

Roundtable with Prof. Naoyuki Yoshino, Prof. Hiroaki Miyamoto, Prof. Tokuo Iwaisako and Masakazu Toyoda

# Recommendations for an Evolutionary Industrial Policy to Achieve Broad Economic Security: What Is to Be Done to Revitalize the Japanese Economy?

By Japan SPOTLIGHT

The Japan Economic Foundation (JEF) held a roundtable discussion on our recommendations for a new industrial policy with the participation of the following distinguished economists, the members of our research and study group having published the recommendations.

- Prof. Naoyuki Yoshino, Emeritus Professor at the Faculty of Economics of Keio University & Chairman of the Group of Research and Study on “New Industrial Policy” organized by JEF
- Prof. Hiroaki Miyamoto, Professor at the Faculty of Economics and Business Administration of Tokyo Metropolitan University
- Prof. Tokuo Iwaisako, Professor at the Institute of Economic Research, Hitotsubashi University
- Masakazu Toyoda, Chairman and CEO of the Japan Economic Foundation (JEF)

(Online Roundtable on July 29, 2022)

## Participants



Prof. Naoyuki Yoshino



Prof. Hiroaki Miyamoto



Prof. Tokuo Iwaisako



Masakazu Toyoda

## Comments on the Recommendations as a Whole

**Toyoda:** Since the burst of the bubble economy in the early 1990s, the Japanese economy has been stagnant for more than 30 years. We call these years the “lost decades”. Meanwhile, in the regions surrounding Japan, geopolitical uncertainty has been increasing, as shown by the intense US-China confrontation and North Korea’s repeated offensive missile trials. The Russian invasion of Ukraine is also not only a threat to Europeans but a serious threat to peace and stability in the regions around Japan. I believe that in these circumstances, the most effective way to achieve economic security for Japan is to “maintain and expand” our national competitiveness. Our research and study group aimed at assessing how to revitalize Japan, with discussions among distinguished experts from business and academic fields, and publishing our solutions in the form of

policy recommendations.

Today, I would like the members of the roundtable to discuss why they came up with these recommendations, how different they are from the policies of the current Japanese government and what would be necessary for their realization. It is true that the Japanese government has pursued a number of policies, such as those in the “Abenomics” package of late Prime Minister Shinzo Abe, and the current prime minister, Fumio Kishida, has also recently announced economic policies to realize a “new capitalism” with an emphasis on income equality in his “General Guideline 2022 on Economic and Fiscal Management and Reform”. However, we have not reached a perfect solution yet with any of these public policies.

First, Prof. Yoshino, our chairman of the group, could you please comment on the recommendations overall?

**Yoshino:** Regarding Japan’s three decades of a stagnant economy, I

believe that the aging of society was – and is – one of the big structural impediments. An aging society is said to be a structural challenge facing South Korea and China also, and thereafter Vietnam and Thailand. Japan is the frontrunner of aging societies, so I would think we need to cope with it somehow to maintain economic vitality.

One of the issues in our aging society is the continuously expanding fiscal deficit due to increased social welfare expenditure for elderly people. What is most important about this fiscal question is that there has been little change on the expenditure side these past two decades, except for continuous increases in social welfare spending that are now more than double what they were 20 years ago. But expenditures on social infrastructure, education or defense have little changed. Interest payments on the national debt have not increased thanks to a special monetary policy keeping the interest rate at zero or negative in spite of such a huge debt, and this is very lucky for Japan. But at the same time, it is why politicians have never been under pressure to reduce the fiscal deficit and it has not actually decreased at all.

Another issue about the macroeconomic phenomenon around the aging society is the declining effect of monetary and fiscal policy due to the larger percentage of elderly people who are less inclined to expand their consumption.

Additionally, a Keynesian macro-policy would work to reduce temporary unemployment but would not work well to resolve structural economic issues. The relevant policies to deal with them must focus on raising productivity by encouraging innovation. Without such policies, the economy cannot be restored. The challenge faced by the Japanese economy today is that there has been little or no achievement in structural reform or innovation for these 10-20 years. Our study group showed how we could achieve this.

I think that Japanese private businesses have not been working on structural reforms so far. I believe that elderly people should continue to work and contribute to society as much as possible without having to retire so easily in order to maintain the vitality of our aging society, but businesses must change their management style. It is not a seniority-based salary and promotion system but a productivity-based one that would provide all employees of every class and age with incentives to achieve their best performance. Japan's seniority-based system was established in the 1960s when Japan enjoyed its highest growth era, since skilled workers had an incentive to continue to work for small and medium-sized enterprises (SMEs) under this system and the burden for their labor costs incurred was limited thanks to the high economic growth and inflation at that time.

