

# *Intellectual Cabinet* 2001

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*A policy debate forum from Japan*

**THE TOKYO FOUNDATION**



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# 2001

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# 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 researches and to the presentation of qualified 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 sound and constructive policy debate and proposing original policy initiatives.

*Intellectual Cabinet 2001* is our second English-language digest of the newsletter, compiled with some of the key issues discussed in the newsletter during the year.

It is our sincere hope that this booklet could introduce the latest policy debate in Japan to a wide audience in the world and help foster global policy dialogue on various issues.

March 2002  
RESEARCH DIVISION,  
THE TOKYO FOUNDATION

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# Environmental and Economic Strategies in Japan

*Kazuhiro Ueda*

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The relationship between the environment and the economy is one of a trade-off in that pursuit of revitalization of the economy and industrial activities brings deterioration of the environment, while giving priority to environmental conservation brings stagnation of industrial activity. In other words, the environment and the economy are incompatible.

## **Measures for conserving the environment do not necessarily entail investment with no profit**

Whenever the discussion turned to promotion of environmental policies, industry never failed to raise its voice in opposition. In the background, environmental conservation policies were seen as investment that would not create any profit for companies. In other words, environmental measures had to be taken because there were regulations, but they were to be avoided as far as possible. As a result, not only were environmental measures viewed as bringing expense and no profit, but as reducing productivity. Even today, there remains a strongly rooted concept in Japanese industry that the environment is incompatible with the economy.

Environmental conservation measures, however, do not necessarily mean investment with no profit. Take for example the internationally well-known case of the regulations on car exhaust

fumes that were introduced in the 1970s and the action taken by Japanese car manufacturers. At that time, the Muskie Act had been passed in the USA, imposing strict regulations on car exhaust fumes to improve air pollution, but implementation of the law was delayed by the political clout of the big three car manufacturers. On the other hand, a Japanese version of the Muskie Act was passed in Japan, but Japanese car manufacturers concentrated on developing technologies that would enable them to clear the strict standards, and they achieved resounding success. This led in the end to better quality cars and had a positive effect on international competition. It also led to the conquest of US markets which had delayed implementing the regulations.

**Well-designed environmental policies can stimulate technical innovation, leading to enhanced competitiveness of industry**

Normally, new needs for products are picked up in the marketing process. But the environment is a public asset and hard to express in terms of a need for an individual product. Environmental controls are therefore a means of incorporating society's need for the environment in the product, in this case the automobile. Dynamism is the foundation of economic growth. The response of the Japanese automobile industry to environmental regulations to enable it to "meet environmental regulations with technical innovations" is a typical example.

In referring to this example, Professor M. Porter of Harvard University stresses that "if environmental policy is well designed as a lever for technical innovation, it can boost the competitiveness of industry on international markets." In the US too, the chemical industry, which incurred high environmental costs, is improving its performance in international trade. Germany and Japan constantly achieve higher rates of GDP growth and increased productivity than the US under strict environmental regulations. Consequently, "well-designed environmental policies stimulate technical innovations linked to reduced costs and improved quality, and companies that succeed in this have a relative advantage on international markets and are able to earn profit." If consumers and users give priority to the environmental quality of prod-

ucts and companies, this trend will undoubtedly grow.

**Attention should be directed at town planning aimed at restoring the landscape, as is being attempted in regions where decline has accompanied destruction of the environment**

Amidst changing social awareness and public policies, companies are gradually coming to regard implementation of environmental policies in a positive rather than a negative way, and this is linked to competitiveness. Paradigm conversion from a highly wasteful society to a recycle-oriented society, the growing number of companies which have acquired ISO14000 certification, and the activities of green consumerism are indications of this.

Such a turnaround of ideas is also seen in regional development and town planning. Regional development in Japan was strongly based on attracting companies and promoting mass production of engineering products, and resort development tended to concentrate solely on developing standard golf courses. In recent years, however, there has been an increase in development methods, known as internal development, that give priority to the regional character and identity, and conserve and utilize the landscape, old streets, traditional culture and unique resources of the region. By implementing such methods, development does not come into conflict with conservation. Many regions are endeavoring to preserve the local environment and resources, and promote development of local industry and tourism in combination with modern technology and know-how.

Attention must also be paid to regional planning that restores the natural surroundings, ecology and landscape being undertaken in regions which have declined following environmental destruction. The "Parco Plan?" which originated in Emilio Romana? province in Italy with the aim of promoting the coexistence of production and livelihood with nature while restoring reclaimed land to the sea or to wetlands is well known, as is the "Groundwork Trust" in the UK which promotes projects by systemizing the main bodies, based on the principle of partnership aimed at improving and regenerating the local environment. A similar trend is beginning to be seen in Japan in typical polluted areas. It is a

kind of regional redevelopment aimed at revitalizing declining regions that are bearing the debt of post-war industrialization, not just by repaying the debt, but through environmental regeneration.

