prices. This is because monetary policy in general is expected to control aggregate demand but the current inflation comes from the shock to aggregate supply. The best policy to deal with this is to raise aggregate supply by boosting total factor productivity. One big issue, in this regard, is why productivity growth or technological innovation encouraging it has been stagnant this past decade.

In Japan, where we face the challenge of an aging society, I believe we will need more labor participation by elderly people from now on. So we should promote innovation such as robots that can assist these older people in their labor participation. With nations such as South Korea, China, and Thailand in Asia and also the European Union where societies are rapidly aging, these robots would constitute a large export industry for Japan.

Secondly, I noted two points on my first visit to Southeast Asia in 1984 that indicated Japan’s supremacy in Asia. One was that, with four distinct seasons each year, Japan has a more favorable climate than any nation in Southeast Asia and this produces a greater working efficiency. The other was that, having visited libraries in universities in Southeast Asia, I found there were more books in Japanese university libraries than in Southeast Asian ones, where I found very few good books. So these things convinced me that Japan would never be surpassed by any Asian nation.

However, at this moment, with well-developed air conditioning and the Internet, all Asian people, if they understand English, can access a wide range of references without visiting a library. They can study or work almost anywhere in more comfortable circumstances, and I

think this is how Asian learning standards are rising. Also, there are many people with English abilities in places such as Singapore and Malaysia. The key to winning the competition in Asia is how rapidly people can understand English references, and it will be crucial, in this light, for Japan to maintain its educational standards.

Next, I think the weak yen will continue in the long run as a structural phenomenon. This will favor Japanese exports, but exports in quantity will not increase very much, since many Japanese firms have already shifted their production bases overseas. In terms of imports, the weak yen triggers inflation in the nation, but for foreign tourists, the cost of Japanese goods will drop and so the merits of tourism in Japan would rise.

Finally, on the future of the Chinese economy, the strength of China’s economy has come from controlled exchange rates to some extent, and that enabled China to sustain global export bases. But with the gradual liberalization of capital transfers, it seems to be getting more difficult for China to control its exchange rate. I mentioned in May 2019, in an article in a Hong Kong journal, that Chinese real estate prices had reached a bubble in terms of Chinese economic indicators. I mentioned the same thing in NHK World News highlights. In response, many Chinese said that the Japanese bubble economy was born after the end of the High Growth Era but that Chinese real estate price rises were not the outcome of a bubble economy as the Chinese economy was still in the midst of growth.

But I believe that excessive investment in real estate seriously affects China’s local public finances. The reason is that Chinese local governments with small tax revenues maintain their revenues by selling land owned by the public sector. So Chinese local public finances are now facing a challenge.

Toyoda: The next question is for Prof. Watanabe. On the issue of their relations with the Chinese economy, G7 leaders discussed whether they should pursue decoupling or de-risking. Eventually they agreed on de-risking as proposed by the European nations. The White Paper made an analysis on this question with two scenarios.

The first one involved 100% tariffs set mutually and non-tariff barriers, and that probably indicated decoupling, and the second one showed a division of the economies like the US-China trade war, seeming to imply de-risking. It warns that the first case’s impact on the world economy is considered to be a negative 7.9% and the second one’s is a negative 2.3%. I think it would like to say that the confrontation between the United States and China would result in no benefit to any country. However, if China attempts to reunite with Taiwan by military force, I am afraid we will have to go in the direction of decoupling. What do you think about the future of China-Taiwan relations and their economic impact?

Watanabe: If decoupling truly happens, there would undoubtedly be

significant economic damage to Chinese and the world economy. As Prof. Yoshino mentioned, what the world economy is facing is nothing but a supply-side shock. Decoupling of supply chains for political interests would exacerbate this shock. So by looking at China's policy stance carefully and addressing its challenges correctly, pursuing de-risking is needed. And the most crucial target of de-risking must be to raise to the maximum the cost of enforcing any change in the current situation through military force. The greater the economic benefits of maintaining a peaceful status quo, the bigger the lost benefits by military action would be, and these lost benefits would be the cost of military action.

In the case of Russia, it was originally reluctant to join globalization through manufacturing and it adopted a development strategy based on exporting commodities, and thus this opportunity cost was low and it decided to launch a military invasion. International trade rules have been constructed to manage and secure the cost of divergence from globalization. So it is necessary to use these rules at this moment. However, the existing rules are not well prepared for dealing with authoritarian nations' policies or business customs different from the free and democratic nations and so it will be necessary to upgrade them.

We often see the "Taiwan Crisis" mentioned in the media now. China and Taiwan have been claiming sovereignty over the island for almost 70 years, during which time there has been permanent military tension between them. This tension is the basis of the "crisis" and we should take good note that any Chinese action to reunite with Taiwan through military force could topple the global economy, not just those of Taiwan and Japan. In such an event, many of the industries in Taiwan would move to the US, and I think it would be Japan that would be in the biggest trouble. In order to make this difficult to happen, I think it will be necessary to maximize the costs to China of any military action through rules and disciplines.

What are these points of discipline? The issues of state-owned companies or industrial policies are often mentioned with regard to China. I think we should set up international rules to tackle a type of industrial policy that allows some countries to monopolize profits unilaterally. Additionally, we should have rules that ensure the growing benefits are commonly shared by all players. While the US opposes this, I think Japan, the Global South or the EU can support it.

Meanwhile, a more critical issue in current rule-making is that there is no clear rule on how to define the exceptions to free-trade rules for a reason of national security. Russia, for example, showed no concern for rules when it launched its military invasion of Ukraine.

The CPTPP, which China has formally applied to join, has an article on the national security exceptions that says an exception is

endorsed only after a convincing explanation to the members is accepted by them. On the other hand, the RCEP, of which China is a member, says that exceptions for national security can be left to any member's own interpretation, effectively meaning that, in the RCEP, there is no rule on exceptions for national security.

Toyoda: The White Paper mentions that historical experience tells us that every 20 years free trade and protectionism emerge in turn. Prof. Urata, what do you think about this observation? If it is so, I believe we should keep supporting free trade as much as possible even though at this moment protectionism is temporarily dominating the world. What do you think we should advise the Japanese government to do with regard to policy? And could you also give your view on the role of Japan in promoting the CPTPP or RCEP, or even the restoration of the WTO dispute settlement mechanism?

Urata: I roughly agree with the idea that free trade and protectionism emerge in turn every 20 years, but we need to clarify whether it is exactly 20 years or not. Looking at the history of the 20th century, which began with free trade, World War I and the Great Depression followed it and caused significant damage to the world economy, and then protectionism took hold. This was then followed by World War II. Drawing lessons from the negative impact of protectionism, the General Agreement on Tariffs and Trade (GATT) was established and trade liberalization began. This resulted in expanded global trade and rapid growth of the world economy. Even though there were some countries that adopted protectionist policies, such as import substitution policies, in general trade liberalization was further promoted during this period.

This trade liberalization trend was then drastically changed with the global financial crisis in 2007. To counter the damage caused by this crisis, nations took policies to protect their own economies and industries. Now the US-China confrontation, the Covid pandemic and Russia's military invasion of Ukraine have all followed and the uncertainty of the business and economic environment has increased significantly. Many countries have been taking protectionist policies to cope with this situation. This is largely what has been happening recently.

To achieve stable growth of the world economy, expanded trade and investment must play a key role. To achieve expanded trade and investment, it is crucial to minimize the uncertainty surrounding them, and for this purpose it is important to build up a rules-based trade and investment system and take full advantage of it.

On the question of the role of Japan in this regard, it is true that Japan recently joined the Multi-Party Interim Appeal Arbitration Arrangement (MPIA), an attempt to replace the WTO dispute settlement mechanism which has not been functioning for a while. But Japan did not join this at the early stage when it was established

by the EU, Canada, Australia and others. It was only in March 2023 that Japan joined it after many arguments. I believe that Japan should have not only collaborated with the EU and others and joined at the early stage but should also have achieved a leading role in creating this mechanism.

Among the many challenges faced by the WTO, besides dispute settlement, is the delayed build-up of trade rules and trade liberalization. There have been arguments about the creation of plurilateral trade agreements in specific areas like digital trade, investment facilitation, and micro, small and medium-sized enterprises (MSMEs), and I think Japan should be playing a role in leading these arguments. Furthermore, assuming that the CPTPP and RCEP play a key role in trade liberalization and the creation of trade rules, Japan should endeavor to help increase the members of those FTAs.

On the question of China's joining the CPTPP, Japan should be positive in accepting its membership. Having said this, China's membership must be approved only if the requirements imposed by the CPTPP are met by China; otherwise, it will be considered premature if the conditions are not fulfilled.

Current Chinese Economy Development

Toyoda: Our second issue for discussion is the current state of the Chinese economy. Prof. Watanabe, it is often said these days that China suffers from the "Japanese disease", judging from its real estate recession, high youth unemployment, stagnant consumption growth, and so on, all leading to deflation. What do you think about this? What are the reasons for this stagnation and what is the outlook for the future Chinese economy?

Watanabe: I visited China in July 2023 after a long absence. Many people said the economy was malfunctioning, and many business activities had completely stopped due to the long lockdown from the pandemic. Around December 2022, the economy opened up again but failed to achieve an explosive restoration. This was largely due to smaller growth in domestic consumption as well as lower external demand than expected, implying that the economy had not yet recovered from the pandemic's impact. But more fundamentally, I think there has been a significant rise in uncertainty about domestic policies and this has been a body blow to the economy.

