

Exclusive Interview

LEADERS IN JAPAN

No. 2

Minister of Economy, Trade and Industry
Ken Saito



From 30 Years of Stagnation to Sustainable Growth: Economic & Industrial Policies Supporting the Structural Transformation of the Japanese Economy

By Naoyuki Haraoka

The Japanese economy is returning to strength, with a virtuous cycle between wages and prices, and the stock market rising for the first time in 35 years. For our second interview with a Japanese leader, we spoke with the key figure in METI's policy to sustain this trend, Minister of Economy, Trade and Industry Ken Saito.

(Interviewed on April 8, 2024)

Current State of the Japanese Economy

JS: With the Nikkei 225 hitting a new record high for the first time in 35 years, some are hopeful that the lost 30 years are nearing an end. What are your views on this?

Saito: Currently, the Nikkei Stock Average is at an all-time high, and for the second consecutive year companies are accelerating their wage hikes, with the fourth round of spring labor-management negotiations this year showing a 5.20% wage increase, going beyond 5%. Furthermore, for the first time in 30 years, 100 trillion yen in investments has been realized, indicating a turning of the tide.

However, it is not an easy task to change in two years the cost-cutting, shrinking mindset that has been in place for 30 years. This is the critical point. We must translate the turning of the tide into structural changes in the Japanese economy, completely overcoming deflation and shifting to a growth-oriented economy. Thanks to the policy measures taken over the past few years, Japan's economy has a chance to undergo a major change in macroeconomic conditions. I firmly believe that we must not let our guard down to miss this opportunity and end up in the same situation as we were in the past. I want to mobilize all our policies to tackle this issue.

JS: What caused the 30 years of stagnation in the Japanese economy? And what has changed that has

led to expectations that the end is near?

Saito: In the 30 lost years, there was the bad loan problem, the global financial crisis triggered by the bankruptcy of Lehman Brothers, and the impending population decline. Private-sector capital investment remained flat at around 80-90 trillion yen, the rate of wage increases in spring labor offensives remained at 1-2% year over year for the last 20 years, and technological innovation stagnated. And the government also recognizes that, under the private-sector initiative, its efforts to create new value, focusing on market environment improvement measures to remove constraints on the private sector, have been insufficient as a result.

On the other hand, under the current circumstances the trend of companies raising wages has accelerated for two consecutive years, domestic investment has reached the highest level in 30 years, and the appetite for capital investment remains high. We believe that this is due not only to transitory external factors but also to changes in the macroeconomic environment, including changes in the international economic order and structural labor shortages, as well as the effects of industrial policies such as support for semiconductors that have been implemented over the past several years.

Expected Industrial Policies

JS: In order to realize sustainable growth, I believe

that we must increase productivity and strengthen the economy through industrial policies. What industries in particular should we consider as driving forces? Are they GX-related, such as EVs and hydrogen vehicles, or DX-related, such as AI, semiconductors, or the space industry, which has been the subject of a lot of good news recently?

Saito: In order to secure growth over the medium to long term, we believe it is necessary to develop industrial policies with a firm focus on targets. As for the next engine of growth, we believe that fields that solve social issues will grow, and we have set GX and DX as two of our targets. We believe that Japan has a promising future not only in these fields, but also in EVs, hydrogen, AI, semiconductors, space, storage batteries, offshore wind power, biotechnology, and other areas within GX and DX. I believe that METI must compete and win on a global scale in these fields while at the same time working to improve the macroeconomic environment. We believe that by doing both of these things, we can lay the foundation for a long-term virtuous cycle in wages, the economy, and prices.

JS: There are positive aspects of AI and semiconductors, such as increased productivity, drastic improvement of work efficiency, and promotion of innovation as a catalyst for growth, but there are also various negative concerns, such as the possibility of the spread of fake news. I would like to ask how we can overcome the negative aspects without hindering the positive aspects.

Saito: AI is an entity that can lead to the creation of innovation but also carries various risks, and the world is now discussing how to ensure a balance between the promotion of innovation and discipline for managing those risks. As for Japan's position, Japan's basic stance is not to regulate in advance, but to proactively respond to the rapid evolution of AI with an approach that encourages businesses to respond on their own initiative. Specifically, we plan to soon publish the AI Business Operator Guidelines in cooperation with the Ministry of Internal Affairs and Communications, so that business operators can fully utilize AI in line with their risks.