In future, environmental policies should not be negative policies that minimize the effects of the burden created by industrial and regional development, but must be implemented strategically as industrial policies and regional development. In other words, what is needed is environmental policy combined with industrial policy, and environmental policy combined with regional development and town planning. This will lead to the accumulation of new technologies and expertise in regional development, and create a source of employment and competitiveness.

We must reassess our sense of values with regard to affluence and create innovative industrial activities backed by logic. This will enable us to find future environmental and economic strategies for Japan.

# Mountain of Issues to Surmount

**Heizo Takenaka**

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In order to revive the Japanese economy, it is necessary to proceed with two forms of restructuring. These are “reactive restructuring” and “proactive restructuring.” This fact was also expressed in the reference by Prime Minister Mori in his Diet speech to “defensive restructuring” and “offensive restructuring.” The former is the elimination of the three excesses (plant and equipment, debt, and employment), which are the negative inheritances of the crash of the speculative “bubble” economy. The latter is structural reform in order to respond to the new environment formed by the information technology (IT) revolution and globalization.

Looking back at the economic policy of the Japanese government for 2000, although there was some progress visible on both fronts, the situation can definitely not be called adequate for dealing with changes in the global economic environment. 2000 was a year that left no few problems concerning the speed of reform.

**It is hard to claim that the outside pressure of “international accounting standards” has been adequately utilized**

Let us start with reactive restructuring first. Elimination of excess plant and equipment, amortization of bad financial assets, rationalization of personnel assets, and other corporate restructuring accelerated from 1999 and gave rise to the rise in stock prices up

to the start of 2000. In the banking sector, one large merger after another was announced and from 1999 to 2000 an environment was finally created proceeding to serious amortization of bad financial assets.

As government measures for promoting such restructuring, strict encouragement for quick corrective measures and a legal framework facilitating mergers as well as tax arrangements to promote amortization were studied. However, even though part of these government measures were implemented, it is hard to claim that they were adequate. The stance of the Finance Revitalization Committee concerning quick corrective measures was moved back and forth by the personnel at the top and at times a quite backward posture. Serious revision of the Commerce Act requires time and the establishment of the necessary tax system also went no farther than exceedingly partial measures. It is thought that a major reason why corporate restructuring proceeded from 1999 to 2000 was ultimately the powerful forward moves in opening up corporate information as required by international accounting standards.

It is well known that there has been demand that corporate accounting, particularly for large corporations, conform with international standards and by making consolidated accounting (including subsidiaries) mandatory, it made it difficult to hide problems in subsidiaries and current values were employed for asset evaluation, which was a powerful incentive promoting re-active corporate restructuring.

However, as will be discussed below, from the second half of 2000 onward, the market took a severe attitude toward the lack of thoroughness of these measures. Although the external pressure of international accounting standards was used to promote restructuring, the application of healthy competitive pressure on financial organs through quick corrective measures and the application of competitive pressure to the corporate sector as a whole through relaxation of regulations and other measures can not be said to have been adequate.

**In order to use the chance provided by the IT revolution, the role of the IT Strategy Headquarters is extremely large**

Looking back over economic policy in 2000, what can not be overlooked is the importance of the "IT Strategy Conference." In order to make use of the historic opportunity provided by the IT revolution, the fact that such an organization was established within the Prime Minister's Office is quite valuable. This is a good example of proactive restructuring.

At the IT Strategy Conference, there were two crucial study items. First was the strategic construction of high-speed Internet infrastructure and the second was raising the general level of information literacy.

For infrastructure, it was declared that within five years, Japan must build the highest level infrastructure in the world and that in order to accomplish this, competitive policies will be promoted to put to use lessons from various nations. These points can be seen as a major accomplishment. However, all the concrete policy issues, such as on what kind of base will NTT be split up and privatized to create a competitive system and how a system of responsibility will be created for attaining these targets, were left for the future. After the end of the Strategy Conference, the IT Strategy Headquarters (with ten members each from the government and the private sector) was established based on the Basic IT Act. It must be said that this is extremely important.

Furthermore, the IT Strategy Conference did not provide sufficient fruit concerning policies for increasing information literacy and this was left as an issue for the future. The IT Strategy Headquarters has a large responsibility for the future of these issues.

**Falling into a vicious cycle: Increased government deficits ➡ Increased financial risk ➡ Feeling of economic stagnation**

With these two types of restructuring underway, what should macro-economic policy have been for 2000? How well did actual policy do? Concerning these points, there is a quite interesting fact. Reflecting the efforts for corporate restructuring discussed above, the settlements (consolidated basis) for the first half of Fiscal Year 2000 for the companies listed on the stock exchange (ex-

cept for the financial sector) showed profits 2.8 times those for the previous year, but stock prices remained low during the second half of last year. The fact that stock prices were low even though the actual economy was doing fairly well reflects the evaluation by the market that the "financial risks" for the future of the Japanese economy is quite extremely large.

