

Intellectual Cabinet 2000

A policy debate forum from Japan

IT Strategies for the Creation of
New Industries

N. Okude

What the Mori Government
Should Do Now

H. Takenaka

The Danger of a Public Finance
and Banking Spiral

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Leader and Style are
the Criteria

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the Japanese Economy

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Converting to "Presentation of
a Future Vision"

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Presenting a Future Vision of
Public Finance

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THE TOKYO FOUNDATION

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— As of March 2001

Preface

As Japan's first totally private, nonprofit and completely independent think tank, the Research Division of the Tokyo Foundation is dedicated to a broad range of policy research and to the presentation of sound policy recommendations based on these studies.

As part of our endeavor to contribute to Japanese policy studies, we publish a Japanese-language newsletter called *Intellectual Cabinet* twice a month based on the discussions at the "Intellectual Cabinet Policy Conference," a forum of high-level policy researchers. The newsletter aims to help create a pluralistic policy process in Japan by providing responsible and constructive policy debate and proposing original policy initiatives.

Intellectual Cabinet 2000 is our first English-language digest of the newsletter, compiled using some of the key issues discussed in the newsletter during the year.

It is our sincere hope that this booklet will introduce current policy debate to a wider audience throughout the world and help foster global policy dialogue on various issues.

March 2001
RESEARCH DIVISION,
THE TOKYO FOUNDATION

IT Strategies for the Creation of New Industries

Naohito Okude
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The potential of the internet as an information resource lies in its utilization not in elementary education, but in higher education and research. The market for the internet is not found in the passive mass entertainment that is the forte of the mass media, but in the sphere of lifelong education which requires active commitment on the part of the user. From the viewpoint of new industries, an attempt must be made to start up new, large-scale industries that will make full investments directly using cash, and not start up businesses by halfway-measures such as money game-type procurement of funds using the stock market, like internet startups do now.

High potential of Japanese manpower and technology

In the industrialized society of the past 120 years, people have been used as information-transmitting machines in the running of complicated projects, and for this, large organizations and large companies were needed. But the important point about utilizing the internet as an information resource is that, in the new industries of the future, there is no need for large organizations or large companies.

Another important issue is the merging of communications and broadcasting. The extreme view has it that conventional broadcasting will be eradicated by the internet, but essentially, what it comes down to is that broadband internet will spread on an infrastructure that merges broadcasting and communications. Core networks will use fiber optics, while access-type networks, for reasons of speed and cost, will be wireless. Japan is in a technically advantageous position in this field. There is a growing need for digital TV in mobile situations where people watch images while on the move; but in the area of digital ground wave transmission systems, the U.S. ATSC system is becoming more and more outdated, as evidenced by the high appraisal afforded the European and Japanese standards (OFDM) which arrived on the scene later.

Japanese manpower and technology have considerably high potential in the field of IT (information technology) and the internet. The problem, however, is not only that there is no means of developing this potential in industry, but that there is a major barrier hindering the development of such technology in society. To break down this barrier an IT strategy is needed in Japan today as industrial policy.

Strategy 1 :

Building an “intellectual properties valuation market” in which Japan would be competitive

From such a viewpoint, the direction of IT strategy, which the government must consider as “industrial policy,” becomes clear. Foremost is the building of an intellectual properties valuation market.

The question of how to put a value on information over which intellectual property rights are held on a cyber network is a domain as yet undecided even in the U.S. A strategic approach to this problem must therefore be considered. It is important first of all to establish markets that deal in information and intellec-

tual properties. In this way, the problems and trouble spots will become clear. Once they have been ascertained, the next thing will be to build a market in which Japan or Japanese companies are competitive.

No one knows what is needed to utilize intellectual properties in next-generation industries. It is like the mechanism generated by the concept of private assets in the early stages of capitalism. Just as modern systems were created only when the right of individual ownership was understood, so too society cannot move forward without solving the problem of intellectual properties.

The issue of intellectual properties should be debated not from the shortsighted viewpoint of simply “protecting” such properties, but in a long-range time frame, taking in the bigger picture of a new concept in a new society. What kind of society is a society based on the right to private ownership of information? Naturally, industry is not created simply by owning information. The need arises, therefore, for the circulation of information, but by what means? Unfortunately, most of the current debate on intellectual properties in the digital age aims to extend the industrial society-centered view to cyberspace. It is necessary to move away from such a viewpoint and debate intellectual properties from a completely historical, philosophical and economic viewpoint.

Strategy 2 :

Establishment of digital literacy in Japanese targeted at lifelong education

The second IT strategy is to establish digital literacy in Japanese with lifelong education as the target.

From the viewpoint of IT strategy as industrial policy, it is a mistake to place emphasis on elementary education. Giving prominence to elementary education is no more than an extension of industrialization age values when it was necessary to

mass produce factory workers who could read. The key market of future society is "lifelong education." People will continue to study throughout their lives and will be rewarded for their studies. An important IT strategy is therefore higher education and its extension.