In order to attract elderly workers to continue to work hard under a productivity-based salary system, companies can adopt ways to

keep hourly wages the same but fix their working days without bonus payments in accordance with their work performance. This is how salaries can be changed in accordance with productivity but can avoid damaging the working incentive of older workers.

It should be noted that in the high economic growth era in Japan, with high interest rates for bank deposits, the money deposited doubled in 10 years and thus workers' income increased as well. It was an economy that effectively achieved double income for all. However, with the economy continuously declining today in Japan, private business cannot afford to maintain a seniority-based salary system which expands their labor costs enormously.

If we abolish the seniority-based salary system and let older workers continue to work under a productivity-based system, we would need robots that could help them so, and this can lead to digital innovation. With such innovation over a wide range of technologies related to the aging society in Japan, we could develop a large exporting industry triggered by new technologies.

Digitalization would wholly transform education and encourage the flow of residents into local areas. At this moment, the pandemic has forced younger people to move to local areas with lower populations than urban areas. Their primary concern is education for their children. With digital education expanding all over the nation, all Japanese kids can take lessons from the best teachers wherever they go. All that local teachers would have to do is supplement what their students learned from their 'virtual' teachers. Thus, even without good preparatory schools in local spots, remote education as such could provide anybody willing to learn, wherever they live and whatever their family background may be, with high-quality learning opportunities. The local teachers could support them with supplementary lessons on the spot. This would eventually improve the quality of education overall and build up human capital as well as enhance productivity.

Current government policies in Japan seem to be rather oriented towards helping the weak. They help the less competitive business firms to survive by providing them with credit guarantees. But for survival, I believe they have to achieve structural reforms, as the current policies simply encourage these firms to continue the same business operations and do not help them restructure their business or raise productivity. This eventually leads to sluggish productivity overall in Japan.

On the issue of the Environment, Society and Governance (ESG) and SDG investment for realizing a sustainable society, there is a point to be corrected in promoting green investment. That is the differentiated definitions of ESG and SDG among the rating agencies. Investors and large enterprises change the allocation of their invested capital in consideration of ESG or SDG after consultations with the rating agencies. But with these differing definitions by the

rating agencies, their invested capital is not necessarily flowing into sectors with the highest growth.

To correct it, theoretically, a unanimously agreed rate on a carbon tax worldwide should be adopted, increasing taxes on firms with more carbon gas emissions and lowering their profit rate, which would eventually lead to a decline on returns for their investors. Investors would monitor such after-tax returns and their invested capital would be allocated to firms with the highest returns after tax.

On the final part of the recommendations, the possibility of Japanese policy support for the development of Asia, high-quality infrastructure and support for SMEs are the principal areas where Japanese experience could contribute most to their economic development. I think we can enhance such contributions from now on.

**Miyamoto:** The Japanese economy has been stagnant for the last three decades. As for GDP per capita, a good indicator of national wealth, Japan exceeded the United States early in the 1990s, but now Japan's ranking has declined to 28th in the world. This means that the problem is structural rather than cyclical. In order to reverse the declining trend of the Japanese economy and put it back on a robust growth path, drastic structural reforms are needed. I agree that the various points raised by Prof. Yoshino would lead to improved productivity and long-term economic growth.

**Iwaisako:** It is true that Japan has been lagging behind in term of economic growth. On the other hand, while income inequality has increased significantly around the world, the increase in inequality in Japan has been only mild. I consider the current situation to be a consequence of Japanese businesses and individuals having been exposed to less rigorous competition. This may have been a beneficial choice for Japanese companies and workers in some respects, but from now on, when we need to promote structural reforms, we have to be ready for a temporary widening of inequality at least. I would like to add that promotion of the structural policies we recommended as a study group summarized by Prof. Yoshino will not necessarily free us from the pains accompanying them.

**Yoshino:** Structural reform policies attempting to transform zombie companies into competitive ones would create pains in the form of increased unemployment in the sectors losing their competitiveness. In order to mitigate such pains in changing jobs, we would need to provide sufficient retraining opportunities, which have not been widely implemented so far in Japan. We can now take advantage of the digital economy and make it possible for those leaving a job to reeducate themselves in various ways by using smartphones.

Digital technology could be applied to not only education at

schools but also professional training programs. With such retraining programs free of charge provided by the government and private businesses through digital technology for everybody at any time, income inequality would be reduced. Such education by digital technology ensuring equal opportunities for learning would encourage competition in the long run. With this, we can pursue a society where people studying hard and doing their best would be successful, while a safety net for the weak would also have to be well developed.

Another point to be noted about our policy recommendations is the proposal for improving the quality of bureaucrats in charge of policymaking in Japan. Unfortunately, the quality of their work is declining and officials increasingly quit jobs in government offices while they are still young. This means that they find their jobs less attractive.