One of these financial risks is the problem of non-performing assets in the banking sector already discussed. Another financial risk drawing attention is the increased government deficit. I have already argued any number of times in magazines that current government deficits can not be continued but there is an increasing possibility that this problem will manifest itself at a relatively early time through clogging up of regional government finances.

What we have seen from the macro-policy perspective is that despite the fact that both reactive restructuring and proactive restructuring are being carried out in an inadequate manner and high levels of economic growth can not be expected, for the past one-two years the government has set high targets for growth. This is related to the political fact that there were elections. Because the government set such high growth targets, this invited a situation in which each time it becomes clear that the targets can not be met, supplementary budget expenditure that increases the amount of government red ink becomes unavoidable. This increased government deficit is increasing the financial risk and strengthening the feeling of economic stagnation. This is the vicious cycle into which we have fallen.

Based on these reflections, the government's economic management for 2001 must further accelerate both reactive restructuring and proactive restructuring and also make clear a posture that decisively breaks with the macro-economic vicious cycle of setting overly optimistic growth targets that eventually result in increased government deficits.



# Toward Realistic Fiscal Reform

*Toshihiro Ibori*

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Concern about the future of the U.S. economy is growing as the twenty-first century opens, and the American stock market has entered an adjustment phase. While uncertainty about the U.S. stock market increases, stock prices in Japan have taken a marked downturn. With the Nikkei stock average below ¥14,000, many financial institutions are suffering latent losses, arousing anxiety about possible instability of the financial system. The sense of crisis is reflected in a series of stock price boosting measures adopted by the ruling Liberal Democratic Party. Uncertainty about the future of Japanese economy can affect fiscal management, and a critical situation in public finance could have a detrimental effect on Japanese economy as a whole.

**As long as interest rates are higher than the rate of economic growth, putting off fiscal reconstruction will only mean greater fiscal restraints in the future**

Japan's fiscal situation is critical. The national debt balance exceeds 120 percent of the gross domestic product (GDP), and there are no signs of improvement in the flow of government revenues and expenditures. If fiscal management remains unchanged over the medium and long term, it is clear that Japan's government finances will eventually collapse. The reason that national bonds

are nevertheless being consumed at a low interest rate on the bond market is because investors optimistically believe that the country's fiscal health will recover.

It is not necessary to repay the entire government debt balance, which is expected to stand at ¥666 trillion as of the end of fiscal 2001. The government does have some financial assets of its own. It could also exercise its option to raise taxes and reduce expenditures. Should the government set to work in earnest to reconstruct its fiscal standing, it will be quite possible to restore the nation's fiscal management to a sustainable condition. The tax burden on citizens as a whole is actually rather light. Consumption tax, for example, is 5 percent, by international standards, the lowest anywhere. The potential for absorbing future tax increases is actually quite considerable: the economy would not buckle even if the consumption tax were raised to 15 percent.

If the Japanese economy is not on a self-sustaining recovery track, however, adoption of policies for quantitative restraint now or in the near future are likely to meet with strong resistance from various political forces, which will in turn delay fiscal management reform. The further the delay in shifting to quantitative tightening, the larger in scale the quantitative restraints will have to be.

That is because the debt increases commensurate to the rise in interest rates whereas tax revenues increase in pace with the growth of the economy. As long as interest rates are higher than the rate of economic growth, putting off fiscal reconstruction will only mean greater fiscal restraints are later needed. Specifically, the higher the ratio of debt balance to the GDP, the larger the surplus margin of primary balance that is needed to check the increase of debt-GDP ratio and maintain it at a certain level.

**What is needed are not short-term policies to quantitatively shore up the Japanese economy but structural reforms that would enable the economy to revive in the medium and long run**

An issue of public bonds worth ¥28 trillion is planned for the general account in the national budget for fiscal 2001. As in the previous year, public works spending is at the highest level ever, and

social-security-related spending is steadily increasing, a reflection of the aging of the nation's population. As a result of the reconsideration of certain public works projects, moreover, the project with the largest increase in expenditure is construction of new Shinkansen ("bullet train") lines. The financial situation of all existing Shinkansen lines, except the Tokaido line, is quite strained. The newly planned lines, moreover, are to be built in far less populated areas, so prospect of their profitability and productivity is low. Public works related to the Ministry of Agriculture, Forestry and Fisheries will be undertaken on the same scale as in the previous year. Agriculture-related public works are especially questionable in terms of productivity. As long as a huge amount of public works expenditure continues to be appropriated for wasteful projects like these, fiscal structural reforms will remain hard to achieve.