The low GDP growth rate, high youth unemployment and the possible bursting of the real estate bubble could be caused not only by the failure to reach a full restoration from the pandemic but also by individual policy mistakes. Youth unemployment has increased due to restrictive rules on digital companies.

Real estate works in China as a substitute for social security and people own real estate for survival. If people become unemployed,

their livelihood is less damaged if they own real estate. So everyone is working with the aim of buying property and suffers from real estate prices declining, everyone ranging from the communist party's leaders to ordinary people. The ratio of loans in stock to total GDP reached nearly 250%, exceeding the level in the Japanese bubble economy. To deal with this, the central government has provided limits to tighten credit for property purchases to avoid the bubble bursting, and this policy has resulted in a great shock all across the nation. It has not only damaged the revenues of real estate companies but has also negatively affected the banking sector's credit policies, as well as the steel industry as the main supplier of construction materials.

The people's confidence in the future and in government policies has shrunk. I think we can say that this situation is a result of the less careful policies of those in power to deal with the bubble economy. In addition, the US and European economies are not yet in full recovery, and so opening up the country will not lead to an increase in exports. The US-China confrontation could be working negatively for the economy, but more than that, the world economy is not in good shape and will basically prevent Chinese exports from growing quickly. I think this is why the Chinese economy is inevitably in bad shape now.

In 2024, the US and European economies will pick up to a certain extent and Chinese exports will pick up accordingly, so the Chinese economy should get better on the surface in 2024. But the more fundamental issue is the rapidly falling trust of the people and the private sector which has promoted innovation in government policies. The current Chinese leaders prioritized dealing with political struggles among themselves over economic policies before the replacement of the administration's leading members was fully completed in 2022.

Getting into 2023, the Chinese leaders communicated with foreign subsidiaries and private businesses in an effort to restore trust. Digital companies with great power and the seeds of innovation would have been the sources of success for the Chinese economy and they may still work well to maintain the economy, but there is enormous distrust among the people toward the government. I think this makes for a negative force against the economy.

Toyoda: According to the White Paper, the country that Japanese companies consider increasingly risky is China. Prof. Urata, do you think rising geopolitical and economic security risks are a cause for the Chinese economy's stagnancy? And why do you think Indian economic growth is higher than that of China or ASEAN, even though it has not joined RCEP?

Urata: China's economic problem has been largely caused by real estate depression, at least on the surface. But I believe that stagnant

inward FDI in China due to the US-China confrontation is another reason. A growing number of foreign companies have started investing in ASEAN rather than in China because of the high geopolitical risks.

On the question of India, its economy has been experiencing high growth and I think there are several reasons. From a short-term perspective, recovery from the pandemic unleashed pent-up demand, activating private consumption and eventually private investment. This is the principal reason for current high economic growth. From a longer-run perspective, the demographic situation with a growing younger population, structural economic reforms and digitalization bode well for the future. A rise in the ratio of the working-age population to the total raises economic growth, and in the case of India both the working-age population and the ratio to the total are increasing. According to a UN estimate, India's working-age population will peak in 2044 and the ratio to the total will peak in 2029, so in terms of demography India's high growth will continue for some while.

Incidentally, China's working-age population peaked in 2011 and its ratio to the total peaked in 2007. So demography will play a key role in the economic growth of both India and China.

In India, a number of economic reforms have been implemented by the administration of Prime Minister Narendra Modi. The most important one was the introduction of a common tax on goods and services all over the nation in 2017. Up until then, the tax on goods and services had varied from state to state. This tax reform has helped to greatly improve the business environment and shows that economic system reform can encourage growth.

Digitalization is another factor behind India's economic growth. Modi implemented a "digital India" initiative – a policy to drive digitalization of the Indian economy – and this resulted in turning informal sectors with significant weight in the economy into formal ones. In particular, financial digitalization has made rapid progress, and that has encouraged a variety of business transactions to be formalized.

A specific example of this digitalization is the introduction of the United Payments Interface (UPI) which has dramatically activated the economy. UPI provides many private businesses with electronic settlement services and promotes cashless transactions. It also makes it possible to have immediate transfers among bank accounts by smartphones. It makes it easy to pay for shopping with QR codes. Personal consumption and private investment have both expanded with the introduction of this system. The development and practice of UPI has not been achieved yet on such a large scale in developed nations, but India, a developing nation, has implemented this policy to maximize the use of new technology. I think that such economic policy outcomes have made the outlook for the Indian economy very positive.

Toyoda: There seem to be a growing number of economists saying that Chinese GDP cannot overtake the US one, or even if that happens it would be temporary. I think there are two possibilities: one is that Chinese global hegemony is achieved 20 years from now, and the other is that Chinese hegemony is not achieved but the US and its allies establish joint hegemony. This came to my mind in reading the White Paper's observation that the ages of free trade and of protectionism alternate. Prof. Yoshino, what do you think about these possibilities?

Yoshino: China has been growing with communism driving politics and the market economy driving the economy. If the power of communism becomes too great, the market economy will stagnate under this political influence. Unless China achieves a balance between the two, it could fail to achieve real high economic growth, though it could achieve growth to some extent. Russia's case is, I believe, a good example. In either China or Russia, if private businesses cannot work well, they would move to other nations. So it is possible that the liberalization of the market economy in China could face a turning point under the current political system.

Another point to be noted is that the Chinese economy's strength comes from the government's control over exchange rates. With this grip on capital movements, China can monitor the flows of funds through all the financial institutions. This means that it can regulate capital movements and continue to control exchange rates. This is the source of China's strength. So another key issue is whether China can continue to control exchange rates while allowing capital liberalization to a certain extent. If China's exchange rate control which also leads to control of exports and imports is gradually weakened, it would weaken the Chinese economy as well. I think in this light it may be difficult for China to continue to expand very considerably. But I do think it will maintain the strength to transplant other nations' industries or technologies to itself.

Finally on the question of real estate, there are three indicators telling us whether the economy is facing a bubble and I think all three show that in China a bubble economy is emerging. The first is the ratio of loans for real estate construction business to the total. This has been significantly increasing recently.

The second is an indicator calculated by dividing house prices by income. Though some IT companies can afford to buy housing even at high prices with their growing revenues, people on average incomes cannot buy real estate, as this indicator is growing too much.

The third one is the ratio of the rate of increase in loans for real estate construction to the GDP growth rate, and this too has been rising these past few years in China.

An additional challenge stemming from all this is the impact on local governments' public finances. The fiscal situation of local

Chinese governments has been in good health in spite of their small tax revenues because they can gain further revenues by selling their owned real estate. From now on, however, they will need income from the central government to cope with the depression in real estate. This would negatively affect the whole nation's public finances.

With regard to India, I think it could achieve robust growth if all goes well. First, digitalization is making progress all over the nation. Until several years ago, broadband networks were only available in large cities, but now the government is trying to introduce them to local regions.

Second, their local economies have started growing little by little with such digitalization, realizing sales and promotion of a variety of goods and services through the Internet. And third, there are Indian Institutes of Technology (IITs) in each region. These have produced extremely talented engineers. There is an increasing number of high-skilled human resources in India, and in this light, I think it would be rather difficult for China to achieve total hegemony.

Asia-Wide Industrial Policy

Toyoda: There is a debate today about Asia-wide industrial policy or policies to strengthen the resilience of supply chains. According to the White Paper, Japanese companies consider ASEAN5 or ASEAN6 the most important venues for their FDI and their expectation about India is also rising. Meanwhile, their expectation about China seems to be decreasing. At JEF, we have been collaborating with ERIA in working on research on “Asia-wide industrial policy” since 2022 and found these nations engaged in “Digitalization”, “Supporting start-ups” and “Decarbonization of the economy” extremely ambitious, and their policies would be useful for Japan to learn as well. Prof. Urata, can we expect ASEAN or India to be a good partner for Japan, and can they be considered a crucial part of a stable supply chain for Japan? What should Japan do to strengthen the resilience of supply chains?

Urata: It is certainly true that India is becoming increasingly popular as a destination for Japanese companies' FDI. According to a survey by the Japan Bank for International Cooperation (JBIC) of Japanese companies in summer 2022, the largest number of firms chose India as the most promising destination for their FDI over the next three years, while China was the second largest. The third was the US. This means that although its attractiveness is less than before, China is still considered one of the most promising destinations for Japanese FDI.

Among the top 10 nations in this survey, five ASEAN countries were included. Vietnam was fourth, Thailand was fifth, Indonesia sixth, Malaysia seventh and the Philippines eighth. We can see from

this survey that India and ASEAN are attractive venues for Japanese companies, and the main reason is their market's growth potential.

Having participated in JEF-ERIA joint research as well, what impressed me most was that ASEAN and India have made enormous efforts to promote a digital economy. Digitalization of the financial sector is also making progress in ASEAN. In starting up businesses, they progressively use a digitalized financial sector for their funding. Traditional financial institutions have not been very well developed in these countries, and this has facilitated the creation of a new business system and environment, contrary to what is commonly believed.