It is a mistake to think that English is necessary at all levels in the IT age. English should be positioned as an intermediary language of communication, and Japanese, our native language, should be used in basic areas such as the creation of thought and ideas. Digital literacy involving thinking in Japanese and expressing oneself in Japanese needs to be established urgently, and to do this, it is necessary to establish systematic high-level IT training using the Japanese language and Japanese words. In order to be able to carry out all training from basic to advanced IT in Japanese, clear IT texts must be prepared. Once it becomes evident that it is possible to work on the front line in a global environment after receiving IT training in Japan, even people for whom Japanese is not their mother tongue will want to learn Japanese. We should create a society where it is natural to use Japanese on the internet.

In the post-IT revolution world, the winners will be those countries that are information literate, in other words, that have many "IT pilots." There is a shortage of IT engineers in the U.S., and at the same time, jobs in IT are considered labor-intensive dirty jobs. But new IT is a creative profession. IT pilots who have received advanced IT training in Japanese will no doubt form a workforce of world-class creative ability.

What the Mori Government Should Do Now

Heizo Takenaka

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Each time a new government has been installed since the bursting of the economic bubble, the issues discussed have been “economic revival” and “invigoration of the economy,” but for the government of the day, there should be a more important issue, one that surpasses the short-term goal of simply improving the economy, namely economic and social reform based on an understanding of the times. Without a correct understanding of the times, there can be no economic revival in the immediate future.

Serious Efforts Must Be Made to Put Finance on a Sound Footing and Establish and Implement IT Strategies

With the general election over, a new political system came into being. If the Diet members elected in 2000 serve their full term, they will hold the reins of government for four years until 2003. The second Mori cabinet, formed on July 4, must devise policies with the four years until 2003 in mind.

Awareness of the four years until 2003 means that the Mori government needs to promote two economic and social reforms, namely sound finance and measures to meet the IT revolution.

The important point to keep in mind is that the population of Japan will peak in 2007 and from 2008 onwards it will start to decline. A fall in the labor force is expected to be seen from around 2005.

As a result of the falling population, the latent growth capacity of the Japanese economy will decline. It is essential that policies that bring with them the pain of financial reconstruction are firmly established by then. If at least five years is required to rebuild the Japanese economy, then a start must be made in the four years until 2003.

The response to the growing IT revolution over the next few years is expected to determine the position of the Japanese economy at the beginning of the 21st century. With a high level of technology and manpower, and a simultaneous shift toward the field of digital household electronic appliances in which Japan excels, a strategic response is urgently required.

In other words, the second Mori government must deal with the two issues of building sound finance and establishing and implementing IT.

The dual structure of cabinet and party should be dissolved and a political system led by the Prime Minister established.

The problem is the means by which the Mori cabinet should implement "economic and social reforms based on an awareness of the times," namely building sound finance and establishing and implementing IT strategies. Under the parliamentary cabinet system, it is presumed that a responsible system for implementing policies is built with the top politician also holding the top position in the administration (in other words, the majority leader becomes the prime minister). However, under the dual structure of cabinet and party, the system today means that the party holds real power. Although the cabinet is responsible for policy, the party has the power to decide policy.

This trend has been evident since the second Obuchi cabinet, but it has spread recently. As a result, the second Mori cabi-

net needs to establish a strong prime minister-led political system as soon as possible without waiting for reorganization of the ministries and agencies in January 2001, and to push ahead with the two reforms of building sound finance and establishing and implementing IT strategies.

The Mori Government Should Take up Three of Former Prime Minister Obuchi's Policies

Prime Minister Mori has claimed to have consistently followed the politics of the late Keizo Obuchi since taking office. However, this expression was simply picked up by the mass media and there was not enough discussion about the policies to be adopted. The late Prime Minister Obuchi provided the opportunity to discuss policy by setting up the Economic Strategy Council, the Industrial Competitiveness Council and the Commission on Japan's Goals in the 21st Century, among others, and considering the results of the deliberations by these committees, the following two Obuchi policies to be taken up emerge.

The first is emergence from the critical situation of 1998 and overcoming the confidence crisis. Once a crisis arises, there is nothing the government can do except invest money regardless of how it looks. The purpose of the policies pursued by the Obuchi government, such as public investment in banks, economic measures and zero interest, was to prevent the occurrence of such a "crisis."

The second is promoting reactive restructuring. In other words, the Obuchi government hammered out various policies aimed at getting rid of the three excesses, equipment, debt and employment, burdening the Japanese economy.

And thirdly, the Obuchi government attempted to carry out proactive restructuring aimed at broad structural reform to create a 21st century economy and society, as symbolized by the response to the IT revolution. The need for broad reforms, such

as deregulation, pension reform and sound finance, is emphasized in the proposals of the Economic Strategy Council and the Commission on Japan's Goals in the 21st Century.