I have been thinking about the requirements for bureaucrats in Germany, Japan and France at the international conferences that I attended. American and British officials can work freely in English, their mother tongue and the language used at various conferences and in international organizations and even in Asia. Americans work in English and promote business development without the help of government officials, but Japanese, German and French businesspeople could face a challenge in international competition as English is not their mother tongue. Germany has a government organization similar to JETRO in charge of helping businesspeople in business negotiations and attending international conferences. The French are also engaged in similar government-private sector collaboration. In this regard, without competent bureaucrats, the Japanese would find doing international business more challenging.

## **Transformation of Business Management**

**Toyoda:** On the question of business management reform, our recommendations refer to not only large enterprises but also SMEs on their need to change their management style. On large enterprises in particular, they need reform of their management style from a seniority-oriented one to competency-oriented one. What is to be done specifically for this? Why do they have to do so? Prof. Miyamoto, please start the discussion.

**Miyamoto:** After the burst of the bubble economy, the Japanese economy fell into long-term stagnation. During this period, Japanese businesses have become less aggressive and their management has become defensive. To be more specific, they ceased to invest in human resources and capital. Wages also remain stagnant. Wages are basically determined by managerial judgement and thus without a positive business outlook or a rise in labor productivity, they

cannot be raised.

What could firms do to break through such a closed situation? Our research and study group proposed that the seniority-based wage system be abolished and replaced with a merit-based wage system. A notable characteristic of the seniority-based wage system is the discordance between productivity and wages. In this system, while young workers get a salary lower than their productivity, the aged have a salary higher than their productivity. By continuing to work until retirement age, a full working life salary and overall productivity can be well balanced.

But what would happen if this system does not work well? Talented young workers are discouraged to work hard, since they have to work with wages lower than their productivity. On the other hand, companies would be reluctant to employ older people, even though many of them are competent and experienced with good business networks, since companies would have to pay them higher wages under the seniority-based wage system. Indeed, companies tend to lower the elderly's wages by rehiring them as non-regular workers after their retirement. This means that competent older workers are not given good working opportunities or high wages.

Our solution is simply to make productivity and wages equal, that is a merit-based wage system. Its largest merit is to provide anybody from any age group with working opportunities. The more competent they are, the higher salary they could earn, regardless of age or gender. This is a good system in terms of the possibility of raising a company's produced value-added by enabling diverse people to work together, which would lead to enhanced productivity. One challenge is to have proper work performance assessment in a merit-based system. Japanese companies have unfortunately been incompetent in fair and objective assessments of job performance based on a worker's skills or what they achieved in their jobs, since they have been used to salary and promotion decisions based on the number of working years or faithfulness to faction leaders within a company. So now we must start developing fair and objective working performance assessments.

In the US, for example, wages are determined in negotiations between the employee and the manager according to how many of the goals set by the employee have been actually achieved and how much reward is to be paid for them. In this way, objective assessment of the work performance has been established.

An additional merit of performance-related pay is to make it easy to practice a new working style. Many companies in Japan adopted teleworking during the pandemic. But according to a survey on teleworking, managers pointed out that "they do not know how well their staff are working" and employees say that "they do not know if the managers correctly evaluate their working performance." This means that they do not have any job performance assessment

system. In Japan, without person-to-person contact between an employee and a manager, it would be difficult to demonstrate how well he or she has worked.

This is very inefficient, because long working hours would not necessarily lead to high productivity. With a relevant work performance assessment, shorter working hours producing sufficient output could be correctly evaluated. A merit-based wage system thus encourages a more efficient working style.

As for SMEs, we could avoid producing inefficient zombie companies. There have been industrial policies in Japan, in particular related to SMEs, that have prevented or retarded the entry and exit of firms, which could have an adverse effect on competitiveness. From now on, with a proper understanding of efficiency by both business people and politicians, there need to be drastic reforms to promote new entrants and eliminate vested interests to strengthen Japan's competitiveness.

One example of various policies negatively affecting business growth is subsidies for employment adjustment. This may have been effective in stopping bankruptcies during the pandemic and preventing an increase in unemployment, but at the same time it is true that it has retarded business and structural reforms.

According to the Tokyo Shoko Research Survey on corporate bankruptcies, there were fewer bankruptcies in 2020 in the midst of the pandemic than in 2019 before the outbreak of the pandemic. It may be true that employment adjustment subsidies worked well, but it may also be the case that the subsidies saved companies that should have gone bankrupt in accordance with the market mechanism. I think such policies which could prevent efficiency need to be gradually changed.

On the role of financial institutions in structural economic reform in Japan, I would like to mention a view introduced in our research group discussion – that it is important for financial institutions to raise their business value from now on by sharing their business plans with their supporting companies.