It is also true that many ASEAN nations such as its founding members like Indonesia, Malaysia, the Philippines, Singapore, Thailand and one of the latecomers, Vietnam, have been integrated into not only Japanese companies' supply chains but also those of many other nations around the world. Unlike these ASEAN nations, India is not sufficiently involved in supply chains. One of the reasons is that it still continues with protectionist policies. These delays in opening up trade while attracting FDI make for inconsistent policies, and seem to make it difficult for India to be integrated into supply chains.

To enhance the resilience of supply chains, I think technological support from Japanese subsidiaries for the host country's companies to improve their competency or human resource development would be very important. The Japanese government's official development assistance (ODA) would also be helpful in achieving this objective.

Toyoda: What do you think about the future potential of ASEAN5 or ASEAN6 and India in addition to China, Prof. Yoshino, as a former president of the ADB Research Institute? India is not a member of the RCEP, so could this be negative for India's competitiveness?

Yoshino: The Indian economy's connection with the rest of the Asia is becoming much stronger. In particular, relations between Singapore and India have been greatly strengthened. There are three main ethnic groups in Singapore – Indians, Malays and Chinese – and the Indian group is contributing to stronger ASEAN-India relations. The people in this Indians group are competent in mathematics and are becoming prominent in the IT sector.

In the area of trade, since ancient times in Africa, Indians have been working on intermediary trade and this tradition is still contributing to a variety of relations among Asia, Africa and India.

I believe that the keys to achieving closer relations between Japan and India or ASEAN in the future are in areas like SME finance, infrastructure and telecommunications. Japanese SME finance or start-up finance could be used in this regard. In particular, in selecting finance for SMEs in developing nations like India, the Credit

Risk Database (CRD) Association collects data and calculates the probability of bankruptcy based on it and uses it to select destinations for finance. This business model of financing SMEs with high growth potential based on data analysis using a scoring model supported by daily business data has been used uniquely by Japan. The CRD Association has concluded an agreement with the Philippines and now the Philippines has also started a scoring model for financing SMEs. This Japanese method of SME data analysis could be a kind of know-how for use across Asia, including India and Southeast Asia.

On start-up finance, what we call crowd funding has begun in Vietnam, the Philippines and Mongolia. Funding availability for start-up businesses in the banking sector is particularly limited, so encouraging their growth with crowd funding instead in local areas would be one possible funding method to be used in India and ASEAN.

Toyoda: India, ASEAN5 or ASEAN6 are nations of the Global South and could strengthen their political influence in the world as a group by maintaining neutrality in the confrontations between the US, Europe and China, Russia. Prof. Watanabe, what do you think would be the international political or economic implications of Japanese companies' developing supply chains among Asian Global South nations? Could Japan work as a bridge between the Global South and the US and Europe?

Watanabe: For the past two decades, Japan has expanded its supply chains of several industries such as textiles and electronics across countries, creating jobs and benefiting both Japan and the host nations. This success was due to stable trade rules, including consistent tariffs and transaction regulations, even when production moved overseas. For example, the electronics sector enjoys zero tariffs. These trade practices have been highly beneficial for the Global South, and extensive data analysis supports this. As the European Union and Japan hold significant negotiating leverage against China and the US, they can enhance trade and investment rules to ensure stability amid growing geopolitical risks. This can benefit the Global South and is one way Japan can support Asian economic growth.

It is also important for Japan to support the Global South nations by making their industrial structure more progressive with higher value-added. Specifically, with the rise of technology focusing on digitalization, Japan should support these nations in this transition. Additionally, policies should be implemented to promote a data market after the initial push for digital technology. Currently, data is dominated by platform giants like Google and Microsoft. By establishing a data market, small and medium-sized enterprises (SMEs) can access the data they need. The World Development

Report 2021 by the World Bank emphasized the significance of data and its governing institutions for everyone's better livelihood. The report highlighted the nature of data as goods, and that its value is realized only through use, making it hard to treat like typical market goods. This uniqueness, combined with its non-standardized nature, suggests that establishing a data market is challenging.

However, China is attempting just that. A major focus of China's 14th Five-Year Economic Policy Plan in 2021 was to develop a data market. The Chinese Communist Party aims to disrupt data monopolies held by tech giants like Alibaba and Tencent, enabling SMEs to access this data. Their approach involves setting data standards and evaluating data based on these standards, hoping this could lead to manageable pricing. If successful, China's standards might become the global norm for data transactions.

Introducing a workable set-up for a data market would greatly benefit ASEAN SMEs, using these standards as a valuable reference. Therefore, as digitalization surges, we need a policy framework guiding its rules. This would be advantageous for both Japan and the Global South.

Toyoda: Wouldn't encouraging data distribution contradict protection of private information? Developed nations, in particular Japan, tend to be very concerned about privacy protection, which does seem to discourage data distribution.

Watanabe: In China, the framework for the protection of personal data is now well-established. The effectiveness of this system hinges on the enforcement of various laws. Transferring data from China to another country requires strict adherence to privacy protection, with legal penalties for non-compliance. The Chinese public's awareness of this issue has significantly increased, making it nearly impossible to conduct data transactions without privacy safeguards. In my opinion, the overall structure of privacy protection in China is comparable to that of developed countries now, except for the inappropriately wide range of potential state intervention. This exception would become a focus of tension between some authoritarian countries including China and countries under democracy and constitutions.

Final Remarks

Toyoda: Could all of you please give us your final remarks on the main theme of raising the Asian economy's sustainability in development? If possible, any remarks on the CPTPP would be appreciated.

Yoshino: Japanese companies or research institutes should now purchase a wide range of data on finance for their analysis. They

have to buy software for analysis from other countries. Japan seems to be considerably behind the rest of the world in the area of data and software for analysis. However, as I have said, in the area of finance for SMEs I believe that we Japanese can support India and ASEAN in the analytical methods for a host country's business data.

The aging population in Asia provides another main stream of economic development. South Korea, Thailand and Vietnam are all moving towards aging societies, as well as Japan. If Japan can promote development of robots and other tools to help elderly people continue to work, these products would become a large Japanese exporting industry to India and ASEAN.

Japan can also continue to support India and ASEAN in accommodation of telecommunication infrastructures. It is only Japan that provides training for the engineers working on maintenance and repair of these infrastructures in addition to support for their construction. High-quality infrastructure development, particularly in the field of nationwide telecommunication networks, would make it possible for India and ASEAN to achieve sustainable growth. With Japan's support for telecommunications, farmers could sell their food products through the Internet and with developed transportation infrastructures the smooth movement of goods and people could be achieved. So I believe that people living in local areas in India and ASEAN will become richer and this would lead to political stability and enable governments to achieve long-term economic policies.

Watanabe: Japan should confidently voice its concerns to China. While smaller countries might not be able to do so, Japan has the capacity to both challenge and address unilateral actions by authoritarian nations that act non-cooperatively. It's vital for Japan to defend and enhance the international order. Japan should not hesitate to invest time and effort into this crucial role. The EU and Japan stand in a similar position in terms of relations with China and the US. Europeans are more experienced in the prevailing rules, but their knowledge about China is perhaps limited and they are not as close as Japan to the geopolitics of Asia. So I think Japan has to act to maintain a rules-based international order while considering effective ways to speak to China.

Both the EU and Japan have comparable stances concerning their relations with China and the US. While Europeans might have a deeper understanding of the prevailing rules, their knowledge about China and proximity to Asian geopolitics might not match Japan's. Therefore, Japan should lead in upholding a rules-based international order and find effective ways to communicate with China.

Regarding the treated wastewater from the Fukushima nuclear plant, China appears to be using it as a tool for economic coercion. Japan should explicitly state that China isn't adhering to the rules in this matter. China is responsible to show the scientific evidence on

the (potential) contamination of marine products if it would ban on importing Japanese marine products. Japan should swiftly address this infringement. By outlining what's permissible under international standards, Japan needs to demonstrate its commitment to voicing concerns about such issues consistently.

Urata: India-Japan relations are not very well developed compared to ASEAN-Japan. In order to make relations with both India and ASEAN mutually beneficial, Japan must help these nations, mostly in "the middle-income trap", to become high-income nations with enhanced competitiveness or productivity. Specifically, they need human resource development and improvement of institutions such as legal and education systems. Japan can contribute to their development in this regard. Japan should do it with like-minded nations such as the US, Australia, Singapore and European countries.

On the issue of human resource development, we should increase the number of students coming from India to Japan, since there are only around 500 currently, compared to many more from Nepal. There are also few students from Japan going to India. I think that deepening the relations between Indian and Japanese universities would contribute to the further progress of the bilateral relations.

On the question of FTAs, the RCEP and CPTPP have now been ratified by all the member countries and are functioning. I think it important to monitor them to see whether each member nation's commitments are being fully implemented and the accepted rules are being followed. To achieve these objectives, FTAs' secretariats play an effective role. I would like Japan to take more positive action to establish these secretariats as a country that made a great contribution to the conclusion of the agreements. The economic benefits of these FTAs will increase as the number of member nations grows, and Japan should play an active role in expanding their membership.

Toyoda: Japan's relations with ASEAN and India are very important, as well as relations with China. We should spare no effort to create a world that benefits Japan and all Asian nations. **JS**

Written and translated by Naoyuki Haraoka, editor-in-chief of *Japan SPOTLIGHT*, with the cooperation of Tape Rewrite Co.