If stock prices remain at a low level and if the government activates financial measures to stimulate the economy in the name of boosting the stock prices, the fiscal situation will grow even worse. Of course, the cumulative public deficit does have the effect of sustaining the Japanese economy by means of public demand. But, as is clear from the experience of the 1990s, the effectiveness of bolstering the economy through public demand is limited. Rather than short-term policies for quantitatively shoring up the economy, those involved in the market want to see structural reforms and policies bold enough to enable the Japanese economy to recover in the medium and long run.

### **Fear of future fiscal collapse has closely linked to current economic performance and stock price levels**

A distinct feature of the recent economic environment is that fear of future fiscal collapse has closely linked to current economic performance and stock price levels. The worst-possible scenario, in which the economy is stalled again by fiscal management measures, is bringing evidence of fiscal collapse out into the open. If recovery of fiscal health is delayed for the sake of immediate economic performance, adoption of future quantitative restraints could be rendered unrealistic.

Even if the Japanese economy has the reserve strength to absorb heavier tax burdens, the consumption tax could never be raised to as much as 30 percent. Especially under weak government leadership, the maximum tax increase and expenditure reduction that the national economy as a whole can absorb cannot be achieved. The greater the necessary tax increase and the more drastic the reduction of public works and social security expenditures, the more difficult the task will be to achieve in one fell swoop.

Once investors in national bonds on the bond market feel a sense of crisis regarding the future of the economy, these bonds will immediately become risky assets. If the values of the bonds crash, many financial institutions that hold large number of national bonds will suffer massive capital losses. This can trigger financial panic. The fear of fiscal management failure would make it quite possible that financial distrust would recur and the economy again fall into a stall.

The urgent priority in fiscal management is to present a realistic scenario for reconstruction that will foster investors' trust in the market so that they will consider the future restoration of fiscal health feasible. If the economy is bound to be seriously sluggish for the time being, there is no need to drastically increase taxes or reduce government expenditures. It will be meaningful and beneficial, however, for the government to keep people clearly informed of the extent of quantitative restraints expected to be necessary in the future.

If the current low level of stock prices is linked to apprehensions about the future of Japanese government finance, the government should not waste time in adopting necessary policies and institutional changes that will pave the way for fiscal and structural reforms. It should strive to increase people's confidence in future fiscal management by taking such measures as: adoption of a taxpayer numbering system so as to erase people's feeling of unfair tax burden; revision of the current project assessment system to reduce wasteful public works; streamlining of the local allocation tax system that has corrupted morals in local governments; and reform of the public pension plan, which relies on the working generations to support a rapidly increasing population of elderly, imposing an unfair burden on younger people.

# Asia's Economic Challenges

*Shujiro Urata*

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The final ten years of the twentieth century left the Japanese and other Asian economies, which had been steadily growing until then, with serious challenges. For Japan the decade had opened with the bursting of speculative bubble economy, and excesses of that era still haunt the country, since no adequate measures were devised to overcome its negative effects. Even now, at the beginning of the new century, the light at the other end of the long tunnel of post-bubble recession is not in sight. Other East Asian economies had been growing rapidly from the mid-1980s, but in 1997 they were suddenly hit by the currency crises. The following year, they experienced minus growth on an unprecedented scale. They have since been moving toward recovery at a faster-than-expected pace, but not to the point of regaining the rapid growth rates of previous years.

We can learn much about the future of economic recovery and growth in Japan and other Asian countries now struggling with difficult circumstances, by looking at their potential competitiveness. This report examines the economic tasks they have to deal with in order to increase their competitiveness, referring to the results of surveys we have conducted at the Japan Center for Economic Research (*Ajia Nihon no senzai kyosoryoku* [Potential Competitiveness in Japan and Asia], December 2000).

**Japan sustains strong competitiveness in science and technology, but its ranking in education, finance, and corporate activities has fallen**

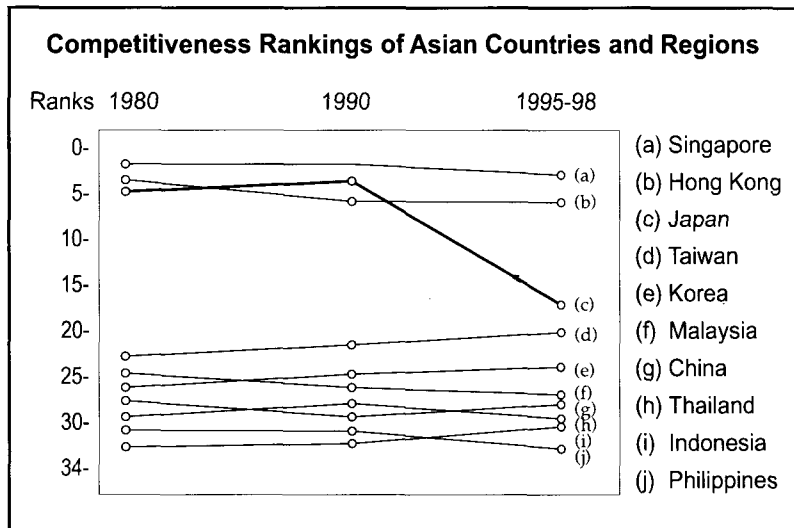
The competitiveness of the thirty-one OECD and Asian countries and regions were assessed in eight categories: international finance and trade, corporate activities, education, domestic finance, government, science and technology, social infrastructure, and information technology (IT). By analyzing the variables that affect each category, we estimated each country's score, and ranked the countries/regions on that basis. Their overall competitiveness was obtained by estimating the average values for all the categories.