In addition, based on international discussions on safety, the AI Safety Institute (AISI) was established in February 2024 in the Information-technology Promotion Agency (IPA) with the cooperation of the Cabinet Office and other relevant ministries and

agencies. In the future, we intend to collaborate with international partners, including those in the United States and the United Kingdom, centering on AISI, in order to ensure safety.

Fake news is another element of concern, and this is also being examined by the Ministry of Internal Affairs and Communications, as well as by fact-checking organizations and other private-sector entities. METI is also promoting technological development to support decision making in dealing with fake information through the Economic Security Critical Technology Development Program. In any case, we would like to organically combine both the promotion of innovation and discipline for risk management to create an environment in which our country and its industries can win through the use of AI.

JS: China's rise in EVs and other vehicles has become a hot topic, but what are your thoughts on the future of the Japanese auto industry?

Saito: First of all, the automobile industry is basically a key industry that also supports the Japanese economy, so I believe that we must win the international competition at all costs. As for carbon neutrality in the automotive sector, no perfect technology currently exists, and the situation differs from region to region, so for the time being a variety of vehicle types, including EVs, hybrids, and FCVs, are expected to coexist. In Southeast Asia in particular, it is unlikely that EVs will move forward in one fell swoop, so a wide variety of vehicle types will coexist. From the perspective of winning the competition, I believe that Japan's basic strategy at this point is to pursue a variety of options.

Specifically, with regard to EVs, we will take a variety of strategies, such as launching the domestic market through vehicle purchase support and infrastructure development, or strengthening the domestic manufacturing base for storage batteries and technology development, but we will also take a comprehensive approach with the objective of winning the competition in EVs.

With regard to FCVs, we would like to promote initiatives that include support for vehicle purchases, infrastructure development, and overseas development of fuel cells themselves, with an emphasis on commercial vehicles that can take advantage of their characteristics. For hybrids, I think the key is to combine this with efforts to decarbonize the fuel itself, so I think it is important to create a large-scale, efficient production process for the commercialization of synthetic fuels in the early 2030s. In pursuing this variety of options, it may mean changing the center of gravity a

little, depending on the situation.

JS: Regarding space, following the successful launches of H-IIA and H3, there has been a series of good news such as the successful pinpoint landing on the Moon. The small commercial Kairos rocket did not complete its mission to separate a satellite, but I hear it will try again at an early date. Space is also very important in terms of economic security. The global trend seems to be shifting from government-led to private sector-led efforts, especially in the US. Do you think that Japan will follow this trend?

Saito: Although the launch of the first Kairos rocket was a great disappointment, I think it was very meaningful that Space One attempted to launch a commercial rocket with a practical satellite on board as the first private company in Japan to do so. We look forward to their next attempt after examining the cause of the flight termination.

In addition to civilian applications such as satellite communications, the space sector is playing an increasing role in military security and economic security, such as missile defense, and I believe it is becoming increasingly important from a policy perspective. On the other hand, in recent years, there has been a significant increase in the number of startups and other industries entering the space business worldwide, and space development now seems to be shifting from government-led to private sector-led efforts.

In this context, METI has been supporting the development of small satellites, providing demonstration opportunities in space using commercial launch vehicles, and supporting the development of applications using satellite data. I believe we are now entering the stage of commercialization of our achievements.

A new Space Strategy Fund has been established in JAXA. This fund will provide support for the full-scale commercialization of the private satellite and rocket industry on an unprecedented scale. This is an area in which we should continue to make strong efforts.

JS: I believe that support for startups is extremely important in terms of sustainable growth. I understand that METI has been putting a lot of effort into supporting startups recently. For what purpose? What are the results?

Saito: I believe that startups are very valuable in that they can be a

driving force of the Japanese economy, solving social issues at a rapid pace through innovation of new technologies and ideas, revitalizing markets, and improving the productivity of existing companies. In this sense, we are taking various support measures. METI has been working to develop Japan's startup ecosystem by sending entrepreneurs overseas, expanding public capital to venture capital firms, and promoting startup development and collaboration through the tax system, as well as strengthening support for deep-tech startups.