**Toyoda:** How is it that Japanese companies cannot seem to transform their seniority-based system into a competency-based one? Any additional remarks on this issue?

**Yoshino:** I think Japanese business firms find it difficult to assess differences in competency. In the US this is not true. For example, in US universities professors can be fired or their salary reduced if they produce few academic research outcomes or poor teaching in classes. In Japan, managers hesitate to make distinctions in assessments of their employees' performances, but I think they should be more used to doing so.

**Iwaisako:** In order to enhance labor mobility we will need to reform the Japanese labor law system which excessively protects the employment of permanent employees. Japanese universities have started to introduce an annual salary system and it is mostly adopted for younger faculty members. However, from the viewpoint of employees, if the average salary remains the same, there is no incentive to accept an annual salary system based on detailed performance evaluation. If an annual salary system is to be used, the salary must also go up on average. I believe in this regard that our average salary should be raised if an annual salary system is adopted, not only the salaries of the professors with good performance.

## Reform of Universities

**Toyoda:** Our recommendation point out that universities need to be reformed as well. It is true that the global ranking of Japanese universities is continuously declining. Prof. Iwaisako, could you tell us what are the challenges Japanese universities face and how they can be mitigated?

**Iwaisako:** Japan has failed to take any initiative in creating a global ranking system of universities. We have just observed that the US and European leading rankings have become global common measures for assessment of university performances.

Japanese universities need to provide education both in English and in Japanese. On the one hand, top universities in mature, developed countries have historically had a responsibility to the societies to which they belong to educate their own elite groups in their native languages as well as in international languages, such as English and French. Japanese universities face the challenge of how to balance such social responsibility and the need to meet the demands of globalization.

Put another way, it is important to clarify what role the country and its people want their universities to play, and to what extent. Unlike in South Korea and China, which are interested only in raising their universities' global rankings, there are social responsibilities that universities in Japan and in Europe have been taking historically to foster elites in society and enhance the overall level of national education. We cannot give up these responsibilities just to raise global rankings.

So a nation needs to think seriously about how it can achieve consistency between both global rankings and the national role of universities in its own society. But it is an undeniable fact that Japanese universities are behind in globalization. This is self-evident in looking at the number of foreign faculty staff. This lack of diversity is an issue faced by Japanese businesses as well. What matters here

is how we can attract to Japanese universities or Japan as a country to live and work in not only superstar professors or CEOs but also medium-level experts with an annual salary from 10 to 50 million yen whose professional skills would be welcomed anywhere in the world.

The primary factor in attracting such high-skilled workers is salary. It is true that the wage level of Japanese workers is low and in particular professors' salaries are low. However, I also would like to point out that higher education has become rapidly commercialized on a global level since the beginning of the 21st century. So in top universities, in particular in departments or academic areas closely related to business opportunities, the salaries of professors have been rising significantly. It will be extremely difficult to attract competent academics to Japanese universities based on the salary standard of the average Japanese professor. With current salary levels, it is also hopeless to attract even Japanese academics working in overseas universities to return to Japan.

In US universities, the salary level differs among areas. In business schools, medical schools or some areas in engineering schools, a professor's salary is extremely high, but low in other fields like language studies, literature or in education schools. Whether similar differences in salaries would be accepted in Japan is a challenging question. In Japan as well, different salary standards have existed among universities since the old days, but there have never been any differences among the faculties in a university. Changing this salary system in a Japanese university would be rather a decisive reform.

In addition to salaries, in order to attract high-skilled foreign workers a Japanese university would need to conduct faculty meetings in English and prepare its administrative procedures in English as well. More importantly, questions about family matters, particularly their children's education in Japan, need to be properly addressed. To attract competent researchers from around the world to Japan, we must accommodate high-quality education facilities for their kids in Japan. They are thinking about enabling their children ultimately to enter top universities the US or elsewhere. In this light, they need to be educated in English in Japan. But such an educational environment is difficult to facilitate in Japan. This is a challenge not only for universities but also for businesses.

My last point is that there is a sensitive issue remaining between the Japanese Ministry of Education (known as MEXT) and universities. That is, once they can collect large funds on their own, the ministry's influence over them will inevitably decline. The bureaucrats would not like any policy limiting their power. So MEXT is reluctant to allow universities greater fund-raising capacity. This means that politics needs to play a key role in achieving fundamental university reform to expand a university's autonomy. We need

politicians determined to enact fundamental reform.

**Toyoda:** In the US, even state universities collect donations on a larger scale than the grants they receive from state governments. It is certainly an issue whether the Japanese Education Ministry would allow such freedom for Japanese universities. However, even in Japan, there is a tax system for donations at least. Would a university's autonomous action to raise salaries by taking advantage of this system not be allowed in Japan either?