Roundtable with Amitabh Kant, Prof. Shujiro Urata, Prof. Yukiko Fukagawa & Masakazu Toyoda
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I ndia – the Future of a Powerful Country

By Japan SPOTLIGHT

Participants



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Masakazu Toyoda

Introduction by Masakazu Toyoda, Chairman of JEF

According to estimates by the United Nations Economic Office, India's population reached 1.43 billion by the end of April last year, making it the most populous country in the world. On the economic front, India is expected to overtake Japan in terms of GDP in the late 2020s to become the third-largest country in the world. If the Chinese economy stalls and fails to overtake the United States, India could well become the second-largest economy in the world by 2050. On the management side, India has a wealth of human resources, and among GAFAM members, the CEOs of Microsoft and Google, as well as the chairman of Kameda Seika in Japan, are from India.

India also has a strong presence on the international political scene as a leading member of the Global South amid the deepening division between G7 countries and China and Russia. While holding the presidency of the G20, India surprised the world in September 2023 when it reached a summit declaration on the afternoon of the first day of the meeting, which was expected to be difficult to agree upon. India also made its presence felt at COP28 in 2023.

Furthermore, on the scientific front, India became the fourth country in the world to successfully land unmanned on the moon in August 2023, beating Japan, and is likely to become a significant player in the space business. On the cultural front, India is famous for its movie industry. Personally, I love Indian movies and often watch them on airplanes.

I have been wondering why India did not join the RCEP while

concluding free trade agreements with Australia and the UAE. It is unfortunate that India's complicated regulations and underdeveloped infrastructure are factors that make foreign companies, including Japanese companies, cautious about investing in India at the moment, even though it is one of the most promising investment destinations.

Today, three experts will gather to discuss the future of India, a great power full of contradictions. The first is Mr. Amitabh Kant, sherpa of the G20. Until recently, he was the CEO of NITI Aayog, a government think tank established at the initiative of Prime Minister Narendra Modi to promote structural economic reforms. The second is Shujiro Urata, professor emeritus of Waseda University, who is well versed in international economic issues. The third is Prof. Yukiko Fukagawa of the School of Political Science and Economics at Waseda University, who is an expert on Asian economies.

First, I would like to ask Mr. Kant. India's recent growth has been remarkable. Since 2014, the growth has been averaging around 6%. The latest World Bank report released in October last year projects a growth rate of 6.3% for both 2023 and 2024. This is the highest growth rate among the G20 countries, and 1-2% higher than that of China. The reasons for this are said to be population growth (demographic bonus), progress in deregulation, and digitalization. What do you think is the main reason?

Macroeconomic Development – Reforms to Encourage Growth

Kant: Thank you, Toyoda-san. Last year we grew at 7.3% and in the

current year we are projected to grow at 7.2% in 2023, and in 2024. This is far higher than any large economy in the world and higher than any estimates made by international organizations. This is the cumulative effect of a wide variety of steps taken by the government since 2014, firstly wide-ranging economic reforms. The goods and services tax was implemented all over the country – it's like having one tax across all of Europe; the corporate tax rate was reduced to international levels, and sectors for foreign direct investment were opened up – almost 98% of FDI now comes in through automatic routes. A new bankruptcy law, modern regulations for real estate, removal of retrospective taxation, commercial exploration and mining, and codification of labor laws are among the long list of economic reforms which India has undertaken. Production reforms have also been introduced to bring size and scale to manufacturing in India.

Secondly, digitization. Today more than 11 billion transactions take place digitally every month in India. We are transferring government benefits directly into the accounts of people and we do FAST payments which account for 46% of the real-time FAST payments in the world. Entire government processes and departments have gone fully online. India's digital public infrastructure has delivered ease of doing business and ease of living. Thirdly, innovation and entrepreneurship. The start-up movement in India has seen India become one of the largest start-up ecosystems in the world and in 2016 we were close to 400 start-ups, but today we have more than 110,000 and are creating new business models and disrupting traditional sectors.

Lastly, a trust in infrastructure investment is creating a world-class multimodal transport network in India, moving goods and people. Leveraging GIS, an overarching masterplan has been created to guide investments. Since 2014 government expenditure as a percentage of GDP has doubled from 1.7% to 3.4%. These investments are lowering the costs of logistics and enhancing our competitiveness. So, this is the broad perspective in response to your question.

Toyoda: Very impressive, thank you very much. Dr. Fukagawa, you are familiar with Asian economies such as India and China. What do you think are the characteristics of India's growth compared to China? What do you think are the advantages and disadvantages from the viewpoint of promoting investment by foreign companies, including Japanese companies?

Fukagawa: As one who has been observing Chinese economic development for decades, I think there are lots of differences, but the first one is that after all China remains the biggest so-called "East Asian economy" that has been committed to manufacturing and export-oriented developments. India is wholly different in this path. The second thing is that of course China and India are big geographic countries so there is always the relationship between the

city areas and their other regional areas. As far as I know, India has made big progress in utilizing GST, the tax that used to be very different between provinces and states, and that has resulted in huge progress in terms of transaction costs for businesses in India. China did not have this kind of problem because it is far more homogeneous in terms of structures. What is interesting about China's early development is that the Chinese provinces are competing with each other very fiercely, trying to improve their business climate and attract more FDI, and trying to boost exports desperately. At the same time, the provinces were learning from each other very rapidly. As a result, as a whole the Chinese investment climate had become more standardized, but in India there seems to be still lacking this sense of competition. Some states are doing very well like Mumbai or Gujarat, but some stagnating states still exist and so from a foreign investors point of view it is very hard to imagine India as an integrated whole big market and that's probably one of the big differences.

The other thing is the expectation of India's demographic bonus and that is very different from China which has already started to see the decline of its population. In order to enjoy a demographic bonus fully, I think we need three things. We need a young population, but also the labor participation ratio is important. Even though you have such a large number of young people, they are not guaranteed jobs. The third is labor productivity and in terms of the demographic dividend India should be more interested in investing heavily in education and also trying to be more focused on job creation, because China did enjoy this demographic dividend as its competitive advantage was in its labor-intensive manufacturing industries. So I think India is full of potential but we need some very clear priorities and sequencing of industrial policies.

Toyoda: Thank you for your interesting comparison between the two countries. Let me next ask Prof. Urata, who looks at the world economy as a whole. The challenge for India is said to be the large gap between the rich and the poor. The savings rate is low and there is no virtuous cycle of high savings and high investment. What should be done to overcome this problem?

Urata: Yes, the low savings rate is a problem for India and there are several reasons for this; one is, as you mentioned, income inequality. The savings rate is lower for low-income households compared to high-income households so the increasing income gap in the form of increasing low-income households will lead to lowering the savings rate. But I think there are other factors which also led to a decline in the savings rate. I understand that this is a very serious issue which India is now facing and I have read some articles about this issue. These other factors include pent-up demand from the Covid-19 pandemic. Pent-up demand led to active consumption not only by low-income households but also by high-income households. Inflation also encouraged households to spend before prices of

products went up and low interest rates encourage households to borrow from financial institutions to spend. All of these and maybe some other factors too contributed to increasing consumption and lowering the savings rate.

Also, active government spending, which resulted in a fiscal deficit, contributes to the low gross savings of the country. Investment plays an important role in promoting economic growth and domestic savings are a major source of funds for investment, and therefore a low gross savings rate is a problem in terms of achieving sustainable economic growth. To increase gross savings, it is important to deal with the problems I mentioned. Lowering the inflation rate is a big challenge and reducing the income gap or income inequality is another challenge. How can India reduce income inequality? I echo what Fukagawa-san mentioned – education or training should be given to people from low-income households as this could increase their income and in turn contribute to increasing the savings rate. Also, labor mobility. Mr. Kant talked about reforming the labor market and perhaps this has already been done, but I think it is very important to make a more flexible and mobile labor market so that people can switch their jobs from low-productivity ones to high-productivity ones. Finally, reducing the government deficit is important for India to increase its gross savings.

Toyoda: Mr. Kant, could you please comment on Prof. Fukagawa's and Prof. Urata's comments, and if you have any objections or points you would like to add, please do so.

Kant: These are all very valid comments and I want to respond to some of them. One is that during the last eight or nine years the government has laid a lot of stress on infrastructure and it has focused on providing essential services to the citizens of India. It has built close to 40 million houses in the last nine years, and that's more than the population of Australia. It has also provided about 110 million toilets to its citizens. It has provided piped water connections to 53 million Indians, and also built about 88,000 kilometers of roads. It also came out with a new educational policy focusing on improving learning for children and it has focused on providing insurance to 500 million Indians, and all of it is cashless so you can move to any part of India and carry your insurance with you.

What will drive growth in the coming years in India will be the extent of digitization. Every Indian citizen has a digital identity and every Indian has a bank account. Between 2015 and 2023 we opened 500 million bank accounts. We then linked up bank accounts to digital identities and mobile numbers, and we have over a billion mobile phones, so everyone does digital transactions on mobiles and we do 46% of the real-time FAST payments in the world. We are using this model of digital public infrastructure to provide education to spread wealth in many other areas, so we are technologically leapfrogging in many of these areas, and we will rapidly grow and

expand.

