

Structural Reform of the Japanese Economy

By Kobayashi Koji

The Hashimoto Administration is undertaking a package of structural reforms in six areas—administration, public finance, social security, the economy, the financial system, and education. In an era when the world is increasingly integrated and people, goods, money and information move freely across national borders, the socioeconomic system that Japan has maintained for the last 50 years is neither sufficiently flexible nor appealing to attract such human and material resources. Thus has arisen the need for a sweeping reform of the nation's socioeconomic system.

In particular, aggressive promotion of the overhaul of Japan's economic structure as part of the six-area reform package has become an essential challenge to eliminate two major concerns over the Japanese economy, namely the hollowing-out of industry and a decline in economic vitality stemming from the advanced aging of its population.

Arrival of megacompetition era

Firstly, an era of mega-competition has arrived when economic activity is increasingly globalized and businesses choose countries for better profit and returns on investment as a result of economic development in Asian countries and advances in information and communications technology. Businesses are seeking to operate abroad in quest of lower costs and optimum production footholds. Manufacturing operations in Japan, as in North American and European countries, are forecasted to be increasingly transplanted abroad in the future. These business practices are difficult to stop, but they could cause a hollowing-out of industry if relocations abroad outpace the creation of new jobs at home, or if businesses are forced out of Japan as a result of distorted domestic high-cost structures.

Not surprisingly, therefore, foreign

investment in Japan remains at a low level—about a ninth of direct overseas investment on a stock basis—due to the high-cost structure and other factors, thus preventing a revitalization of the Japanese economy.

Forthcoming large-scale aging of society

Secondly, Japan is facing a large-scale aging of its population in the near future at a pace unprecedentedly rapid in world history. It has been said to date that behind Japan's economic success lie two factors—a high-quality labor force and ease of obtaining investment funding due to the country's high savings rate. But Japan will now face uncertainty about its labor supply—with the graying of society—and of investment funds—with the savings rate sagging. Furthermore, there is a strong possibility that taxes and other public burdens on the people, the working generation in particular, may become excessively heavy compared with the nation's economic scale unless the public sector as a whole—including social security and government finance—is made more efficient, and the allocation of benefits and the sharing of burdens are optimized. Given that background, the Japanese economy faces a growing risk of its potential vitality declining.

Promotion of economic structural reform

There is little hope of restoring health to public finances and maintaining our social security system, to say nothing of enjoying an affluent national life, unless we cope effectively with these problems faced by the Japanese economy and push aggressively for "economic structural reform" designed to establish a powerful, tenacious economic foundation on a medium- and long-term basis.

In the short term, Japan is required to achieve economic growth led by domestic demand—focused on the private-sector—as curbing government spending for the purpose of putting the deficit-ridden financial house in order becomes inevitable. In that sense, it is required to build an economic society which can maximize private-sector energy by pursuing economic structural reform centering on deregulation.

With such a strong perception of crisis, the Japanese Government adopted the "Program for Economic Structure Reform" in December 1996 in the form of a cabinet decision and, in May this year, adopted the "Action Plan for Economic Structure Reform" detailing the program in another cabinet decision. The government is supposed to promote reform steadily in accordance with the plan through full cooperation among ministries and agencies, and follow up on its progress each year.

Outline of the Action Plan for Economic Structure Reform

The action plan comprises three main pillars: development of an environment to create new business activities, creation of an internationally attractive business environment, and restrictions on the public burden on taxpayers and businesses from the viewpoint of maintaining economic vitality. The contents of the plan are diversified in many areas. The following is a summary of their main points.

I Development of environment favorable to new businesses

From the standpoint of securing opportunities for high-quality employment into the 21st century, it is very important to develop an environment favorable to new businesses and create new business activities, as well as make existing industries more value-added. In this connection,

the plan calls for solution to problems associated with such factors as funding, human resources and technology.

(1) Funding

Measures such as implementation of a sweeping reform of the financial system are to be taken in order to diversify sources of financing and improve the capital market, and thus ensure smooth supply of funds to new business activities.

(2) Human resources

The plan calls for support of corporate internships (under which students undergo work experience as part of college education) and for the use of a stock option system made possible for general companies to adopt under a legal revision enacted during the last ordinary Diet session which ended in June. These are among the steps contained in the plan to smoothen the shift of human resources to new and fast-growing business fields and the supply of human resources with creativity and the spirit of challenge.