**Iwaisako:** Only a limited number of universities are allowed to do so in Japan. Designated national universities enjoy this freedom as such. The top national universities are eager to be designated ones, not because they expect direct advantages from budget allocations, which are not so great, but because they want the freedom for fund procurement. For example, they could scrap very old government officials' residential apartments on their campus sites and sell the land to private concerns or build new ones for rent to earn funds.

In the US, donations are socially well accepted and the names of many large donors to business schools are attached to the names of those schools, but this would be most unlikely for Japanese national universities, as it would not appear to be socially acceptable.

Special knowhow is necessary if a university's management is to depend upon donations from outside the university. It is not an easy task. Sporadic donations every year will be affected by the donors' financial situation, largely depending upon the general economic situation, and thus these are not stable sources of revenue. To get stable revenue, there are endowment funds with large sums of money piled up in US universities. These enormous sums guarantee a large annual expenditure on routine costs such as salaries for professors and research activities, as well as maintenance of large facilities. I think it would take time to build up this system. Of course, it is better for Japanese universities to start working on this immediately, but even if they can collect donations more freely, it would take another two or three decades for them to build up such an American system.

**Yoshino:** In the international university rankings, the rating institutes cover only papers and articles published in peer-reviewed English professional journals for their evaluation. Papers written in Japanese, German or French are not covered for evaluation.

Recently in Asia, a few Singaporean universities have achieved higher ranks, but they are concentrating on this by such means as inviting a number of leading scholars to their faculties or strengthening job search guidance so their students can get good jobs in big prestigious corporations. Meanwhile, many Japanese universities concentrate only on raising their deviation value

estimated by large preparatory schools showing how difficult it is to pass their entrance exams, meaning how smart their students are, a status considered important in Japan.

On a different note, I believe professors of finance and monetary policy would need to work hard to catch up with the latest trends in academic progress in this area, and in this respect the efforts of professors working in Economics Departments are different from other human sciences professors'. I think we should take account of their productivity in the salary system and pay higher salaries for distinguished professors.

**Miyamoto:** The question is whether Japan provides a good working and living environment for foreign experts working in Japan. Earlier, we talked about the need for a proper education system for their children. I think that we should seriously consider how Japan can be a country that attracts foreign high-skilled workers. The International Institute for Management Development (IMD), a Swiss business school, created an index of attractiveness for foreign experts. It ranked Japan at 49th among 64 countries, an extremely low level. It is not only universities but also private corporations that cannot attract distinguished experts from outside Japan due to the lack of social institutions providing a good environment for their living and working. We must change this.

**Yoshino:** What matters for foreign experts in living in Japan is not only their children's education but also jobs for their spouses, since most of them have jobs as well.

**Toyoda:** The whole of Japanese society must become more friendly for English-speaking people. I guess English is not yet commonly used in Japan.

**Iwaisako:** I do not think in the center of big cities like Tokyo you would find it difficult to make yourself understood in English. Of course, it is different from New York or London where you can communicate anywhere in the city in English. But even in Tokyo, you can communicate rather well even if you speak only English. However, it is one thing for ordinary foreigners to be able to live in Japan without speaking Japanese that much, and another to be able to work at universities or in businesses when high-skilled foreign experts are expected to play major roles, without being aware of language barriers. The English required at such a level is very different.

In shopping at a supermarket or talking with a railway official at a station, there would not be any great challenge but buying or renting a house for a family would need more language skills.

While in US universities, there are staff in charge of life support for the foreign faculty and also specialists providing advice or services

to find good schools for their kids, there are none in Japan, not only at universities but also in business corporations. In other words, they would need to speak a high level of Japanese rather than daily conversation level.

Japanese youth today, in particular in the big cities, can speak better English than the global average. Young Americans, though all of them speak English as their mother tongue, are mainly interested in their own country rather than other nations. I think young Japanese are more internationalized than young Americans. Even compared with Koreans, in the sense that there is a wider range of internationalized youth in Japan, I think young Japanese are more internationalized. So foreign experts having started to work in Japan would find it easy to get used to daily life here. The problem is that they would find it not easy to work on more complex duties related to their life and work in English, as they would find much fewer Japanese who could speak high-level English and provide them with good advice. Therefore, we must have more Japanese who are comfortable with speaking and explaining about more complicated matters in English.

## Digitalization & Regulatory Reform

**Toyoda:** We need more deregulation to promote the digital economy. On the digitalization and deregulation of the Japanese economy, how do you think foreigners would view it?

**Yoshino:** When foreigners try to undertake difficult administrative procedures, they have to hire lawyers able to speak Japanese fluently, as they cannot do it in English. Administrative forms for various procedures are not digitalized and they have to go to offices and get forms and fill them in and explain about the forms in face-to-face meetings with the responsible officials.