In terms of overall competitiveness, Japan once ranked very high, taking fourth place in 1980 and third place in 1990, while in the more recent period of 1995-98 its rank had fallen to sixteenth. As this shows, the 1990s was Japan's "lost decade." We may note that Singapore ranked first in both 1980 and 1990, and the country ranking highest in the 1995-98 period was the United States. In the area of science and technology, Japan ranked second, after only the United States, in 1980, 1990, and the most recent period as well, but in other categories its ranking declined. Even in the category of science and technology, Japan's score, as opposed to its ranking, reveals that the gap vis-à-vis the United States has not shrunk at all and also that Korea and Taiwan are rapidly catching up.

Japan's ranking fell considerably in the areas of corporate activity, education, and domestic finance. Among factors responsible for the lowered rank in education were a low rate of high school graduates going on for higher education and a decrease in the proportion in the GNP channeled by the government for education. Japan's lower rank in domestic finance was due partly to the fragility of financial institutions that is symbolic of the current financial recession and due partly to the underdevelopment of direct financing. Declining competitiveness in the category of corporate activity was attributed to the drop-off in investment resulting from lower earnings.

The table shows Japan's ranking in each category for the 1995-

98 period. Japan has a great deal to accomplish if it is to recover competitiveness in not only corporate activity, education, and domestic finance, as mentioned above, but in international finance and trade, infrastructure, and IT as well. Specifically, it must expand imports and foreign direct investment inflows, improve the efficiency of communications and transportation, and encourage the use of information technology. The Japanese government is doing its best to foster information technology by setting up IT Strategy Headquarters and other organizations, but in use of personal computers and the Internet, Japan lags behind not merely other major industrial nations but Singapore, Hong Kong, Taiwan, and Korea as well.



Japan faces many challenges as it seeks to recover its competitiveness. In order to meet them, the government must eliminate regulations and implement appropriate competition-stimulation measures, thereby creating a lively and attractive market environment that encourages private-sector corporate competition and promotes technological progress. Domestic incentives for deregulation are low, so it is important to make effective use external pressure. In the past, multilateral trade liberalization under the GATT (predecessor of the WTO) and bilateral negotiations such

as with the United States were effective. Now that liberalization is at an impasse at the WTO, workable measures for liberalization through bilateral free trade agreements, such as that with Singapore, are now under negotiation.

**The competitiveness of Singapore and Hong Kong are high, but that of the ASEAN countries and China remain low**

Competitiveness varies widely in Asia. Singapore and Hong Kong rank high, while Malaysia, Thailand, Indonesia, the Philippines and other ASEAN nations (except Singapore) and China come in under twenty-fifth place. Taiwan and Korea have been ranking higher in recent years, but they stand at around twentieth. There still is a vast gap between them and the major industrial nations. China and the members of ASEAN (except Singapore) rank very low in almost all the categories, which is indicative of the many tasks they have to deal with in order to improve their position. (See table.)

Singapore, Hong Kong, Taiwan, and Korea—the so-called Asian NIEs (newly industrializing economies)—share a common weakness in education and in science and technology. Taiwan and Korea also have much room for improvement in such areas as domestic finance, government, social infrastructure, and information technology. These points are justified, indeed, if one recalls that the main reasons for the currency and financial crises that hit many East Asian nations were inefficiency in the domestic finance and private enterprise sectors and inability of governments to adequately supervise these two sectors.

Further progress is expected in globalization and information technology. Competitive nations, capable of taking advantage of these new developments, will grow even more whereas countries where competitiveness is lackluster will be left far behind. In order not to lag behind the industrial countries and competitive developing nations, it is imperative that Asian countries be keenly aware of the magnitude of the problems they currently face and work hard to solve them.