Creation and Implementation of a Responsible Action Program Is Needed

There was not enough discussion about how to meet the IT revolution under the Obuchi cabinet. So the decision now to appoint a minister in charge of IT and set up an IT strategy committee is a move in the right direction. And it is good that a prime ministerial aide in charge of IT is being considered in anticipation of the cabinet secretariat system in 2001.

It is important for the Mori cabinet, as the successor of Obuchi politics, to move toward creating and implementing a responsible action program regarding various policies laid down by the Obuchi government. This goes without saying so long as the Mori cabinet claims to have inherited Obuchi politics.

The Mori government has the chance to revive the Japanese economy. In addition to the economic crisis receding and the economy looking brighter, the IT revolution is propelling the economy forward faster than expected. With public support for the cabinet running low, a strong policy package led by the prime minister is needed to increase the centripetal force of the government. The time has come to draw up and implement an ambitious revolutionary plan based on an awareness of the coming four years.

The Danger of a Public Finance and Banking Spiral

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In April 1998 the Hashimoto Cabinet decided economic measures worth 16 trillion yen and went to the polls in an Upper House election, but lost. The Obuchi Cabinet which emerged from the election pledged to implement economic measures worth 10 trillion yen and tax cuts of 9 trillion yen, and from the outset it pursued positive finance styling itself as the "Economy-reviving Cabinet." At the end of the year, economic measures worth 27 trillion yen were implemented, a positive budget was drawn up including the issue of 30 trillion yen of national bonds in the 1999 budget, and policies were adopted for alleviating negative growth, including hammering out economic measures worth 10 trillion yen in the supplementary budget. However, the proportion of total revenue supplied by national bonds after the supplementary budget exceeded 38%, giving rise to a the situation where procurement by issue of national bonds was greater than tax revenue.

Outstanding government debt at the end of 2000 stands at 650 trillion yen

The economy showed slight signs of recovery in 1999, bringing

the prospect of escape from negative growth. What does it mean, though, when negative growth persists even after taking economic measures totalling just under 10% of GDP? What would have happened if the measures had not been taken? Assuming that the multiplier of public finance expenditure is 1.5, the growth rate becomes minus 15%, creating a deflationary spiral. Or were the economic measures nothing more than ineffective tax cuts and investment, and thus a squandering of public finance? When the amount invested before the Obuchi Cabinet came to power is included, the cost of economic measures totals 120 trillion yen. The outstanding government debt at the end of 2000 will therefore amount to 650 trillion yen.

To be sure, without economic measures the economy would stall. Economic measures are needed not so much to restore the economy to health, but to rather merely sustain it at its present level. Implementing economic measures stimulates demand.

But the economic system immediately adapts and returns to its original level. So more economic measures are needed, and unless they are on a grander scale than before, the economy worsens again. And in areas where employment expands only as a result of economic measures, unemployment becomes a problem.

Keynesian policies assumed a "mechanical" economic model, and the effectiveness of the policies was viewed by building up linear relations in the form of simultaneous equations. But the actual economic system is not mechanical; it is adaptable and complex like a living creature. So even if the measures are temporarily effective, the economic system soon adapts to them and the hoped-for results cannot be achieved.

Contradiction of further deterioration of the economy unless reckless spending is undertaken in the name of public investment

Economic measures are a kind of stimulant. Unless the Japa-

nese economy breaks free of public investment at some point, it will become addicted as if to a drug. Reform of the financial structure began in 1996 when the economy showed signs of picking up, but the problem of bad credit, another negative legacy of the bubble era, exploded and the economy again fell into recession. Since the collapse of the financial system causes the economic system to stop functioning, naturally every measure was taken to prevent this. It took a year, however, to deal with the problem of bad credit, and this added to the depression. As there was little prospect of recovery, economic measures worth 43 trillion yen, or 10% of GDP, were implemented in 1998.

The government's economic measures are essentially only a means of alleviating the shock, and the economy will not improve because of them. If the economy could recover as a result of economic measures taken by the government, the Soviet Union would not have collapsed. The Soviet Union collapsed because it squandered its economic resources on building missiles and nuclear weapons, and Japan is squandering its economic resources on wasteful projects that go by the name of public investment. Furthermore, it is caught in the dilemma of watching the economy deteriorate further if it does not spend recklessly.

The massive accumulation of government debt makes future policy implementation difficult

Implementation of present economic policies is made possible mainly by the "zero interest" policy. However, the booming U.S. economy results in the introduction of a hike in interest rates, and Japan's shrinking black-ink current balance is finally affecting the exchange rate, and thus Japan too may not be able to avoid raising its interest rates.