This is truly laborious work. To reduce this we must reform the system and digitalize all such procedures so they can be done in English and be easy to do very quickly. In order to achieve this, we would need to reform the Japanese civil service system eventually. We need more English-speaking government officials involved in administrative procedures who could talk with foreign customers in English. They would then find Japan a very business-friendly society.

Above all, the financial sector is the one in strong need of such reform. In order to make Tokyo the most competitive financial market in Asia, we would need to enable all administrative procedures to be done in English rather than Japanese, otherwise all the large financial institutions will be gone to Singapore.

**Miyamoto:** Japanese government offices are still working with paper and fax machines. At the beginning of the pandemic, I heard that it

took a long time for the Tokyo Metropolitan Government to count the number of people infected, since they counted the numbers of faxes sent to them from each health center and put that data into a computer. This is truly outdated and an unbelievable story. It would be even more problematic if there was nobody in their offices who was critical of it. Of course, there was a shortage of digital equipment but what concerned us more was that there was none who had the technical skills for digital operations. I agree with Prof. Yoshino in saying that digitalization cannot progress unless the Japanese civil service system is reformed into a digital-friendly one.

**Iwaisako:** Japanese government officials in the lower ranks tend automatically to protect information that is not necessarily important with security passwords. That prevents the smooth flow of information. The situation is the same both in government offices and business corporation offices. We must be determined to fix it.

**Toyoda:** Is there no excessive protection of security in the US and Europe?

**Iwaisako:** Well, I think this is not limited to Japan. But in Japan we have a very robust hierarchy system. Once the seniors decide on something, their subordinates cannot change it without the seniors' agreement, and thus excessive security protection can be inflexible.

## Civil Service System Reform in Japan

**Toyoda:** Reform of the Japanese civil service system is unanimously considered important by all of us in our recommendation. Prof. Yoshino, could you tell us what needs to be done for this reform specifically?

**Yoshino:** First, in the case of a vertically divided administration like the Japanese one, every official tends to be strongly conscious of protecting their own ministry's or agency's interests. But I think Japanese government officials need to work for the whole national government. To lead them in this direction, all government officials must be recruited as a whole, not by each ministry or by only two or three groups. Then they should be transferred among the ministries horizontally. This is how they need to be educated comprehensively as civil servants working for the whole national government and not as officials working in the interest of each ministry.

Next, Japanese government officials' working time is excessively devoted to Diet discussions. I think that working on assumed Q&A prepared for ministers in advance by government officials is a waste of time and energy. It is important for each minister to discuss policy issues intensively with Diet members in each session without

prepared Q&A, just like in an academic conference. So I think, in principle, that notification of questions in Diet sessions can be done a week beforehand and the persons responding to those questions should be the ministers.

**Toyoda:** Asking young officials about a vertically divided administration, they answered solidly that it would be fine with them to eliminate such an administration. The thinking of reformers lags behind that of these young officials, and this gap could discourage incentives for the latter.

**Miyamoto:** It is an undeniable fact that the country runs smoothly because bureaucrats are excellent and work well in driving the administration. Even with long hours on Diet affairs and insufficient overtime pay, they support the administration well. But there are fewer candidates for bureaucrats among young people and moreover many of them increasingly quit soon after having started work. This is the time when we need to change the civil service system to enhance attractiveness of work as a bureaucrat.

**Iwaisako:** I have a concern about the recent criticism of bureaucrats in Japan. The scandals regarding government statistics in recent year have revealed that officials in some ministries working on statistics have not done their job well for a long time, prompting the argument that the nation should not spend so much money on their salaries and the number of civil servants should be decreased. But all this occurred because of the shortage of human resources for data and statistics compiling sections. There are very few Japanese government officials in terms of their ratio to GDP. In this regard, it is wrong to say the number of government officials should be reduced, and there must be many cases where the number should be increased in response to the needs of the work.

In particular, in the case of the government's economic statistics, private businesspersons on temporary transfer to government offices are also engaged in this statistic-making. But we cannot get precise data unless the administration acknowledges these workers as professionals and pays them accordingly and provides sufficient numbers of such statistical workers.

The argument over reducing the fiscal deficit for fiscal sustainability must be fundamentally related to the question of social security expenditures, and whether the government increases or decreases the number of statistical workers will not change so much the overall fiscal deficit.

**Toyoda:** As you mentioned, the percentage of young bureaucrats quitting their jobs after only a few years is increasing. In this light, we see the Japanese media today highlighting the need to improve

their working environment as well as the quality of their work. Could you elaborate on this?