My view is that, as the Bank of International Settlements has said, India has achieved in nine years what it would have normally taken 47 years to achieve. I really feel that this focus on infrastructure which the government has made the private sector investment in will accelerate in the coming months and investment rates will rise, and what you will see is the private debt to GDP ratio growing. The balance sheet of the private sector is in a very good condition. All the companies are making good profits and the bank balance sheets could not be better. They are in excellent health and my view is that private investment will accelerate in a very big way. The government has opened up the FDI regime in a very big way and you will see FDI growing and expanding in the coming years.

The issue about India being a large state is correct, and therefore growth with equity is important. It can't be that some states grow while other states do not, and it's very important that all states should accelerate the pace of growth. The southern part of India and the western part of India are growing but the eastern part of India needs to grow rapidly. And some states like Odisha have done very well in recent times and are a beacon of hope, and I am sure that in the coming years they will further accelerate the pace of growth.

India's Trade Policy Key to Further Success

Toyoda: I would now like to ask Mr. Kant about trade policy. India has decided not to join the RCEP, although it has been participating in negotiations with great enthusiasm. Bilateral free trade agreements have been concluded with Japan, Australia, the UAE, and other countries. Many people wonder why India did not join the RCEP. For India, too, people think the growing markets of the Asia-Pacific are important. Many may have been afraid of a flood of imports from China. In that case, the TPP without China may be a good thing for India. What do you think?

Kant: So my belief is that we have signed these bilateral free trade agreements because we found them to be mutually beneficial. This shows that India is not averse to free trade and on the contrary our goal is to better integrate ourselves in global value chains. We are strong believers in free trade, but the economic environment in which the RCEP negotiations started and then concluded are very different. We pulled out of the RCEP because Indians' concerns were not being fully addressed. This was a decision guided by pragmatism rather than idealism. Close to 43% of our labor force is still in agriculture and furthermore millions of enterprises are still micro enterprises with much room to grow. We wanted to safeguard the interests of the millions of our small and medium-sized enterprises (SMEs) and farmers, and any trade agreement with a bilateral regional or multilateral focus must ensure that the interests of all countries are being met. Each country has national priorities and those priorities cannot be compromised. We are great believers in

free trade and we strongly believe that free trade helps to lift people above the poverty line; free trade enables growth and poverty elimination but trade agreements must be mutually beneficial, and to our mind the RCEP was not beneficial to India. The CPTPP we are examining and we feel it can be a win-win for everyone, including India.

Toyoda: India did not join the RCEP because it is said to be concerned about agriculture and SMEs that would be affected by free trade. There was a time when Japan had similar concerns about agriculture and some SMEs. Prof. Urata, how do you think Japan overcame those concerns and is now leading the way to the CPTPP? Do you have any advice for India?

Urata: This is a difficult and sensitive question. Japan's policy for non-competitive sectors like agriculture and SMEs in my view has been a combination of protection and promotion. As for the agricultural sector, the five sacred agricultural products are rice, wheat, beef and pork, dairy products and sugar. These five agricultural products were excluded from liberalization in any ETA/ FTAs that Japan has concluded. As for negotiations in the RCEP and TPP, as you know Japan was able also to exclude these products from liberalization. That is how Japan "overcame" this difficult problem, but in my view, this is not a very good way to deal with the problem that these sectors are faced with.

What I think we should have done is to commit to trade liberalization on a gradual basis over time, but what Japan did was to exclude them and that means no liberalization at all for some time to come. But I think we should commit ourselves to liberalizing the trade regime in these sensitive sectors over time, while accepting that the government may provide some assistance to them to reduce adjustment costs in dealing with unemployment problems and problems which may be reflected in the loss of industry in some rural areas, and so on.

Turning to SMEs, the difference between government policy towards agriculture and SMEs is very clear. In my view, SMEs are not protected by high tariffs but they are given assistance in terms of getting low interest-rate loans from public institutions and some kinds of subsidies to improve their technology. These are so-called promotion policies and SMEs are not given protection by trade policies. Having said that, I would like to recommend India to commit to gradual trade liberalization, although I know it is very difficult, particularly politically, but I think it is important to liberalize over time and during this process reforms should be conducted and implemented so that in the future these sectors become more competitive.

Toyoda: Are you suggesting that India should have some exclusions?

Urata: No, exclusion is something that Japan should not have done. Japan should have committed itself to liberalizing the sectors over time, not right away but gradually.

Toyoda: Prof. Fukagawa, China is enthusiastic about the RCEP. Why is this a difference between India and China? I think India needs to increase the level of market openness in order to succeed in its "Make in India" policy. What do you think? Can India really become a superpower if it remains cautious about free trade or competition?

Fukagawa: That's another difficult question. There is a kind of impression in the last five years or so that India is rather going in the opposite direction, although as Mr. Kant emphasized, India is more for free trade but actually we have seen an import licensing system for automobile tires, color TVs, air-conditioners and many chemicals or even solar power generation facilities. So we can understand that India is behind China in regard to trade liberalization, even though the RCEP of which China is a leading member is not a very high standard of liberalization. Also, if you look at India's huge trade deficit with China in terms of goods traded, you will see that Indian industries are less competitive than Chinese ones. In light of this, I guess it would be very difficult to gain a trade surplus just with industrial policies that try to encourage exports with subsidies.

Japan used to be quite similar in terms of agriculture but as was pointed out, the CPTPP was a great opportunity for Japan to be more serious about agricultural reforms. We have been doing a lot of reforms about land expropriations of farm areas in Japan and we restructured the land and now have more younger people going into agricultural businesses. So we definitely need some market pressure if we are to make reforms, and that's one thing. The other thing I would like to counter with regard to India's integration policy is your initiative about the service sector. I know that after introducing the public identification system, India is pursuing a very interesting social experiment in trying to upgrade its huge public services, as partly pointed out by Mr. Kant. So if this is the situation, I think India has a huge comparative advantage in various services, including ICT, and so if the RCEP doesn't look very realistic, then why doesn't India participate in the DEPA Agreement first and try to participate in rule-making on data movement or data technologies, and then it may have a great opportunity to take the initiative based on its own experiences. This should be very much appreciated by latecomer Asian countries which are inferior in terms of competitiveness in the service industries, as opposed to their super competitive hardware manufacturing.

Toyoda: Maybe the key ideas here are gradual liberalization and government assistance if necessary, and thirdly service sector competitiveness. Mr. Kant, do you have some comments on this?

Kant: Some very relevant suggestions have been made and I greatly

appreciate them because I'm a great believer in free trade and I believe that it's not possible for any country to grow at a higher rate over a three-decade period without trade. Exports have to be the key driver of growth. The challenge with the RCEP was that there was very little giveaway on the services sector where India has its strength and no one wanted to compromise on the services sector, but they wanted India to compromise on every other sector, and this was becoming very difficult for India. But India is not closed to the RCEP at all and will at an appropriate time consider this proposal anew. I believe that as we move forward with many of our bilateral FTAs, India will look at this issue from a different perspective, but that will be a question of the agreement being mutually beneficial.

India's Foreign Policy as a Leader of the Global South

Toyoda: Turning now to foreign policy. Against the background of rising geopolitical risks such as the US-China confrontation, the Ukraine crisis, and the Gaza crisis, India's role as a mediator between the G7 and China/Russia as a leading player in the Global South is coming under scrutiny. Will India take a different position from its traditional nonalignment policy? On the other hand, India is participating in the Quad and the Indo-Pacific Economic Framework (IPEF), which are being promoted from the perspective of economic security, but the concept of improved market access is not included. What is the attraction for India?

Kant: Our position on the various geopolitical risks has been quite clear and raised in the appropriate forum of the United Nations. We have taken a pragmatic stance in view of these crises and we have seen how the destruction of global value chains has impacted the global economy. Inflation disruption in industries was just one of the effects of the pandemic that showed us that supply chains need to be resilient and diversified.

The IPEF for prosperity provides members with flexibility and they are not required to be signatories to all four pillars of the IPEF. India has recently signed on to the supply chain resilience agreement of the IPEF. India is open to the world and wants to integrate itself into global value chains. Signing up for this pillar of the IPEF provides us with this opportunity. In the same way, India also signed on to the India-Middle East-Europe Economic Corridor during the G20 leaders' summit in New Delhi. We seek to establish ourselves as a reliable and trusted trading partner.

India's membership of multilateral forums also allows us to champion the concerns of the Global South. For instance, we have hosted the Global South Summit which informed the priorities of our G20 presidency. The inclusion of the African Union into the G20 and our ability to achieve a full consensus at the G20 on all issues is a testament to our commitment through membership of such groupings. We will continue to champion the needs of the Global

South. That is our perspective. We will continue to work in the interest of global economies and will continue to work in the interest of the Global South. The important thing to realize is that 80% of growth now is coming from emerging markets and two-thirds of the growth in the next three decades will come from emerging markets, and the Global South will continue to play a critical role in the global economy.

Toyoda: I would like to ask Prof. Fukugawa the same question. The Ukraine crisis is clearly a violation of the UN Charter by Russia. How would you evaluate India's refusal to participate in economic sanctions against Russia?

Fukagawa: India has been in a close relationship with Russia in terms of security and has been importing lots of weapons from Russia due to the potential tensions with China probably, so we can understand the position of India. However, we still expect India to be a country of the rule of law and a country of democracy and so in such terms I think one of the things we need to do is to make India a more efficient country in terms of energy, as well as food self-sufficiency. As Mr. Kant pointed out, India has been chronically pressured on inflation both by energy resource price hikes and food price hikes, and that is why India recently introduced controls on some exports. However, we all know that India has huge room to improve its efficiencies in these two sectors, so if we can cooperate it should create a very nice partnership with Japan. And since we are a resource-poor country, we have been making great efforts to make electricity transmission as efficient as possible, so this could be a good partnership between us while we try to enhance our ties in times of geopolitical insecurity.