A one percent premium is already attached to government guaranteed bonds on international financial markets, and problems arising from the collapse of national bond prices are

no longer merely issues for thing of the future. It will be impossible to continue with zero interest rates, and interest rates will have to go up. When this happens, the national bond price will collapse and the government will be unable to procure funds. The only way to counter this will be for the central bank to underwrite national bonds, leading to inflation. We have seen this happen in Russia and Latin America. The collapse of the national bond price creates hidden losses for the bank, leading to fears of a public finance and banking spiral.

Because previous economic measures were implemented on too grand a scale leading to accumulation of government debt, making it extremely difficult to implement policies in future. On the other hand, financial controls are declining, and funds unconnected with economic policy, such as lavish spending to counter the falling birthrate, and child allowances, will be budgeted, resulting in unbelievably bad administration of public finance.

Furthermore, government guarantees are being overissued by every ministry and agency, burdening the government with invisible risk. The Obuchi government considered it sufficient to deal with problems when they surfaced, but it must be recognized that the situation is not that easy.

The Japanese economy in the 21st century will be supported by the strength of the private sector economy, not by public investment.

The Japanese economic system must therefore be capable of meeting structural changes in the world economy and the new technical revolution centered around IT (information technology). There must be elimination of overinvestment and overemployment, but an expansion of M&A for the sake of industrial reorganization, as well as expansion of market business, reform of the Japanese management system, improvement of the labor market, and fostering of venture businesses.

At the same time, the government must promote in its area

of banking, the structure reforms of public finance, administration, social security, the economic structure, and education. It must also forge ahead with the local government system, local public finance, the tax system, financial investment, and the labor market. Such reforms in the private and government sectors will create the foundations for the Japanese economy in the 21st century.

Leader and Style are the Criteria

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Each time an election approaches, discussion turns to the topic of the election issues. In today's highly complex society, however, it is not easy to pick out one or even a few policy issues as being of decisive importance. In addition, all the political parties hide anything that is to their own disadvantage, only stressing what is favorable, so it is surprisingly difficult to show where a party stands on important policy issues.

Changing from factional dynamics within the Liberal Democratic Party to politics centered around the party leader and prime minister

There is a simpler criterion for making a decision than policy, however, and it concerns the leader. A Lower House general election is essentially an election to choose the prime minister. Whichever party wins, the key issue is who will be the next prime minister.

This simple fact was not understood by the public because the Liberal Democratic Party held a majority for such a long time. It was taken for granted that the Liberal Democratic Party would win an election in the Lower House, and the only ques-

tion was by how many votes—would it be a narrow margin, a stable majority, or a landslide victory? In fact, only two prime ministers have resigned as a result of losing a Lower House election, Prime Minister Miki and Prime Minister Miyazawa.

Mostly, a change of prime minister occurred in Liberal Democratic Party leadership elections. In other words, in Japanese politics, Liberal Democratic leadership elections were more important than Lower House elections, and factional dynamics within the Liberal Democratic Party were more important than confrontation between the ruling party and the opposition.

Recently, however, this trend is changing. Hashimoto was elected leader in the Liberal Democratic leadership election in 1995 because he was expected to be popular among conservatives in the confrontation with the powerful opposition Progressive Party in the next general election. And, in fact, in the 1996 general election Hashimoto's Liberal Democratic Party beat Ozawa's Progressive Party. As a result, Hashimoto was reelected party leader without difficulty in the 1997 leadership election.

Obuchi was chosen as party leader to weather the financial crisis in the wake of the rout of the Liberal Democratic Party in the Upper House elections in July 1998. Prime Minister Obuchi attempted a number of unique innovations, including using his unique style and personal connections to appoint former prime minister Miyazawa as Finance Minister, Hiromu Nonaka as Chief Cabinet Secretary, and Taichi Sakaiya as Director of the Economic Planning Agency. He also organized economic strategy meetings. Having weathered the crisis to somehow or other, naturally Prime Minister Obuchi was able to pull through the leadership election in September 1999 without difficulty.

In actual fact, however, the leader of the Liberal Democratic Party is rarely reelected. After the emergence of Tanaka as Party Leader in 1972 until Obuchi, there were 13 Liberal Democratic Party Leaders, but only three, Nakasone, Hashimoto and Obuchi, were reelected one or more times.

In other words, the reelection of Hashimoto and Obuchi signals a new trend. To put it simply, it signals a change to politics centered on the party leader or prime minister. The conversion from bureaucratic leadership to political leadership has long been talked about, but political leadership, of course is centered on the prime minister. Progress has gradually been made in focussing on the prime minister over the past few years.

The safe choice of someone with few enemies produces party leaders with few leadership qualities

This was not the case, however, in the choice of Mori as party leader. The previous two party leaders came from the Obuchi faction and there was no candidate for the next party leader in the Obuchi faction. Koichi Kato was and is opposed to the alliance with the Komeito, so it was difficult to choose him as long as the alliance continued. There were problems in the Eto–Kamei faction, Yamazaki faction and Kono group, too. In this respect, Mori had the fewest enemies and represented the safest choice. This is the reason why Mori became party leader and prime minister.

