

An Analysis of the Hiraiwa Report

By Wakatsuki Mikio

The birth of the Hosokawa Cabinet last August ended a political system that stretched back nearly 40 years. But earth shattering change has not been limited to domestic politics. The end of the Cold War has changed the international political scene as well as economics. In Japan, the economy continues to be hobbled by a lingering recession, with job insecurity growing in the post-bubble environment.

Upon the inauguration of the Hosokawa Cabinet, a private advisory panel to the prime minister, the Advisory Group for Economic Restructuring (dubbed the Hiraiwa Committee), was formed in September reflecting the need to establish new directions for restructuring the economy along with political and administrative reforms in the new world order. In other words, the panel, headed by Keidanren (Japan Federation of Economic Organizations) Chair Hiraiwa Gaishi was expected to draw a chart which will navigate the Japanese economy into the uncharted waters toward the 21st century.

Alongside these long-term structural challenges, the government was under pressure to implement quick measures for urgent economic problems, such as a deepening recession and widening trade imbalance. As any short-term measure was expected to be related in many ways to long-term reform, to make them consistent was also urgently required.

Comparison with previous reforms

There have been several previous attempts to restructure the Japanese economy. Best known were the 1986 Maekawa Report, compiled by an economic committee headed by former Bank of Japan Governor Maekawa Haruo, and the follow-up 1987 New Maekawa Report.

These two reports, reflecting the situation where Japan's surplus which had

increased steadily after 1980 had intensified international friction, sought to realign the Japanese economy more harmoniously with its trade partners by reducing the current account surplus while maintaining growth.

Compared to them, the current round of reform attempts are more ambitious as they seek to overhaul the very economic system that was the vehicle for Japan's current prosperity. For the first time, the goal is to seek to reduce the current account surplus as the result of a new domestic policy which stresses a higher quality of life to generate new vitality in the economy.

This new approach is clearly illustrated in the four reform targets of the Hiraiwa Report: the creation of a socioeconomic system that is transparent and open domestically and internationally; creative and vigorous; consumer-oriented; and harmonious with and understood by the rest of the world. A particular emphasis was put on creating a transparent, consumer-oriented and less regulated socioeconomic system as opposed to the existing producer orientation based on protection and regulations.

Proposed policies

To achieve these targets, the report proposes five major policies highlighted by relaxing regulations, domestic-led growth, bracing for a rapidly aging society, opening the market, and fiscal restructuring. Deregulation and fiscal restructuring are the core and for the former, especially, an interim report containing actual proposals has been submitted.

Regarding deregulation, the report made it clear that economic regulations are "exceptions" in a "principally free" system. This recognizes that various public regulations which may have contributed to Japan's development have become rather binding and too rigid for today's mature and internationalized

socioeconomic system. Thus, the report proposes drastic revisions including elimination of regulations.

To ensure effective deregulation procedures, the report recommends some concrete measures including stricter application of the Anti-Monopoly Law, enactment of products liability laws, a five-year action plan carried out from within the Cabinet, and a powerful watchdog organization that would oversee the action plan and the enforcement of deregulations.

In order to make the economy more domestically oriented, the report proposes beefing up the social infrastructure including a fiber-optic information communications network, reforming the education system to place more emphasis on creativity, and facilitating a more flexible and mobile labor market.

In terms of the aging society, there is a call for a comprehensive welfare vision including an efficient social security system which will allow seniors to live comfortably.

On opening the market, the report assumes that a meaningful reduction in the current account surplus can be achieved in the medium-term by opening the big Japanese market to the rest of the world and implementing multilateral foreign aid. Thus, the report calls for measures to shift the economy to domestic demand and to make the market more accessible.

The final point, reforming the fiscal structure, is a key component along with deregulation and plays a role in connecting the immediate stimulus package with medium-term economic restructuring. Reform of the tax system plays a crucial role. This was expressed in the report as "a comprehensive reform focusing the review on the balance between direct and indirect taxes." This means rectifying the direct-indirect balance through, on the one hand, reducing direct taxes, which would boost the economy, and, on the other, raising indirect taxes to prepare for the

future aged society.

On the spending side, the report proposes reform of the current rigid expenditure to allow for a build-up of the future social infrastructure at the expense of the current generation before society becomes more aged. These proposals for restructuring tax and fiscal spending reforms are expected to be reflected in the immediate economic stimulus measures.

Evaluation and problems

Let us now evaluate the Hiraiwa Report in line with its main characteristics.

The first point to be appreciated is the scope of the report which seeks a dramatic overhaul of the entire system. Japan's current system is one typical to developing nations in which the bureaucracy cooperates with the private sector to seek growth through a combination of various protections and regulations in order to catch up and get ahead of advanced nations. During postwar reconstruction and the subsequent high growth period, the system worked well and led to the current state of prosperity. As the economy reached a stage of maturity and internationalization, however, the system has become a fetter on the vitality of the private sector and has kept Japan from playing a more harmonious role in the international community.