Improvements in education, science and technology, and social infrastructure require active and efficient government assis-



### Rankings by Category among Asian Countries and Regions (1995-98)

	Overall	Int'l finance and trade	Corporate activity	Education	Domestic finance	Government	Science and technology	Social infrastructure	Information technology
Singapore	2	8	7	19	9	1	21	2	6
Hong Kong	5	3	3	12	2	3	26	27	11
Japan	16	13	10	25	13	7	2	13	14
Taiwan	19	20	5	18	15	20	11	25	13
Korea	23	28	24	24	24	12	18	11	18
Malaysia	26	24	17	28	7	29	31	26	26
China	27	22	31	29	23	24	25	24	28
Thailand	28	31	28	27	20	28	30	17	27
Indonesia	29	27	30	31	31	26	27	29	30
Philippines	31	29	26	26	28	31	28	31	29

tance. Stimulating of corporate activity, domestic finance, and information technology require reduction of government intervention through deregulation. We should be aware that there is a shortage of human resources, funds, information, and so on in other Asian countries, and the assistance of Japan and other industrial nations, as well as development aid organizations such as the World Bank and the Asian Development Bank will make an important contribution to this endeavor.

# Toward Closer Ties Between Europe and Japan

*Noriko Hama*

*Economist and Research Director,  
Mitsubishi Research Institute*

If “so far yet so near” is the way to characterize the close ties between the United States and Japan in spite of geographical distance, “so near yet so far” would still regrettably have to be the label on Japan’s relationship with the other Asian countries in its immediate vicinity. As for Japan’s relations with Europe, “so far, and just as far,” again regrettably, is apt to remain the reality, if not the aspiration.

In the trilateral relationship between Japan, Europe, and the United States, the Euro-Japanese axis was always apt to be regarded as being the weaker link. The relationship has tended ever to give the impression, for better or worse, of a diluted version of U.S.-Japan ties. Any progress in market liberalization issues between Tokyo and Washington was followed by a similar progress between Europe and Japan. When trade frictions arose between Tokyo and Washington, relations between Japan and Europe would grow strained in more or less the same vein. Efforts have been made on both sides to break away from this second hand image, one of which has been the attempt to create a framework for political dialogue. Nonetheless the relationship is yet to emerge fully from the shadows of that other axis in the trilateral formation.

**Failure to identify an issue of common urgency and the one-versus-many configuration are weak points in the Europe-Japan relationship**

One of the major weak points in the Europe-Japan relationship is that the two sides have not thus far really been able to identify any issues upon which they share a genuine sense of urgency. Even as both sides wished keenly to deepen existing ties, neither side has ever been quite able to eliminate a certain sense of contrived dialogue. It would seem to this writer that the problem has been not so much one of the lack of a common set of issues but more a matter of perspective. The search for dialogue material seems invariably to have taken the U.S.-Japan mode of discussion as the role model. An odd way to go about things, when it was precisely those U.S.-Japan relations out of whose shadow the two sides have struggled to emerge.

Another problem has been the inevitably one-versus-many aspect of the Europe-Japan relationship. It goes without saying that the European Union is not a monolith. However much European Commission representatives and the political leaders of the countries that take turns to hold the rotating EU presidency loyally speak with a EU voice, they still have diverse minds of their own. Tribute is amply paid to the efforts to create common policies and institutions. Yet people's attitudes and sentiments will forever remain uniquely their own. Long may it be so. On the other hand, this internal diversity of Europe, as irreplaceable as it is, does however make it difficult to create a platform on which in depth dialogue can take place within a Euro-Japanese dimension.

**A common compelling concern for Japan and Europe is what to do about an increasingly inward-looking United States**

Nonetheless, this writer would like to think that Europe and Japan actually share two compelling concerns. One is what I have taken to calling WTDA, otherwise to be known as the "What To Do about America" problem. Europe and Japan have spent too long fretting over what to do about their relationship with each other. A change of perspective that allows the two sides to look at common issues of interest outside the immediate sphere of their

own bilateral ties, should bring a new dimension to the discussions. And there is certainly much that calls for a pooling of ideas in the context of WTDA.

For America's econo-political perspective seems to be growing steadily inward. This is perhaps only to be expected. With the era of what came to be known with a great deal of legitimacy as the "Pax Americana" now behind us, it should come as no surprise if American eyes seem increasingly to turn away from the grand design of global affairs toward its more immediate domestic concerns. Of its own accord, the United States chose to sever the dollar's link to gold in 1971, thereby abandoning its position as the single international key currency nation of the world. In this strict sense, the United States is no longer the world's superstar, notwithstanding the overwhelming preference shown by the world for the dollar as a method of transaction and as a store of value. It has become one among a number of local heroes, albeit standing a great deal taller than the rest. Yet the habits of superstars do not die easily. One hopes that a combination of superstar habits and an inward-looking mindset does not become the hallmark of the Bush administration.

None of this is to say that Europe and Japan should jointly round on the Americans. Yet an introverted United States is surely an issue worthy of serious enough common concern between Europe and Japan. The changing landscape of a post-postwar world requires new ideas, both broadly as well as in the more focussed context of the US-Europe-Japan trilateral relationship. The hope is that in discussing such matters of broad-brush yet nonetheless urgent significance, Europe and Japan will become able to go beyond the somewhat stilted dialogue of past years towards a deeper partnership.