Simply put, Mori was not chosen as party leader to push through some initiative or other. Nor was he chosen to confront a strong opposition, or resolve important policy issues; he was chosen through traditional factional dynamics. In the background, it was judged that support for the Democratic Party was leveling off, the economy was showing signs of recovery, and the party was sure of maintaining its majority in an election if it was allied with the Komeito.

However, as a result, someone greatly lacking in experience became prime minister. Numerous scandals surfaced and slips of the tongue were head throughout the nation, culminating in the words “divine country” which created an uproar. It is probably not correct to criticize this as a articulation of right-wing views. Prime Minister Mori does not hold such views. Rather, it

must be said that his making superfluous comments in an effort to fit in with those around him, without any consideration for his own position as prime minister, shows a lack of leadership qualities. A key matter for Prime Minister Mori was the hosting of the summit, and for this he simply did the rounds of the G8 countries. Now the summit countries place tremendous importance on democracy. Doesn't Mori understand that "divine country" is inconsistent with democracy (and, at the very least, that it will be the focus of strong criticism)?

The Democratic Party should hammer out a new style not available to the Liberal Democratic Party

The Liberal Democratic Party thus made a big mistake in choosing its leader. However, if the electorate becomes disaffected and fails to go to the polls, it is possible that the turnout in the next election will be extremely low and the Liberal Democratic/Komeito/Conservative government may remain in power. It is also possible that if there is an appropriate change of leadership within the government and a change of atmosphere, the Liberal Democratic / Komeito / Conservative government can stay in power for another four years. Yet it is certainly not desirable for a government that has clearly lost the confidence of its citizens to linger on in power.

The opposition, particularly the Democratic Party which is the leading opposition party, must stress that voters go to the polls in large number. At present, they cannot immediately put forward a new and very different set of policies in the area of diplomacy, security and finance. So what should they do?

I think that the Democratic Party should hammer out a new style not available to the Liberal Democrats. For example, they could pledge to make half the members of the Cabinet age 50 or under, or make one-third of the Cabinet women. Or they could make the acceptance of bribes for services by politicians a more serious crime than it now is. The regulations on ethics for gov-

ernment employees were tightened (I think they went much too far, but that is not a matter for discussion here), but politicians are allowed to do as they please. As stated in Article 15 of the Constitution, the duty of government employees and that includes politicians is to serve all, not just to serve some. However, when a politician first looks out for the good of his electoral constituency, nothing is thought of it. This trend is a major source of distrust.

There are some pledges which the Democratic Party would find it difficult to make. But there is no party pledge which would satisfy every candidate. The only way to challenge the government and take power is not by looking for a consensus, but by taking risks. The interest of voters must be won back by adopting this kind of radical style. Japan cannot afford to entrust the next four years to a government that does not have the trust of the electorate.

Ideas for Reviving the Japanese Economy

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We are entering a phase where it is extremely difficult to judge the economy. For the first time since the “ten lost years,” companies are steering toward positive investment. Unlike in the past when lavish government spending ended literally in a “boost to the economy,” there are definite signs of an autonomous recovery. Of course, that does not mean a conventional “economic recovery.” Reflecting the fact that structural adjustment of the Japanese economy is moving at a snail’s pace, the trend toward recovery is limited to fields in which Japan is competitive in the global market economy. In fields with a legacy of debt from the past, there has been a succession of bankruptcies that run counter to “economic recovery.” This is symbolized by the fact that the dramatic recovery of stock prices in the first half of 2000 did not result in real estate prices hitting bottom, and stock prices are again falling.

Growing risk of downward slide in the U.S. economy which is the engine driving the world economy

Slight irregularities can be seen in the U.S. economy, when the world is in fact dependent on the high, inflation-free growth of

the U.S. economy. A downward slide in the performance of IT-related industries which are driving the economy has appeared and there is increasing instability on the stock market. An adverse effect can be expected if negative household savings become the norm and household balance sheets suddenly worsen due to a sharp drop in stock prices. There is growing risk of a downward slide.

Behind the high, inflation-free growth of the U.S. economy is a drastic cutting of costs, an elimination of "waste." A waste-free economy was created by reducing stocks, encouraging outsourcing, and introducing results-based wages, thereby reducing costs and increasing production at the same time. However, there was so much waste in the U.S. economy from the 1950s to the 1970s that it was often ridiculed as "the bureaucracy." In fact, this is another important opportunity for high, inflation-free growth, because it was possible to hold down costs surrounding increased production by eliminating "waste."