Thus, the report deserves kudos for expressly pointing this out and emphasizing the need for deregulation as the key for change. Yet success under the existing system has been so impressive that a voluntary dismantling of the framework will likely be met with strong resistance, and tremendous energy will be required. Thus, to gain support from the public, it is indispensable to indicate a concrete path to and clear image of a vibrant socioeconomic future in the next century. However, in



Chairman Hiraiwa Gaishi presents the final report of the Advisory Group for Economic Restructuring to Prime Minister Hosokawa at the prime minister's residence.

part due to lack of time, the report failed to offer any quantitative clues which are needed for indicating a reasonably convincing blueprint of the future.

The second positive point of the report is its emphasis on deregulation as the pillar of core policies, and its unwavering statement, "regulations are exceptions in a principally free system." This statement is quite forceful and

bold, deserving recognition. The call for an independent watchdog to facilitate deregulation was also a bold stroke. A table was attached to the report which included more than 10,000 government regulations, effectively demonstrating the pervasiveness with which public regulations control our lives. Abolishing all but the most necessary should bring new vitality and creativity to the economy.

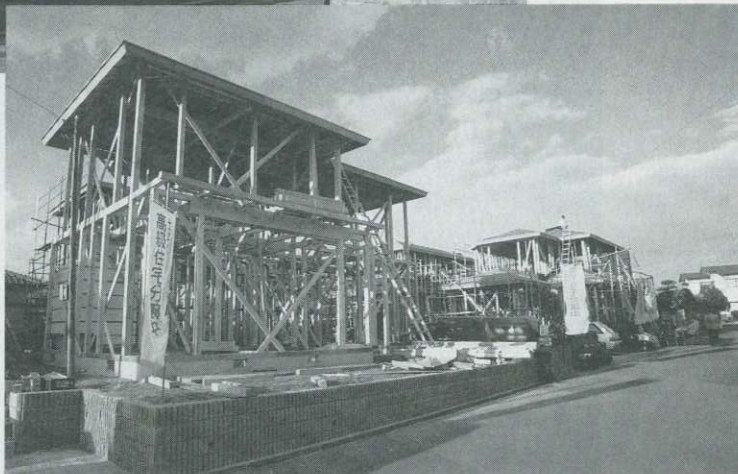


Predictions are that the economy will place priority on consumers and that land and housing controls will also be relaxed.

One important question is how far the basic stance of "principally free" will go in eliminating invisible and unwritten regulations and how effective it will be in correcting the conventional "trait" of the Japanese which seeks an official nod in unwritten areas. To facilitate this, an independent commission that receives complaints and investigates over them seems vital but the report is rather vague in delineating the nature and authority of such an organization.

A third point to note about the report is its proposal for fiscal reforms as a supportive factor in close connection with immediate stimulus packages and a medium-term economic restructuring. Although the report uses the term "revisions in direct-indirect balance" and avoids direct mention of income-tax cuts and a consumption-tax hike, the intention is clear.

However, no concrete measures are mentioned, even though, admittedly,



they are politically delicate. For example, there is no mention of how quick and how great the direct-indirect balance should be rectified to respond to the rapidly aging society, nor whether the expected hike in the consumption tax should be discussed within the framework of revenue neutrality or net reverse increase. Similarly, for spending, the report recommended a revision of the current rigid allocation system, noted that the spending structure should be more accentuated and efficient, and allow for investment for the future social infrastructure. Yet there is no clear guideline for financing offered in the report.

The fourth point, which is an overall criticism, is that the report seems too

long in ideas and too short on substance. For example, despite the emphasis on consumer orientation, the report only offers a rough outline on how to actually achieve this. Vaguely it states that a more consumer-oriented socioeconomic system can be reached through deregulation and a shift to an economy driven by domestic demands. Likewise, in proposing a scenario for a significantly large reduction of the current account surpluses, the report bubbles on about shifting to a domestic demand-led economy and easier market access. It is thus questionable if this proposal can gain support from the rest of the world. There is no comment on the rice issue in terms of liberalizing the domestic market. Also missing were comments

on potential growth of the Japanese economy, and directions for new industrial frontiers, for example, advanced information and telecommunications.

Yet, despite these ambiguities and compromised expressions, the report as a whole still scores high as it contains many important proposals and is undoubtedly a very valuable chart for navigating the Ja-

pinese economy into the next millennium. Obviously, the biggest challenge is to crystallize the report into actual policies and reap the desired results.

The late Henry Wallich, former governor of the Federal Reserve Board said, "Experience is the name we give to past mistakes, reform that which we give to future ones." To avoid having the current reform efforts ending up on the scrap heap of "experience," strong government leadership and the will of the people to demand the enforcement of the proposals in the report are needed.

Wakatsuki Mikio, chairman of the Japan Research Institute, Ltd., previously worked at the Bank of Japan for nearly 40 years until July 1993.