**Yoshino:** I believe that they should build up a competency-based salary system and pay salaries as high as in the private sector for those with high competency. For example, the salary of officials on the managerial track should be same as the average among the 100 companies listed on the first section of the Tokyo Stock Exchange and their pensions should be equivalent to those in other major nations in the world. They should also enrich programs for training and studying abroad and set up an online education system. As we have seen an increasing number of remote meetings since the pandemic, we should promote online training for bureaucrats such as web seminars among global leaders when they are not so busy. That, I believe, would lead to the establishment of a support system by Japanese bureaucrats for the global development of private businesses.

## Mobilization of Labor Market

**Toyoda:** I agree that the government sector may as well get rid of its seniority-based salary system and transform it into a productivity-based one, as well as in universities and business enterprises. What matters would be a competency-based system rather than a seniority-based one that could achieve labor market mobility. Prof. Miyamoto, what do you think about this? Enhancing labor market mobility may cause pain, but do you think it is still necessary?

**Miyamoto:** I think that Japan should thoroughly promote labor market mobility. There will be criticism that it would cause unstable employment and have a negative impact on workers' welfare. But I think the opposite would be the case. With labor market mobility, people would be able to work in accordance with their own lifestyle or preferred work-life balance. In order to achieve an individual worker's optimal career path as well, promotion of labor market mobility would be an ideal policy option, as workers would be given many job opportunities with it.

Mobility means not only active movement of labor, but also more freedom for workers to move whenever they prefer. Thus, labor market mobility does not necessarily mean the end of lifelong employment. If some people want it and it is possible, they can still choose lifelong employment. So labor market mobility would have a very positive impact by enlarging the freedom to choose.

The Japanese employment system, such as lifelong employment and seniority-based wages, has become ingrained. The Japanese employment system was created and prevailed in the postwar high economic growth era. There were two factors that made it possible:



rapid economic growth and a large youth population.

Since Japan's economy kept growing, firms had to recruit more workers every year. The increased labor demand was met by the large youth population. Once hired, the employees were never asked to leave the companies, and de facto lifelong employment was established. With the economy growing for many years, salaries continued to rise annually. And the longer people worked, the higher their salary grew. This is how the seniority-based system was built up. But regrettably, these two preconditions do not exist anymore in Japan. We see stagnant economic growth and an aging society. These changes have made it difficult to maintain this employment system, and we now need labor market mobility to provide all the labor force with job opportunities.

From a macroeconomic perspective as well, it is important to promote labor market mobility. Academic research shows that labor market mobility would enhance productivity and achieve the "right person in the right place". The Japanese labor market is inflexible and enhancing its mobility could be a challenge for some in the short run, but in the long run I believe its merits exceed its demerits.

According to a survey on employees' satisfaction with their current job in Asian countries conducted by Persol Research & Consulting Co., in Japan only 52% of respondents were willing to continue in their current job. This is the lowest among the Asian countries covered by the survey. This means many Japanese workers do not necessarily want to continue with their jobs.

However, on the question whether they will change their job, only a quarter of the respondents say they would. This survey implies that there are many people who are not satisfied with their current job but have no choice but to stay in it. The reason for this is that the Japanese labor market is rigid. By enhancing mobility, I think there would be many more chances and job opportunities for people, and that is why I believe the Japanese labor market should be mobilized.

## Role of Universities in Revitalization of Local Economies

**Toyoda:** Regional governments and universities are expected to play a key role in the revitalization of local economies and collaboration among industry, government and academics. With the development of regional economies, the whole Japanese economy can achieve growth. What role do you think regional universities and governments must play to achieve it, Prof. Iwaisako?

**Iwaisako:** Such universities must think about what role they are expected to play in local society, and it is important to encourage them to contribute to their local economy through consultations about regional situations and circumstances.

On regional governments, they need to select the services they provide and concentrate their resources on them, integrating them with local bodies under the prefectural government. Otherwise they will suffer from fiscal challenges that could result in national fiscal difficulties. Selection and concentration of regional governments' public services is becoming a policy led by the national government.

## Arguments on the Fiscal Deficit

**Toyoda:** While some people continue to warn about Japan's expanding fiscal deficit due to a variety of issues ranging from the Ukraine crisis to climate change, there are others such as advocates for Modern Monetary Theory (MMT) saying a fiscal deficit would not pose any challenge. What policy direction on this issue do you think our research group has provided?

**Yoshino:** In the US, the MMT argument was that an increasing fiscal debt should not be regarded as a great challenge, as the central bank could increase money supply by taking on the burden of the fiscal deficit. But this was found to be wrong in Europe and the US, and now all the governments there have started monetary tightening policies.

The biggest issue regarding the fiscal deficit is the increasing social welfare expenditure that is dragging significantly on the economy. In responding to this issue, our recommendations argue that enabling elderly people to work as many years as possible by abolishing the seniority system and promoting labor market mobility would greatly reduce social welfare expenditures. With older people working longer as much as possible, their dependence upon social welfare would decrease and thus the national debt would decrease as well.