However, a world without "waste" is also a world without a shock-absorbing "buffer." When things are going well, everything progresses extremely efficiently and smoothly, but if multiple unforeseen situations occur, there is the possibility of a sudden crisis. The word "multiple" is important here. Even if the shock is great, provided that it is just one kind of shock, a "waste"-free organization can quickly grasp the problem and deal with it, but if there is more than one shock, without adequate idle resources to deal with them simultaneously, the result will be a plunge into crisis.

Compared with the age of "big ships and enormous guns" when there was a lot of waste in the U.S., it suggests a surprising weakness to multiple crises. I do not think that the present situation is one of "multiple unexpected negative factors," but attention must be paid to the accumulation of "systematic risk" when an explosive political risk capable of upsetting general expectations is compounded by economic risk.

Enormous systematic risk of no confidence in the government should be avoided

Seen from such a viewpoint, economic policy in the latter half of the year must avoid systematic risk originating in Japan and be prepared for systematic risk originating in the U.S. The biggest systematic risk in Japan is the lack of confidence in the Japanese government arising from the continued public deficit. What is urgently needed is the announcement of a feasible plan to reduce the public deficit and a commitment to that plan. Attention must not be diverted from the fact that public expenditure prolongs the life of departments where, properly speaking, structural change is needed, checks the flow of resources to growth departments, and as a result dampens the economy, delays real recovery, and increases the enormous systematic risk of no confidence in the government.

That is not to say that public expenditure is not necessary. Risk taking in the private sector is concentrated in a few areas, and when many departments are groaning under the legacy of past debts, the public sector is required to support attempts to create a "mechanism" for the success needed for recovery, and to give the first push linked to the cycle of "one success leads to another."

At the present time when systematic risks originating in the U.S. are on the increase, the recovery of the Japanese economy must be achieved not by "a divine wind from outside," but by "reforms instigated from within." If the private sector cannot take the initiative, then the public sector must do so instead. Otherwise the Japanese economy will face "ten years without the possibility of recovery."

Looking at the content of public expenditure, the lack of a sense of crisis is spine-chilling

If you look at economic policy in the latter half of the year, and especially at public expenditure, the lack of a sense of crisis is

chilling. As ever, politicians fail to face up to the existence of systematic risk, and seem to have absolutely no interest in a future program to reduce public expenditure on the concept of "election measures = economic recovery." Government officials endeavor to obtain a budget by dressing up old projects in order to justify the existence of their own section within a vertical administration that has already descended to "section" level, in the form of currying favor with politicians. Even now there are still a lot of projects "necessary for the promotion of IT." The issues have become so dwarfed that they are almost impossible to understand without knowledge of the disputes over spheres of influence among Diet members connected to government agencies, such as whether or not to transfer "public works-related costs" to "facility costs."

Public expenditure required now is not massive spending in order to put one "box" of dubious cost-effectiveness on top of an existing "box," but investment in "mechanisms" to produce bodies that will create new markets. As for local government measures, it is not a case of building roads or schools in the provinces, but creating the bodies that will use them effectively. Even if vast sums are spent on improving the "infrastructure," without the bodies to use the infrastructure, it is meaningless. For example, it is worthwhile to spend money on a project that will create the framework for private bodies to digitize documents. If the demand is there, the private sector will meet the supply. Know-how will then be accumulated by the private sector through such projects and this will create new supply and demand.

What the Japanese economy needs now is "ideas," and what is most lacking in current policy is "ideas." There is not much time left and the risks are growing. We must get through this difficult period with economic policies based on new ideas.

Converting to “Presentation of a Future Vision”

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In assessing Japanese foreign policy in the year from 1999, it can be said that there were no particularly outstanding failures, but neither were there any major successes. There are three important areas in evaluating foreign policy: crisis management, handling of important international relations, and a future vision. Although there have been no serious errors in any of these areas, there are clearly many problems, including the limitations of the domestic order and the question of political leadership.

There may have been no specific blunders, but there are clearly serious general problems

Looking at crisis management first of all, the most direct problem concerns Japan and Japanese nationals, and a slightly more indirect problem is crisis management in the international community. In the case of the former, in spring of 1999 there was the affair of the suspicious ship in the Japan Sea, and the hostage crisis in Kyrgyzstan in the summer. And in the international community, there were the major crises in Kosovo and East Timor. At first the aspect of crisis management was promi-

ment in the handling of the Asian financial crisis in 1997, but by 1999, it was important international relations and a future vision, rather than crises, that were prominent.

Whatever the crisis, there were no major failures in Japanese foreign policy. Compared with the confusion immediately following the launch of Taepondong missile by North Korea in the summer of 1998, the handling of the ship crisis represented a marked improvement. In the Kyrgyzstan crisis too, the hostages were safely released. Japan's response to the Kosovo crisis was not positive, but considering the geographical and historical background, neither was it to be particularly criticized. In comparison, Japan's response to East Timor left a negative impression. Nevertheless, in the end, peacekeeping troops from Southeast Asia were sent to East Timor with Japanese aid, and together with troops from Australia and Korea they succeeded in restoring order.