Toyoda: Japan is emphasizing cooperation with the Quad, IPEF, and other organizations amid the intensifying US-China confrontation. To ensure economic security, I think it is important for Japan to be involved in the region. Prof. Urata, how would you evaluate India's participation with regard to ensuring economic security?

Urata: I think India's participation in the Quad and IPEF is very important in dealing with China's rapid rise in the international arena and its very aggressive regional foreign policy. India and Japan share common values such as democracy, human rights, freedom of speech, and so on. Because of that, I would like to see India play a constructive role as it has been playing in maintaining this position and protecting the international order which China is threatening to change. I would like to see India lead the group of developing countries in the so-called Global South to achieve this objective of maintaining and protecting the international order and I am very pleased to hear Mr. Kant talk about this. I think I echo what Mr. Kant was saying about the role that India has been playing on occasions such as the G20 in 2023. Considering the higher growth of the Indian

economy and its higher position in the world economy, I would reiterate that I would like to see India continue to play this very important role more actively.

Toyoda: I think the keyword here is the stability of supply chains. Mr. Kant, please provide any objections or supplementary comments on this matter as well.

Kant: My only comment is that we are in the midst of geopolitical challenges such as the Ukraine crisis and the crisis in Syria and the Middle East, and it is very important that we try to steer developments. The challenge before the global economy is accelerating the pace of growth and if we don't, then sustainable development goals will be hindered. The world needs strong, inclusive, sustainable growth. Almost 75% of countries are facing a debt crisis, and almost one-third of the world is in recession: Germany has gone into a technical recession and so therefore in the midst of these crisis it is very important the countries like Japan and India, which share common values and work together on several platforms, need to promote sanity. We need to drive rationality and trade, we need to drive prosperity, and we need to work for the citizens of the world. And therefore it's very important that we should bring issues like SDGs and global growth and climate action to center stage, rather than getting caught in these present crises which are confronting the world.

India's Role in Climate Change

Toyoda: We should discuss such potential cooperation between Japan and India further, but before that let me turn to other issues such as climate change. At COP26 in Glasgow in 2021, there was agreement on "diminishing" rather than "abolishing" coal-fired power generation, as proposed by India. In response to this, some said it is a representation of the position of developing countries, while others are critical of India for delaying action on climate change. What do you think?

Urata: As you point out, I think there are two different views on India's position on this issue. One is to support India's position as it is a realistic approach considering the capability of developing countries in dealing with the reduction of coal-fired power generation while achieving economic growth. On the other hand, one can criticize India's position for a lack of interest or eagerness to deal with climate change issues or environmental problems, as priorities are given to economic growth. I understand both views but I am closer to the second view, and if I may say so, considering the environmental problems from a global perspective, India or any other country should accept lower economic growth to deal with the environmental problems. Such an approach would eventually enable the world to achieve high economic growth in the long run and it

would be productive if India could, for instance, identify the conditions which need to be satisfied in order to achieve carbon neutrality by 2050. And then India may come up with measures such as importing technology or borrowing funds from developed countries to achieve these objectives, and so I'm curious to know if such an exercise or such a view has been presented or not.

Toyoda: Prof. Fukugawa, the "bad guy" of climate change measures is "CO2 and methane emissions", and if fossil fuels are decarbonized, then it is fine to use them. How do you view the position of India and other Asian countries which support the position of India with regard to climate change?

Fukagawa: Regarding the point that Prof. Urata has made, India should be aware of the need for tackling climate change, including the threats to agriculture as well as air pollution. One thing India may be able to bargain with is a commitment to more ambitious CO2 reductions while at the same time trying to use leapfrogging technologies to attract ESG investment, including in energy-related business such as renewable energy or sophisticated power-generation technologies. These will probably require a better relationship with the US rather than with Russia or maybe perhaps with European nations. So, I still think India has a lot of room to maneuver and a huge scope to contribute to the future.

Toyoda: Mr. Kant, please give us your own views on India's position on climate change. At COP28, the "abolition" of fossil fuels was discussed and it was agreed to "transition away" from fossil fuels. What is your assessment of COP28? Also, India has set 2070 as the year for achieving carbon neutrality, but is it possible to accelerate the process?

Kant: First of all let me say that India's position has been absolutely clear. We are not responsible for climate change. It is the developed world that has contributed most to historical emissions. All of the carbon space has been occupied at 1.5° C and out of the 2,800 gigatons of CO2 emissions 2,400 has been occupied by the developed world. In terms of per capita emissions, India only accounts for 1.5%, where logically it should have been entitled to 17.5% of the carbon space.

The principle of common but shared responsibilities which was accepted in Paris at COP21 must be respected. Irrespective of that, India is the country which has taken the lead. It is the only G20 country which has achieved its targets nine years ahead of schedule. We achieved 174.53 gigawatts in February 2023 in total renewable energy facilities, the fourth-largest amount in the world. The link between energy security and development is well established and development necessitates prioritizing economic growth, poverty reduction and job creation.

At the same time, we have set ambitious climate goals and we are

not abdicating our responsibility. As I said, we achieved our first targets under the Paris Accord nine years ahead of schedule and now we have even more ambitious targets, so that 50% of our electric and storage capacity will be from renewable resources by 2030. We're also making a huge push towards green hydrogen to decarbonize. My own view on COP28 is that it recognizes the phasing out of inefficient fossil fuel subsidies and a phase down of coal power. The language keeps the 1.5° C goal intact while allowing developing countries the space they need to develop.

It's important that without increased ambition on climate finance and technology transfer, the world's collective goals face a very real risk of failure and the developed world will need to provide increased allocations to the developing world. Assuming that the developed nations cannot have much room for carbon emissions, they should be willing to transfer technology, or provide finances for developing countries to develop technology for environmental protection. Yet they continue to use fossil fuels and try to impose sanctions on developing countries for doing the same.

Therefore, our stance has been that these ambitious goals are contingent on climate finance flows and technology transfer – from billions to trillions was one of the key outcomes of the G20 summit. I think it is possible to be more ambitious but the developed world must advance its net zero goals before ensuring that other developing countries advance their goals. Without developed countries taking the lead in advancing, then zero goals will not be possible. And greater ambition among developing countries has to be matched with greater action by developed countries in the realm of both finance and technology transfer. Developing countries must be supported in this transition.

India's Contribution to Science & Culture

Toyoda: That's very clear. I think developed countries are asking India to accelerate the process of carbon neutrality. In that case, they may have to accelerate their own efforts to make it possible to achieve that, for instance by 2040.

The last issue I would like to look at is science and culture. Dr. Fukagawa, as mentioned at the beginning of this roundtable discussion, India has excellent scientific knowledge and an outstanding cultural heritage. How would you evaluate India's activities and contributions in terms of science and culture?

Fukagawa: One day when I was walking in Cambridge, a scientist from India said to me that India is idealizing Japan and I wondered what he was talking about. But he said that Japan is the only country that has been producing Nobel Prize winners based on their own language, and that is what India wishes to do. So maybe we will have a Hindi-based Nobel Prize winner in the future. We have a large interface with Western cultures and Western intellectual assets, but nevertheless we wish to have some alternative approach towards

humanity's problems. So I think that Indian education is going to be contributing a lot, especially in basic research, which is supposed to provide a public good not only in Asia but also globally. So that's why I was emphasizing the roles of digital-based technologies. Of course, India needs to make some progress in terms of hardware but one of the basic strengths of India is to provide excellent human resources to lead in software, rather than hardware based on hardware manufacturing.

Toyoda: Dr. Urata, until now, I feel that the world has been driven by Western-centric values. In addition to China, I feel that India's activities are changing the world's view of Asia. What is your evaluation of India, which is said to be the world's largest democracy?

Urata: Yes, both India and China recognize that they have so-called major civilizations, in addition to, say, Egypt. Given that India and China had these major civilizations, what we are observing now is a renaissance. This is not so surprising and it is quite natural that the rise of these countries has a huge impact on the world in many respects, including economics and politics. They both have big populations, high economic growth, and importance in regional and global affairs, but there are some differences. One big difference is the one that Toyoda-san mentioned, namely political systems – democracy in India and authoritarianism in China. Japan, being a democratic country would like India to maintain democracy and lead other countries towards democracy. According to some studies by research institutes in Sweden or Finland, the number of democratic countries is declining, and I would like to see India and of course Japan play an important role in maintaining democracy in the world.

Toyoda: In addition to India's success in scientific and cultural fields, there are many people of Indian origin serving as CEOs of world-renowned companies. Yet while India has cutting-edge science and a fascinating culture, discrimination based on gender and status seem to remain. Mr. Kant, what are your thoughts on these issues? Are you trying to change such social constraints?