Meanwhile, we need to increase tax revenues. An environmental tax is an effective way to do this. Climate change is a hot policy issue worldwide. As Japan is the host country for the G7 in 2023, it would be a good idea for Japan to propose a carbon tax or environmental tax at a global standard rate at the G7 forum.

At this moment, many countries including the US and developing nations need an incentive to have a new tax, as they suffer from fiscal deficits. In order to reduce the burden on industries with extremely heavy CO2 emissions like the steel or automobile industries, the concept of net CO2 emissions could be applied. For example, with those industries' green investment in forestry or solar power or offshore power, the saved CO2 emissions achieved by these investments would be subtracted from the original emissions of these industries and thus the tax would be imposed on net CO2 emissions. Such an environmental tax at a globally standard rate would total a huge amount. This idea could contribute to a reduction

in Japan's fiscal deficit and avoid to the need to raise the consumption tax significantly.

## Conclusion – How Can Our Policy Proposals Be Realized?

**Toyoda:** These policy recommendations are made from a perspective different from that of the Japanese government. Could you each state your view on how they can be realized?

**Iwaisako:** There is no silver bullet for fixing all the problems. It is not only Japan but also the rest of the world that faces the need of structural reform. It is certainly true that the Japanese economy has been stagnant for decades but income inequality has not been as significant as in other advanced nations. On this point, I would like to emphasize that with policies to promote competition to raise economic growth, income inequality must be accepted to some extent.

I also would like to say, however, that expanding income inequality does not mean an increased need for a social safety net. There will naturally be wealthy people and not so wealthy people as a result of free competition, but this does not mean that the socially disadvantaged people's interests will be neglected. We have to promote further competition to realize more efficiency in our economy while securing a social safety net for the weak. This is my first point on achieving the goals of our policy recommendations.

One more point is that what the Japanese government must protect from the economic difficulties of structural reforms are individuals and households and not business corporations. The government should build a new society where unemployed people can find new jobs easily. It should concentrate on helping individuals instead of saving zombie companies, and it should prepare a minimum safety net for those individuals.

**Miyamoto:** The most important thing is that we must have a confirmed goal. We need a national consensus about what kind of society we want to aim for.

Under the Abe administration, we had the goal of getting out of deflation. Under the administration of Prime Minister Yoshihide Suga, we set a digital economy and tackling climate change as goals. We must now think seriously about the future direction of our economy and find a goal. In my personal opinion, we should reverse the trend of economic decline during the past three decades. Our research and study group stated the reasons for this decline in our recommendations and so we should try to tackle these factors.

As Prof. Iwaisako mentioned, Japan's economy has not grown, but income inequality has not widened either. In fact, Japan's Gini-

coefficient, the indicator of income inequality, has not increased in the last 20-30 years compared to the US and other advanced economies. So should we keep our current economic situation as it is? If not, it is important for citizens to discuss what kind of economic society we should create.

In the US and other advanced economies, while "Neo-liberalism" has promoted economic growth, it has had adverse effects on society, such as widening income inequality and climate change issues. Given this background, there is a tendency to revise capitalism, which I sympathize with. But I think that Japan has not reached that stage yet. The government is now advocating a "new capitalism", but I think it is important to firmly carry out "ordinary" capitalism in the first place. I personally believe that with policies encouraging the functions of market mechanisms, the Japanese economy could achieve further growth.

**Yoshino:** I think the aging of society is one of the big factors behind the Japanese economy being stagnant in recent decades. In addressing this issue, a productivity-based salary system including the elderly rather than a seniority-based one would raise Japanese productivity. With this reform, I think competition among companies would be encouraged. With the inclusion of older workers in this reformed system, the need to think about innovation to help older workers would bring forth new industries.

In Japan we have less inequality and the pains accompanying structural reform are eased by a variety of policies which expand the fiscal deficit. In other words, though it is wonderful to correct inequality by safety-net measures, this has invited the expansion of the fiscal debt. We cannot adopt policies from now on that support zombie companies and lead to the expansion of the fiscal deficit. Instead, the government should provide equal opportunities for all individuals and companies through digital technology.

With further digitalized education, children can listen to the best teachers' lectures on their smartphones wherever they may live, and this would provide them with equal opportunities. Students at regional universities could benefit from remote education as well by listening to the best professors' lectures at any time online. This is how remote education could expand the value of human capital.

Finally, I would like to emphasize that a productivity-based salary system which avoids the accompanying pains as much as possible would lead to equal opportunities. The government should aid, with public finances as a last resort, those who would still be neglected by social welfare with this new system. I think this is the best policy for us.

**JS**

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