However, Japan's response to these crises, revealed serious problems in foreign policy. The ship crisis clearly showed the inadequacy of how Japan patrols its territorial waters. Practical improvements have since been made in the Self-Defense Force and Maritime Safety Agency systems, but appropriate legislation has yet to be looked into. The fact that the hostages were released in the Kyrgyzstan crisis is cause for rejoicing, but in addition to investigating the background against which this crisis occurred, it is important to find out whether there were not perhaps any problems in the negotiating process. From the character of the crisis, there is no way of learning about the negotiating process from the outside, but it will be a source of future trouble if, as a result, the impression is allowed to spread that political compensation can be gained by taking Japanese nationals hostage.

On the subject of response to crises in the international community, Japan's passivity in East Timor was a major problem. Despite criticism of the framework of the PKO cooperation law

for some time past, attempts to reform the law have constantly been put off. Though cooperation on transportation should not have been that much of a problem either realistically or politically, the government officials in charge judged that it could not be done under existing laws. These are problems of inadequacies in the legal system and a lack of political leadership. There was no sense of a political will to provide visible cooperation.

Important international relations were handled relatively well, but the problem of presenting a future vision remains

Important international relations were handled relatively well. The passing of the guidelines for U.S.-Japan defense cooperation in the spring of 1999 was important for Japan-U.S. relations, as was the rallying of the Japanese economy. Following the visit of President Jiang Zemin to Japan, Japan-China relations were strained, but China avoided making them any worse, and they have shifted onto a more favorable footing. Russo-Japanese relations have actually regressed, but as most of the causes for this lie in Russia's internal affairs, there is little that can be done from the Japanese side to rectify the situation. There will be presidential elections in Taiwan and Russia in the year 2000. It is important to maintain a foreign policy that will not be upset by fluctuating situations.

Relations between Japan and Korea and between Japan and Southeast Asia have improved the most dramatically. Japan's handling of the Asian financial crisis was criticized at first, but when the actual framework for aid was put forward, such as the new Miyazawa plan, it was highly appraised. How can future issues establish and take advantage of this appraisal? Improved relations with Korea are the most important success for Japanese foreign relations in recent years. The initiative of President Kim Dae Jung played a major role, but the response of Prime Minister Obuchi was also important. An attempt must

be made to build an even firmer foundation. I think that measures such as allowing flights between Tokyo and Seoul from Haneda Airport must be adopted to demonstrate concretely that Japan-Korea relations are improving.

The creation of a negotiating framework with North Korea was one of the achievements of Japanese foreign policy last year. Negotiations should continue while adhering to the system of cooperation with the U.S. and South Korea. Policy towards North Korea, however, is flawed in that domestic considerations are too prominent while an overall strategic view is lacking. As this relationship could be said to be the most important security problem for Japan, hardheaded calculation devoid of emotion is needed.

There have been no particularly outstanding failures in Japan's foreign relations with other countries, but neither have there been any special successes. The impression is of somehow barely getting through the various meetings without making a serious error. The high point may have been the breakfast meeting between Japan, China and South Korea at the ASEAN plus Three (Japan-China-Korea) Summit.

A long-term issue in Japan's foreign policy is how to overcome its inability to present a vision for the future. The failure of the WTO at Seattle was not specifically a Japanese failure, but neither were Japanese ideas hammered out forcefully. Here too passivity towards international initiatives due to domestic considerations is evident. The many issues to be dealt with include how to set up an Asian currency fund, how to promote the concept of a free trade zone with Asia, how to revive an inactive APEC, and how to foster the framework between Japan, China and South Korea established at the breakfast meeting. The latter half of 2000 is taken up with summit diplomacy centered on Asia, including the Okinawa Summit, APEC, ASEM, and the ASEAN plus Three Summit. It is to be hoped that Japan's foreign policy will also seriously hammer out ideas in the area of a future vision.

Presenting a Future Vision of Public Finance

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Public finance is an important election issue. Even if priority is given to economic recovery for the foreseeable future and the policy of “Not running after two hares” of public finance and structural reform is correct, financial reform cannot be avoided. The present deficit is not at a level that can be solved by economic recovery.

From the viewpoint of the ratio of GDP accounted for by tax revenue and the degree of tax revenue elasticity,¹ the increase in tax revenue when GDP exceeds 1 trillion yen is only in the region of 220 billion yen, even by a fairly optimistic estimate. An increase in GDP of over 130 trillion yen will therefore be needed to resolve the current deficit of approximately 30 trillion yen by a rise in tax revenue through economic recovery, and this is quite a difficult level to achieve without assuming a bubble economy. Taking into consideration the natural increase in social security costs in the future, wide-ranging expenditure cuts alone will not be enough and a tax increase must be included in the debate. The political parties must present a vision of public finance that boldly confronts the future situation. The following two points must be taken up at this time.