**The U.S. economy is long on competition and short on distribution. The Japanese and European economies, by contrast, are distribution-biased**

A second thing that Europe and Japan have in common is quite simply the shape of their respective economies.

Economic activity can be likened to a triangle composed on

the three sides by the elements of growth, competition, and distribution. Growth stands for employment creation. Competition by the same token is survival of the fittest, while distribution works in aid of the survival of the weakest. An economy is surely at its best, stable and at once dynamic, when these three components of growth, competition and distribution co-exist with equal force, forming a well-balanced equilateral triangle. Such a golden triangle of economic activity is, however, obviously hard to come by in the real world. Even the much-hailed American new economy does not actually have strictly the right shape for a perfect equilateral triangle. The American economic triangle tends towards a long and well-developed competitive vector, while the distributive side of the triangle remains the weaker element. Meanwhile, it can be said of the Japanese and European economies, at least thus far, that they have been long on the distributive side of the triangle, and short by comparison on the competition front.

It has become something of a standard practice to pit the "Rhein model" of capitalism against its Anglo-Saxon counterpart, it being the feature of the Rhein model that it tempers outright market forces with more equality conscious values. Germany's "social market economy" arrangements are the most commonly cited case in point.

The post-World War II Japanese economy is also regarded as having operated in like fashion. Some would even go so far as to say that the Japanese version is a genuine socialist system rather than a modified version of the market economy. In any event, the existing mode of operation has reached a point where it is turning into a liability and making the Japanese economy dysfunctional. The excess emphasis on equal distribution and lack of space provided for competition to function healthily have culminated in a situation in which it is becoming virtually impossible for the economy to form itself into a triangle of recognizable shape.

While matters had not come to such an extreme pass in Europe, it has, over the years had its share of difficulties due to a lack of momentum in the competitive component of its economic triangle. Hopes are high that the introduction of the euro and the globalization of European companies will reshape that triangle.

Only time will tell whether the reality will match those expectations.

Yet for all the need for a greater competitive thrust in both the European and Japanese economies, a simple “Anglo-Saxonization” of their systems cannot be the ultimate solution. Not least because the Anglo-Saxon model itself is a product of the latter twentieth century, and as such, harbours elements of outdatedness as we stand on the threshold of a totally new century. There can be no better opportunity for Europe and Japan to enter into creative debate, both at policy and inter-corporate levels in pursuit of new paths whereby to reach the golden triangle of economic activity.

There is little doubt that Europe and Japan share much room for fruitful dialogue. WTDA and the quest for the ideal shape of economic activity should provide fertile enough ground to keep both sides engaged in serious debate. Hopefully, that debate will lead to a vision of twenty-first-century global harmony that will fittingly takeover from those concepts of international world order that prevailed in the latter half of the twentieth.





# Preparing for the Digital Recession

*Heizo Takenaka*

*State Minister in charge of Economic,  
Fiscal and IT Policy*

The deceleration of the U.S. economy is now manifest. Economic slowdown, coinciding with uncertainty over the Bush Administration's economic policy directions, is behind growing concern about the global economy.

## **The prevailing view is U.S. economic downturn will be mild**

An important point to bear in mind when sizing up the U.S. economy right now is that this is the first recession under the New Economy (the first "digital recession"), and its basic mechanisms are not yet well understood. However, the economic adjustment will basically be mild and will come in for a "soft landing."

Overall, the prevailing opinion is that the U.S. economic downturn will be mild. At the world economic forum held in Davos, Switzerland earlier this year, experts from around the world also agreed that the slack-off would not be severe and that it could be controlled appropriately through Federal Reserve Bank monetary policies.

The basic factor behind this reasoning is that many experts believe that the IT (information technology) revolution built into the U.S. economy is an extremely strong new growth mechanism. Although the full impact of the IT revolution on the economy is not

yet entirely clear, some important evidence has emerged. According to frequently cited research findings by FRB economists, 72 percent of productivity growth in the United States is IT-driven. Performance at this level suggests that the fundamentals of the U. S. economy are very sound.

### **We lack sufficient knowledge and experience of digital recessions**

However, we must bear in mind that the current economic adjustment is the first so-called “digital recession” under the New Economy. Since we lack sufficient knowledge and experience of digital recessions at this point, basically two different and contrasting views prevail.

One is that in a society benefiting from the IT revolution, thorough monitoring of information makes it possible to perform continual, real-time adjustments in the economy, and that this can flatten the curve of the economic cycle. Inventory control technology has certainly vastly improved with IT advances, allowing producers to tailor production to sensitively reflect sales trends and thereby helping reduce fluctuations in the inventory cycle.