As a result, the amount of funding for domestic startups has increased tenfold in the last decade, and the number of university-launched venture companies has more than doubled in the last eight years. The number of students seeking employment in venture companies and startups is also increasing, and there are signs of change in the attitudes of young people towards startups.

We are also seeing the emergence of startups that create innovation and compete globally, as well as impact startups that combine economic growth with solutions to social issues, as we saw with the Noto Peninsula earthquake. We believe that the startup ecosystem in Japan is steadily evolving.

We have introduced a bill in the current Diet session to amend the Industrial Competitiveness Enhancement Act which includes support for startups, and I would like to make a firm commitment in this area as well. Recently, progress has been made with DX, and various new products are being created as a result of the emergence of the new challenging field called GX. We are at a stage where policies to encourage this trend and achieve growth in this area are truly critical.

Maintaining the Population Is Important for Growth Potential

JS: In order to maintain Japan's growth potential over the medium to long term, JEF's Study Group on Population Problems (chairman: Naoyuki Yoshino, professor emeritus, Faculty of Economics, Keio University) proposed that we should take measures to maintain a population of 100 million by, for example, boosting the birth rate by increasing the incomes of young people, establishing a social norm of lifelong active employment for the elderly, and actively accepting foreign workers with a certain skill level by introducing a points system, as in the UK. What do you think?

Saito: Marriage, pregnancy, childbirth, child-rearing, and so forth are based on the free decisions of individuals, and the government has not set any quantity targets such as maintaining the population to maintain the potential growth rate. However, it goes without saying that measures to combat the declining birthrate are important. The most important measure against the declining birthrate is giving the younger generation hope of marriage and child-rearing by increasing their income. METI is working to support medium-sized companies and small and medium-sized enterprises to invest in growth in order to create good jobs in local regions where the wages of young people can increase continuously.

The elderly, along with women, are expected to play an active role in securing Japan's labor force. In order to contribute to the realization of active lifelong employment, we will work on the promotion of healthcare services.

In 2012, points-based preferential immigration treatment for highly skilled foreign professionals was introduced, which allows foreign nationals who have reached a certain level of points based on their duties and career history to obtain a Highly Skilled Professional status of residence. In April 2023, two new systems were established: (1) the Japan System for Special Highly-Skilled Professionals (J-Skip) allows those with a certain level of academic background or professional career and annual income to obtain Highly Skilled Professional status of residence, regardless of the point systems; and (2) the Japan System for Future Creation Individual Visa (J-Find) allows graduates of universities ranked in the top 100 in the world university rankings to be granted preferential treatment in terms of status of residence to facilitate their preparation for employment and entrepreneurship in Japan. We hope this system will further increase the acceptance of highly-skilled foreign human resources and promote innovation.

Furthermore, for solving the labor shortage, METI supports SMEs to improve their productivity by labor-saving investments and other measures. In 2023, the subsidy supports SMEs to implement labor-saving equipment, such as cashless ticket-vending machines. SMEs can select products easily and quickly from an online catalog. Moreover, METI supports investments for the development of new products and services.

Energy Policy

JS: Since the Ukraine crisis, it has become inevitable to balance climate change countermeasures with energy security. In this context, the Japanese

government has proposed the Asian Zero Emissions Community (AZEC).

Saito: A few days after my arrival in METI, I had the opportunity to participate in the AZEC summit meeting, and to be honest I was impressed by how far international cooperation on energy and the environment had advanced. The international energy market has been in turmoil since the Ukraine crisis, and I believe that the importance of ensuring energy security has been recognized in that context. Economic growth will increase energy demand in Asian countries in the future, and therefore ensuring energy security is becoming an urgent issue for them and for Japan.

At the same time, many Asian countries have also set goals of achieving carbon neutrality, so I believe we are in a difficult situation where we have to achieve economic growth, ensure energy security, and work on decarbonization at the same time.