It is important to “embark on financial reform,” and without concrete proposals, financial reform will be meaningless

The first point is to make sure that the issue does not end in a short-term policy of “One hare or two hares.” Of course, it is important to get the timing right to start public finance reform, but even more difficult than the timing is the actual embarking on reform, because financial reform is more of a political problem than an economic policy. It would be possible to write a prescription for financial reform as an economic policy. But expenditure cuts and reform of the tax system also mean changing the composition of existing political vested rights, and whether or not this prescription can be implemented depends on political judgment. For example, the present lack of a solution is rooted in the question of whether financial reform will be difficult even if the economy picks up, and the essential problem is not choosing “One hare or two hares.”

The second point is that without concrete proposals, financial reform is meaningless. The present state of public finance was not brought about solely by economic measures after the bursting of the bubble. Review of the structure of annual expenditure is a long-pending question, and even in the financial reconstruction of 1980, only an across-the-board cut in annual expenditure was implemented and no review of the structure of annual expenditure was carried out. In that sense, this is a difficult problem that is being tackled for the first time.

Simply pledging to “reduce wasteful expenditure” and “carry out administrative reforms” is not the answer to this difficult problem. Each party must put forward a concrete plan showing which items they would cut and by how much, how they would implement administrative reforms and what cuts they would make. As the support base of each party is revealed by what expenditure is given priority, the voters cannot choose without such a plan. As for reform of the tax system, consumption tax is a key issue. The points to be clarified are, will consumption tax

be the main source of revenue supporting welfare, what percent tax is forecast in future, and will there be a conversion to the invoice system.

There should be an overall picture of feasible social security benefits and burdens, and a regional financial system should be set up to ensure a national minimum

Attention should be paid to individual policies relating to public finance, and particularly to the judgment of each party in the following two areas. The first, needless to say, concerns the social security system. Reform of the social security system has recently become an important policy issue, but a sustainable system has yet to be established. Inequality between the generations in the benefit and burden of pensions has been ignored, and supply-side reforms in the medical system are stranded on a reef. We are already within shooting distance of 2025, the year when the aging society will reach its peak, so we are no longer at the stage where abstract terms such as “future security” will suffice. We need to be shown an overall picture of realizable benefits and burdens.

The second is local finance. After the external standard tax² was announced by Tokyo Metropolitan Government, local taxation became the focus of interest, but the external tax itself is not such a problem. What is important is how to create a coordinated system using tax allocated to local governments. There can be no decentralization without changing the current tax allocated to local governments. Local tax revenue sources must be expanded by external taxation etc., but this should be discussed in tandem with the curtailment or abolition of tax allocated to local governments.

The aim of the system of tax allocated to local governments is the “balancing of revenue resources” between local governments. Just as the phrase “balanced land development” permitted lavish distribution of public works, so the “balancing of rev-

enue resources" brought tension-free public finance. Isn't it about time the system for balancing revenue resources was abolished and a system for ensuring a national minimum was established? Reform of the tax allocated to local governments signifies whether or not Japan can throw off the policy target of achieving a "balance" in the age when it was attempting to catch up with the rest of the world, and is an extremely important reform. Late though it may be, discussion has finally built up and this reform must be clearly positioned as a key issue.

"Demerit information" or negative policies, not "merit information," is important when a party takes power

As we have seen above, politically unpopular policies are a point of contention. Previously, simply making pledges in a bid for popularity was no good, but now the issue is particularly negative policies, in that the problem of public finance cannot be put off any longer. In this sense, "demerit information" (expenditure cuts and tax increases) and not "merit information" (expenditure increases and tax cuts) is important when a party takes power.

Demerit information is like, for example, writing "colors may run" on the label attached to a new item of clothing. This kind of information became important in the area of consumption in the late 70s, but at first consumers regarded products to which demerit information was attached as being of poor quality, so the companies were very negative about it. However, in due course the companies which provided this kind of information came to be regarded as reliable. It is the same with risk disclosure by banks. At first, those banks that disclosed their risks were regarded as a major risk, but gradually the banks that made clear disclosures came to be seen as banks with reliable risk management.

It is the same with the pledges of political parties. Most voters know that public finance cannot last with policies that only

“present the good side.” The groundwork has already been laid for accepting the party that is honest about how many unpopular policies it can carry out for a good end, and for having the courage to reveal its unpopular policies.

Notes

1. One trillion yen rise in GDP – 220 billion yen rise in tax revenue Approx. 30 trillion yen revenue deficit – increase in GDP of over 130 trillion yen is required
2. Tax levied on objects that can be judged externally. Tokyo Metropolitan Government decided to introduce this tax in April 2000, and Osaka Prefectural Government in May.

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