(3) Technology

R&D—an important basis for new business activities—and protection of intellectual property will be strengthened, among other things. Cooperation among industry, academia and government will be stepped up aggressively through various measures, including the exchange of researchers and promotion of joint research.

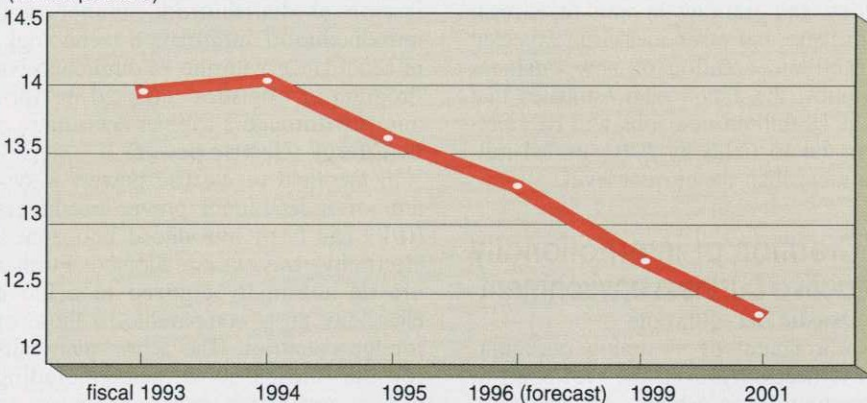
(4) Promotion of advanced information & telecommunications systems

The period through 2001 is characterized as a preparatory period for the upcoming advanced information and telecommunications society. All measures necessary to build it will be taken, including development of network infrastructure such as an optical-fiber network, promotion of electronic commerce, and application of information and telecommunications technology in the public sector.

In addition to across-the-board environmental improvement, the action plan lists 15 fields of potentially high growth, including medical care and welfare, biotechnology, and environment. It has a medium-term program for each field covering the period through 2001 so

Figure 1: Changes in the number of workers employed at domestic manufacturing industries (estimate)

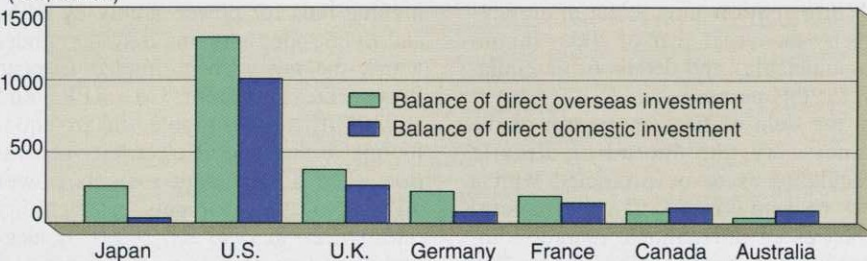
(million persons)



Source: "Survey on Corporate Overseas Strategy" released by the Ministry of International Trade and Industry in November 1996

Figure 2: Balance of inward and overseas direct investments by major countries

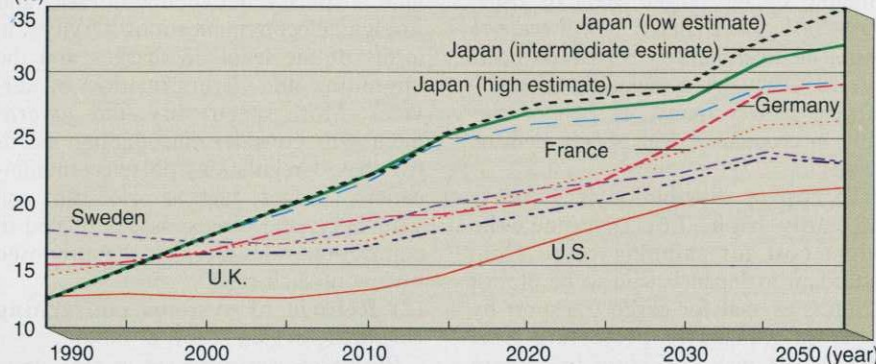
(US\$ billion)



Source—Japan: International balance of payment statistics for fiscal 1996
 other countries: IFS (IMF) calendar year 1996 for U.K., calendar year 1995 for other countries
 Note: Figures for Japan were converted into US dollars by the Ministry of International Trade and Industry at a rate of ¥116.00 to the dollar as of the end of 1996. The source of the rate is IFS (IMF).