In this context, AZEC was launched with the aim of simultaneously achieving decarbonization, economic growth, and energy security, and more importantly, to promote cooperation toward decarbonization in Asia, based on the common principle of promoting decarbonization through diverse pathways that take into account the circumstances of each country. We held our first summit meeting in December 2023 and confirmed these common principles as well as the progress of 350 concrete cooperation projects. I believe we have laid a good foundation for further policy coordination toward decarbonization. We would like to contribute to the decarbonization of Asia by accumulating more concrete cooperation projects. There is a limit to what Japan alone can do to reduce emissions, so I want to work toward achieving the three goals I mentioned earlier simultaneously across Asia.

Foreign Economic Policy

JS: Since the Ukraine crisis, I think it can be said that the international organizations that formed the world's international order, such as the WTO and the United Nations, have become dysfunctional. I think that Japan, with its peace constitution, needs to take the initiative in realizing a new international order based on the rule of law rather than force. For example, in order to protect free trade, we should persuade opponents of it to accept it by advocating for various measures to take care of those who may lose their jobs as a result of free trade, such as by

establishing job replacement assistance and reskilling programs.

Saito: First of all, I believe that Japan has made great efforts to create an international economic order based on the rule of law. In recent years, protectionism has been fostered by geopolitical risks and non-market measures taken by some countries, and if we disregard the order based on the rule of law, the world will once again become a power game where the strong win and the weak lose out. Therefore, I believe that Japan must protect the international economic order based on the rule of law at all costs and cooperate with the rest of the world to realize it.

To this end, the reform of the dispute settlement system is underway at the WTO. Furthermore, I think it is also necessary to conduct rule-making on a plurilateral basis to move things forward in a pragmatic manner.

In addition to the WTO, Japan has made multilayered efforts to build EPAs or trade agreements among other countries and bilateral trade agreements. It is important to increase the engagement of the US in Asia, and although it is always said that it is unlikely, we must continue to make efforts to see if the US can somehow return to the CPTPP, and we also need to pursue various frameworks such as the IPEF and other new frameworks among like-minded countries. I fear that the economic order may collapse rapidly unless we work together with like-minded countries to strengthen the use of rules and cooperate on industrial policy.

On the other hand, it is natural that concerns that free trade could lead to loss of jobs and business arise in each country. Although we cannot completely eliminate such concerns, we should try to address them as far as possible – for example, by providing support that will lead to re-employment and strengthen productivity and competitiveness. While doing so, I firmly believe that free trade rules must move forward.

JS: I think it is very important to balance economic security and free trade, but how should this be done? Is it important to work with the IPEF, Quad, and so forth, or is it more important to activate the WTO and the CPTPP?

Saito: I think we need diverse efforts in balancing economic security and free trade by utilizing the multilayered and bilateral cooperation Japan has developed, including making progress in cooperating with the US in the area of economic security. Such diverse efforts, not

only in the WTO but in many fields, will be indispensable in the future.

JS: There is a lot of talk about strengthening ties with the Global South, and I think it is important to establish an Asia-Pacific-wide economic and industrial policy or a strong supply chain by utilizing the Quad and IPEF. What do you think about this?

Saito: I think the Global South will come to account for the majority of the world's population. Many of these countries will experience significant economic growth, and I think it is very important that we work together with them to create an international economic order based on free and fair rules. It is also important for Japan to contribute to the growth of these countries and build a win-win relationship where we can grow together.

For global rulemaking, it is important to utilize forums such as the Quad, which includes India, a major power in the Global South, and I think it is also extremely important to build close cooperative relationships among like-minded countries for the further development of a free and open Indo-Pacific region. Strengthening the supply chain will also help to advance the development of a win-win relationship with the Global South. For example, countries experienced supply disruptions due to the pandemic. Based on these experiences, the IPEF Supply Chain Agreement, which entered into force in February 2024, includes cooperation to ensure effective coordination under normal and emergent circumstances.

Project-based initiatives are also important, and we have been engaged in specific discussions with countries in Asia, Africa, and other regions on how to strengthen supply chains, such as securing critical mineral resources. In this sense, our relationship with the Global South will contribute to the strengthening of our country's supply chain, and at the same time it will lead to the development of the economic and industrial sectors of partner countries in the Global South. Through such efforts, I believe it is important to move forward together with the countries of the Global South as reliable partners.

JS: Thank you for your time.

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Interviewer: Naoyuki Haraoka, executive managing director and editor-in-chief of *Japan SPOTLIGHT*. He translated this article from the original Japanese.