Kant: More than half of India's population is now composed of women and the prime minister has focused on this in a very big way himself. We have opened hundreds of millions of bank accounts to ensure financial inclusion and between 2015 and 2023 we opened over 500 million bank accounts, over half in the name of women, and over 69% of all micro loans have been to women entrepreneurs, numbering approximately 35 million. We are creating an ecosystem where women are not just seen as the beneficiaries of government schemes but seen as leading development. The focus of the government has been to ensure that everybody has equal access to the benefits of development. Through a combination of governance reforms and leveraging technology we have been able to better target

beneficiaries for government schemes. By ensuring better access, we are empowering the marginalized to chart their own destinies and the focus is clearly on youth and on women in a very big way.

Future of India-Japan Cooperation

Toyoda: That is very interesting. Finally, I'd like to turn to the cooperation between India and Japan. The relationship between Japan and India is very close and friendly. How do you evaluate the current situation and what kind of cooperation do you think should be promoted in the future? Please give your frank opinions on economics, trade, diplomacy, climate change, and so forth.

Kant: Japan and India are natural partners. We have seen success in the automobile sector through the partnership between Maruti and Suzuki, and the role of JICA in building India's Metro systems, along with our country's partnership in the Mumbai high-speed rail project. Many of the Delhi/Mumbai industrial corridor development projects also reflect our close ties. Also in the dedicated free trade corridor, Japan is one of the largest foreign investors in India and ties have only gotten stronger.

India's presidency of the G20 coincided with Japan's presidency of the G7 and I worked very closely with my counterparts in Japan during this time, as India was an invitee to the G7 as well. The two prime ministers have met on several occasions in India and Japan, both bilaterally and as part of multilateral summits. They both want to see the relationship grow. Firstly, bilateral trade between the two countries totals about \$21 billion per annum, being the third-largest and the fifth-largest economies in the world. This level of trading is not reflective of our positions in the global economy. We must both leverage our strengths to build a mutually beneficial and balanced trade relationship. India's potential in food processing, pharmaceuticals and garments sectors can be further utilized, and we cooperate on sanitary and other non-tariff barriers in the food-processing field.

We have a lot that we can learn from Japan in these areas. In return, India can serve as a reliable trading partner and we must also continue our cooperation on climate change and energy transition. With an aging workforce in Japan and a demographic dividend in India, there is room for cooperation between the two nations on labor and orderly migration. Indian students are keen to study in Japan and Japan must encourage them and allow them to work for a few years, given the language requirements. You must become more of an open economy for Indians in both countries, who need to work together to grow and advance together. Thank you very much.

Fukagawa: Of course, I think we have a great potential for further cooperation in various projects and business activities, and as was mentioned we already have the good example of automobiles and subways. But probably in the next phase we are going to share

something that should benefit our societies; we have been suffering, for instance, recently from a huge shortage of pharmaceutical supplies because of our broken supply chain system, but India has a huge capability to complement it. So if we can work on basic research for mass production of pharmaceutical supplies, that will be a great improvement and may also contribute to the Indian medical care industry, which should in the meantime be very much covered by national insurance. So these could be common projects. Also, India seems to have very good evidence-based policy making and we have relatively good quality of data in terms of old-age medical care, so we could develop a complementary relationship with our healthcare industries, and many others. Thus, evidence-based policy making should be one of the positive common strategies for us to share.

Urata: The two previous speakers have made all the points that I agree with, so I will add just one more point. I would like to see more human exchanges involving tourists, students, researchers and businessmen. I especially think student exchanges should be more active. There is the potential for more Indian students in Japan and I would like to see this number increase. I think there are approximately 1,500 students from India currently in Japan, compared to approximately 25,000 students from Nepal. Of course, there are some reasons for this, but the sheer numbers tell us that our relationship with India in terms of personnel exchanges is not very developed and there is a huge potential there. Exchanges between people would increase mutual understanding of their societies and culture, which in turn would expand economic relations.

Toyoda: Recently I have been trying to promote collaboration between Indian and Japanese start-ups. Actually, 50 start-up companies from India are coming to Japan in March or April, so I am excited about that and there will be some new associations between Japan and India in this area. I hope that India, in cooperation with Japan, will lead the world as a great power with an Asian worldview and contribute to building a more peaceful and prosperous world. Thank you very much for your time today.

JS

Written with the cooperation of Joel Challender who is a translator, interpreter, researcher and writer specializing in Japanese disaster preparedness.

Interview with His Excellency Sibi George, Ambassador of India to Japan

India-Japan: a 1,000-Year Relationship that Is Skyrocketing

By Japan SPOTLIGHT with Mohan Gopal

On a cold but sunny weekday morning in mid-January, *Japan SPOTLIGHT* visited the Embassy of India in Tokyo. It faces Chidorigafuchi moat in the Kudan area, a popular area in spring when the cherry-blossoms are in full bloom. We are here to meet with Ambassador Sibi George and are ushered into his spacious office. The ambassador is an amiable soft-spoken gentleman, who greets us warmly and asks us to be seated. Delicious Indian tea is served, and the interview begins.

(Interviewed on Jan. 23, 2024)

JS: Could you please briefly tell us about your diplomatic career and, in particular, what experience you would consider as most important for your career?

Ambassador: In India, a diplomatic career begins when one is selected for the Indian Foreign Service through an All-India Civil Services examination. I took this examination in 1993 and have been a diplomat ever since. In the initial years after joining the Indian Foreign Service, one is required to specialize in a region and language. I specialized in Arabic, basically the Arab world, and started my overseas career at the American University in Cairo followed by a stint at our Embassy there. My subsequent posting was to Doha, Qatar. The Gulf region is very important for India as it is our extended neighborhood. Qatar is an important economic and energy partner for India. After three-and-a-half years there, I moved to New Delhi, where I was placed in charge of the Japan Office in our ministry. Thus, my connection to Japan began 20 years ago. I was very happy with that and for almost four years I was able to engage in our relationship with Japan. That was the time – in 2000 – that Prime Minister Yoshiro Mori visited India, followed by Indian Prime Minister Atal Behari Vajpayee's visit to Japan in 2001. Prime Minister Junichiro Koizumi visited India in 2004. It was a period which was a turning point in the relationship between India and Japan, and this has continued to progress since then.

After successive postings at our Embassies in Islamabad, Washington D.C., and as deputy chief of mission at Teheran and Riyadh, I was back at our headquarters in New Delhi. My first ambassadorship was to Switzerland, Liechtenstein and the Holy See.



Sibi George

Following this, I was back in the Gulf as ambassador to Kuwait. In November 2022, I came as ambassador to Japan. I am also concurrently accredited as ambassador to the Republic of the Marshall Islands.

JS: Thank you. Indeed, a very distinguished career. Generally speaking, your expertise seems to be in the Middle East and the Arab world. As a layman, I feel that Japan and the Middle East seem completely different.

Ambassador: From India's point of view, each region is very important. Japan is very important. East Asia is very important. Why? If you look at the map, India's most important

trading partners are to her east – Southeast Asia, South Korea, Japan, Australia, the United States. Japan has been a long-time, dynamic partner and this continues. The Indo-Pacific region – a confluence of two oceans – is important for India and espousing this, our Prime Minister Narendra Modi has initiated a project named SAGAR (Security and Growth for all in the Region). Japan is a maritime country, and India is also a maritime country. We have many islands – the Andaman and Nicobar archipelago, Lakshadweep and others – in addition to a long coastline. India is as important a maritime power as Japan is. In a nutshell, we cannot say that any one region is more important than the other.

Equally crucial as this region is to us is our extended neighborhood to our west. In addition to energy cooperation, there are 9 million Indians working in the Gulf region. This huge body of Indian diaspora working there is in itself a strategic partnership involving multiple countries in the Gulf.

JS: You have already answered my second question, as to how your thoughts have been about Japan as one of India's partners, so I will go on to my next question. I am curious about your impression of Japan. You worked in the Japan division of your ministry about 20 years ago and now you see Japan as the ambassador of India. Do you see any change in your impression?

Ambassador: For several centuries Japan and India have had a connection, Japan and India had a connection, a traditional, civilizational cultural connection. Daikokuten, Benzaiten, Buddhism, leaders like Swami Vivekananda, Rashbehari Bose, Subhash Chandra Bose, Justice Radhabinod Pal – lots of connections existed at people-to-people level. We maintained that relationship between the two countries. When it comes to 20 years ago at the start of my engagement with Japan, we had a good relationship, but it was more of government-to-government. ODA was a very important element of this. Japan had projects in India; for example, the Delhi Metro project happened during that period. Gradually that relationship transformed into a business-to-business relationship. Later it evolved into a strategic relationship followed by a global partnership. In 2014, that partnership became a special strategic and global partnership which was signed between Prime Minister Modi and then Prime Minister Shinzo Abe. This year is the 10th anniversary of that partnership. It marks a complete transformation in our relationship. As ambassador here, I have travelled to more than 40 prefectures. Wherever I have gone, I have met the governor, local assembly members, the local media, academia, and of course the local Indian diaspora if present. One thing I noticed wherever I visited, that this is a moment for the India-Japan relationship. The India-Japan story is a good one; a great one. An ambassador is a salesman and can sell a good story. I am very happy that we were able to connect with each of these places.

JS: What do you think are the most important issues in the agenda of bilateral relations between India and Japan, in general and also specifically?