Figure 3: Ratio of people aged 65 or older in major industrial countries

(%)



Note: Bold lines denote low-end, average and high-end population estimates for Japan by the National Social Security and Population Problem Institute

Source: United Nations "World Population Prospects 96" "Future Population Estimates for Japan" by the National Social Security and Population Problem Institute (estimate as of January 1997) "Reference Materials for Population Statistics" by the same institute.

as to promote measures for the improvement of surroundings as a whole, such as deregulation, development of core technology and training human resources. With these and other measures expected to facilitate creation of new business activities, the action plan estimates that about 18 million new jobs will be created in the 15 fields by 2010, or 7.4 million more than the current level.

II Creation of internationally attractive business environment

(1) Drastic deregulation

Enforcement of sweeping deregulation is necessary from the viewpoint of correcting Japan's high-cost structure. The action plan calls for services of internationally comparable levels, including cost, to be made available in the fields of goods distribution, energy, and information and telecommunications by the target year of 2001. It contains timetables and details of deregulation for this purpose.

In the field of finance, reform of the financial system including drastic deregulation is to be promoted with a view to remaking Japan's financial market as an international market comparable to those of New York and London.

A. Distribution

In the field of goods distribution, the government is to terminate controls aimed at supply-demand adjustments in principle by the target years of fiscal 1999-2001. For example, it will cease to control the total number of business operators in such fields as domestic air transport and railway freight, as is done currently in accordance with supply-demand situations.

The cost of distribution in Japan is extremely high. For instance, the freight cost for shipping cargo from Rotterdam to Japan is said to be almost the same as that for cargo transport by sea from Kanagawa Prefecture near Tokyo to Hyogo Prefecture in western Japan. In a bid to do away with such unreasonable situations, the government will take comprehensive measures not only for deregulation but for drastic improvement of efficiency in distribu-

tion, including priority-based, efficient development of distribution infrastructure, and promotion of both standardization of distribution channels and introduction of information technology, in accordance with the "Comprehensive Program of Logistics" adopted in April this year through a cabinet decision.

B. Energy (electric power)

In the field of electric power, a system of independent power producers (IPP) has been introduced and a new electricity rates system adopted. Further drastic action is required to achieve electricity costs comparable to those of foreign countries. The action plan calls for the parties concerned—including power generators and consumers—to discuss specific measures to improve the load factor, to further utilize IPPs by, for example, asking power companies to lay down long-term goals for inviting bids for power supply by IPPs, and to consider adopting a system under which the government-funded Electric Power Development Co., IPPs and power utilities compete on an equal footing in the field of electricity generation. The government expects power utilities to apply for cuts in electricity rates twice—in 1998 and 2000—by tackling these issues as soon as possible.

C. Information & telecommunications

The government is to promote sweeping deregulation and create conditions for fair competition seeking to eliminate disparity between domestic and foreign telecommunications services in terms of the level of charges and the upgrading and diversification of services. More specifically, the government will consider introducing incentive-based regulations on telecommunications charges, such as price caps and yardsticks, and discuss issues related to connection rules besides the proposed review of such rules.

(2) Reform of systems concerning corporate organization & labor

Businesses are expected to seek drastic organizational restructuring, given recent legal amendments concerning corporate structures, such as simplification of provisions on mergers in the Commercial Code, in addition to the

proposed lifting of a ban on holding companies. The government is also reviewing curbs on the scope of jobs that can be taken by workers dispatched by job placement agencies so that such employment can be expanded and personnel movements smoothed.

(3) Corporate tax system

Since the 1980s, industrial countries in North America and Europe have gradually trimmed corporate income tax while Japan's has remained high, leaving the nation's effective corporate tax higher than abroad and thus reducing its attractiveness in terms of the business environment. Japan's effective corporate tax rate—combining national and local government taxes—is 49.98% compared with 41.05% in the U.S. and 27% in Singapore. The ruling Liberal Democratic Party and its alliance partners, as well as the government, are actively discussing reform of the corporate tax system with a view to reaching a conclusion in fiscal 1998. The review is based on the viewpoint of maintaining the international competitiveness of Japanese industry, allowing businesses to display vitality, and creating new business activities in addition to the basic perspective of fair and neutral taxation.

III Restrictions on the public burden in order to maintain economic vitality

As for the social security system, the government is seeking to bring it in line with the national economy by, for example, trying to achieve a drastic overhaul of the medical insurance scheme and create a public care insurance system.

The government is also making efforts to attain a sweeping reform of the fiscal structure in order to restrict the size of swollen finances by such means as prioritizing fiscal spending programs and improving efficiency in the public sector. ■

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