Ambassador: First and foremost is our strategic partnership. The Indo-Pacific is one of the most important geopolitical constructs today – the Indian Ocean and the Pacific Ocean. In 2007, late Prime Minister Abe called it the confluence of two seas. Any developments in the Indian Ocean have a direct impact on Japan's prosperity. Similarly, any developments in this part of the world have a direct impact on India's prosperity. Therefore, it is imperative that Japan and India maintain their strategic connection and are able to work together for peace, stability and security in the Indo-Pacific. I am

very happy that we are working bilaterally, and working as the QUAD, and also working in multilateral organizations. So, the strategic partnership is the most important part in our relationship.

Second, equally important is our people-to-people connection. Indians like the Japanese and Japanese like Indians. How many Indians are there in Japan? 40,000. That is not enough. There is so much that we can address together, like the shortage of skilled manpower in Japan. I mentioned that 9 million Indians work in the Gulf. They are Indian citizens. They work there, contribute to economic progress, then return. That is a system we could look at in Japan. Indian students – how many are there in Japan? 1,500. I would like it to be 15,000. There are good universities in Japan and I think this awareness has to be spread in India.

Third, business. There are 1,500 big Japanese businesses in India. I would like it to be 15,000. We need to have small and medium enterprises looking at India. India is an opportunity; it is growing. It has transformed. It is digitally connected. There are more cranes operating in India than anywhere else in the world – there is so much construction happening. Our tax system has improved. India has reformed. Japan must not miss this bus. If India and Japan work together strategically and in business, it will be good for both countries, it will be good for the region and it will be good for the world.

JS: India has a growing young population, while Japan unfortunately has a declining one. Perhaps India and Japan could work together on this?

Ambassador: I fully agree with you. In fact, in the Embassy we have set up what we call "The India-Japan Skill Connect". It is a platform for Indians to know about opportunities available in Japan and for Japanese businesses to be informed about what types of skills they can source from India. India has some of the best universities in the world when it comes to science and technology. We are good at mathematics. India's Chandrayan mission to the moon was done with completely indigenous technology. All materials were made in India. If India can send a completely Indian-made satellite to the moon, surely Japan and India can collaborate in the field of science and technology. In fact, I am celebrating this year as the India-Japan Year of Science and Innovation.

JS: I will now move on to my questions relating to the global economic and political situation. What role do you think India could play amidst the current geopolitical crises?

Ambassador: India is the world's largest democracy. It is a country which has always stood for peace. What India brings to the table is



His Excellency Sibi George and Naoyuki Haraoka, editor-in-chief of Japan SPOTLIGHT at the Indian Embassy

solutions. Any problem, we can find a solution. We do not bring problems to the table. For example, take the case of the G20. India held the presidency for the last year. The world has seen how India addressed the concerns of the Global South. Despite the world being divided, we were able to bring together the G20 countries and have a joint declaration. That is a major achievement – a declaration covering 83 points providing an agenda of hope for the world for the coming years. It was a unanimous declaration that was adopted. In a world that is divided and in conflict, when it came to the G20, we were able to have a document of consensus. This is what India brings to the table – solutions.

JS: In the Indo-Pacific region, as you know, several free trade agreements are in progress – the CPTPP, RCEP and others. What do you think about the role of such multilateral forums, particularly for economic growth and development in the Indo-Pacific region?

Ambassador: When it comes to India, we are very clear in our mind. We will go by any trade agreement that is in our national interest. India is one-sixth of the global population; India must take care of this one-sixth of the global population. We have always believed in fair trade. In business, if one country follows the rule of law and another country doesn't, the agreement does not work. For free trade agreements – bilateral agreements, multilateral agreements – to work, the countries who are signatories must all play by the rules. One party violating the rules in order to enter another's market – it just does not work like that. India actually has a lot of free trade agreements – both bilateral and multilateral. The basic rule of thumb is that it must benefit the 1.4 billion people of India.

JS: Could you please give us your views on the WTO? The Japan Economic Foundation has been supporting the WTO for a long time but unfortunately the WTO's role is declining.

Ambassador: I agree with you. We stand for a strong WTO. India has always stood for the WTO carrying out its responsibilities. We always stand for multilateral organizations performing their roles: for example, the United Nations. We would like to see a reform of the UN as we believe it is stuck in the past – in the 1950s. It is very important that the UN plays its role so that it can help the world. Unfortunately, it is not able to do so as it is stuck in the past. Who represents the African nations in the permanent part of the security council? Nobody. It is not represented. Latin America is not there; the world's largest democracy is not there. So reforms are needed. The same is the case with the WTO. We stand for the reform of multilateral organizations so that they can better address the needs of everyone in the world.

JS: You have stressed the importance of the India-Japan Special Strategic and Global Partnership and mentioned some key priorities. Could you kindly explain some details of those priorities?

Ambassador: Now, why is our relationship called "special"? It is called special for a reason. India and Japan have had no history of conflict. It has been only a history of friendship. That in itself makes it special. When it comes to strategic relationships, I mentioned how important the Indo-Pacific region is. It is very important to maintain peace, stability and security in the Indo-Pacific. Towards this, the two major democracies in the region – India and Japan – have to work together. This is very important. Four like-minded democracies have come together in the Quad for stability and prosperity in the region. In India's priorities, we have identified the Indo-Pacific Oceans' Initiative. It has several elements articulated by India, including maritime connectivity and security. Japan is an important partner in this initiative, particularly in maritime connectivity. This is one priority we have to work on.

The second priority is that it is very important to deepen business engagement. We have been stuck in just 1,500 Japanese companies in India for the last 15 years. Increase! As I said before, India has changed; it is an opportunity. Look at the strategy point of view and enable more businesses to come. It is happening now, but I would like to see a much faster pace.

Third, is our defense relationship. We have excellent defense engagement. We did three major joint exercises last year – Dharma Guardian, Veer Guardian and Malabar. There are regular visits by ships and by defense personnel. We have to work more on defense

technology cooperation.

Fourth is critical technology – semiconductors, quantum computing, AI. These are areas we must work in. We recently signed an MOU on semiconductors. We need to do more of this. It is happening, but again, the pace has to be much faster.

JS: How about cooperation between start-ups in the two countries? We need entrepreneurs in Japan to stimulate economic growth. We need start-ups especially in the IT area.

Ambassador: I see this as a very important area for collaboration. In fact, India has one of the best start-up ecosystems. We have more than 100,000 start-ups and at least 100 unicorns. I see a huge opportunity. We have been having a monthly “India-Japan Start-up Pitching” event here at the Embassy for the last two or three years. So, we are collaborating and can do even more.

JS: My next question is about cultural exchanges between the two countries. You mentioned that student exchanges should be encouraged more. I agree with you. What about some other areas, such as the film business?

Ambassador: I am very happy to mention that a big Indian movie is now being filmed in Hokkaido. Yes, films are a huge opportunity. You can see the popularity of some Indian movies in Japan – *RRR* was a big hit. Have you watched it? It even won an Oscar for the music. There is a connection between India and Japan through films. Also, let me mention food. Very important for both sides. Indian wine is famous in Japan, as also Indian whisky. India has become a good wine producing country now. Of course, Indian curry is already famous in Japan. So food is also a connection between India and Japan. I would like to mention that there is a huge cultural exchange happening between the two countries. We have a cultural center here in our Embassy, which organizes classes in music, dance, yoga and *tabla*. These are attended by hundreds of Japanese. Last year, I presented certificates to 400 students who learnt our cultural art forms. Similarly, we are making other connections – between the saree and kimono; *ikebana*, the Japanese flower display, and *rangoli*, the Indian color display in complex geometrical patterns made on the floor. These are strong connections which we must bring forward. Above all is the connection related to our two civilizations. I have already mentioned Daikokuten.

JS: Yoga is gaining popularity in Japan. Might that be another connection?

Ambassador: I am very happy to mention that over 8 million people practice yoga in Japan. But what is my target? Anyone who breathes is a potential *yogi*. There is much more potential.

JS: Also, vegetarian restaurants. One of the reasons many young Indians hesitate to come to Japan is that we do not have many vegetarian restaurants. I think we should have more.

Ambassador: (Laughs) Yes, yes, that’s right.

JS: The last question is on your views about the future of the India-Japan relationship. Do you see bright prospects?

Ambassador: India is now in what we call “*Amrit kaal*” (Note: In Indian philosophy, this is the best period for peace and prosperity). In 1947, we became independent. After 23 years, in 2047, we will be 100 years old. We have a vision – a vision to become a developed country. A vision to ensure that every Indian is living in a developed country. And we have a partner – Japan. Japan was the first Asian country to become a developed country. Japan was the first Asian country to become an industrialized country. There is a lot that India can learn from Japan. For Japan, India is an opportunity. As India becomes a developed country, Japan is a partner in its progress. We are now a \$3 trillion economy. Soon, we will become a \$5 trillion economy. In 20 or 25 years’ time, India will be a major world economy. And in that, Japan is a partner. We have to work together. My vision of the India-Japan future is one of two major democracies, two developed economies in the region working together for the peace, stability and prosperity of both countries, of the Indo-Pacific region and the world, and in a reformed United Nations where our two countries are on the Permanent Security Council.

JS: I think India’s GDP will exceed Japan’s soon. I hope our relationship is enriched and grows dramatically. I will conclude the interview here. Thank you very much.

Ambassador: Thank you very much.

JS

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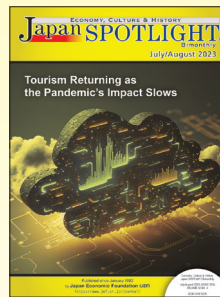
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