The other view is that since it is difficult to evaluate technology in an IT-based society, expectations of new ventures vary wildly, with the end result that the stock market has become much more volatile than before. If large-scale asset deflation occurs, economic downturn will inevitably be correspondingly large and could deepen the economic trough all the more. A digital recession, in other words, by its very nature calls for vigilance.

### **IT-dependent Asian economies are bound to be affected by the U.S. economic slowdown**

The second important point to watch is that the U.S. economic slowdown will have a strong impact on Asian economies, which have become increasingly dependent on IT-related industries.

After their wholesale downturn in the wake of the currency crisis of 1997, the Asian economies recovered rapidly beginning in 1999 (the so-called “V-curve” recovery). The recovery was due to changes in fiscal policy and strong exports, but another impor-

tant factor is that production in Asian countries had by then shifted to IT-related industries. IT products now account for half the exports of the Philippines, Malaysia and Singapore, among others, and developing Asian countries today are globally-important manufacturing bases for such products.

In that sense, the V-curve recovery of the Asian economies was moving in step with the strong IT-led U.S. economy. At the same time, this means that the Asian economies will probably experience considerable fallout from adjustment phases of the U.S. economy, because they have become even more dependent on the United States than before.

### **Bush Administration, economic policy is as yet unclear**

The third point to note is uncertainty over what policies the new Bush Administration's economic staff will adopt—in other words, the direction of American macroeconomic policy is unclear. One of the arguments supporting the view that the economic adjustment will be relatively minor is the generous leeway the government has in formulating policy. The FRB has already lowered interest rates twice this year and further monetary loosening will probably occur sooner or later. Prior to the first rate cut of 2001, the FRB had raised interest rates six times, so this means that the government has much room to maneuver. It also has a relatively free hand in fiscal policy amid concerns about an expanding surplus. As a result, some observers believe that even if a recession occurs in the United States, it will be a “managed” one.

Although there is broad support for this view, the fundamental problem is that the Bush administration has still not defined its economic policy. Significantly, many of the major figures in the Bush Administration are from military backgrounds, indicating the great weight this government places on security issues. Indeed, except for presidential aide Bruce Lindsay, known for his radical supply-side, monetarist views, no notable economic experts are on board. At this point, what policies the new Bush Administration will adopt and on what sort of timetable they will be implemented is simply not known.

Domestic policy in Japan should be managed on the assump-

tion that the digital recession in the United States involves a number of unpredictable factors. The “digital recession” concept applies to some extent to the Japanese economy as well. This is because although the Japanese economy has not again slipped back into a recession, like the United States it is now experiencing a slowdown due to worsening prospects in the IT sector. Rather than temporary measures to boost domestic demand (public works projects, etc.), I believe the best prescription in this case is to adopt policies to foster a thoroughly competitive environment that will elicit an unremitting stream of corporate renovation.

# Toward “Strategic” Structural Reform

*Akira Kojima*

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Calling itself a cabinet committed to reform, the Junichiro Koizumi government that was inaugurated toward the end of April 2001 is tackling the hazardous job of administrative reform. The hopes of Japanese citizens that it will live up to its pledge are shown by record-high popular support ratings of around 80 percent for the new cabinet.

**Now is the last chance to resuscitate the Japanese economy. It cannot be achieved without structural reform**

Since the beginning of the 1990s Japan's economy and society have been stagnant, and the people's sense that the country is at a dead end is blamed on the ineptitude of the government in dealing with the situation. Power changed hands several times, but each of the successive administrations failed to adopt effective policies. Over and over again they instituted stopgap measures, putting off the more thoroughgoing measures that should have been implemented. Structural reform was debated, but no leader had the courage to demand that voters bear the “pain” that would accompany reform, lavishing instead taxpayers' money on temporary “painkilling” measures. A decade was thus squandered, with no progress made in strengthening the basic constitution of the Japanese economy.

Some argue that the Koizumi administration offers the ruling Liberal Democratic Party's last chance for survival. Actually it is the Japanese economy's last chance for recovery as well. If necessary structural reforms are not made within one or two years, the first ten years of the twenty-first century will likely be another lost decade. Even worse, the whole twenty-first century might be lost. Prime Minister Koizumi stresses that there will be no business recovery without structural reform. This is true enough; but it is more important to emphasize there will be no revival of the Japanese economy without structural reform.

**Resuscitating the economy means pushing up the trend line of growth; the key is reform of the structures of supply and demand**

Under the free market economy, no nation is exempt from business cycles. The United States, where prosperity had continued for quite some time, is currently facing a phase of cyclical adjustment for the first time under the New Economy. Japan is now in its third downturn since the bubble burst in 1991. Business by nature is cyclical, so times of decline are bound to be followed by better times. It is necessary, of course, to do what we can to make business fluctuations as small as possible, but what we need to keep our eye on even more is the trend lines of mid- and long-term economic growth. Since the early 1990s the growth trend line of the Japanese economy has been on a sharply downward curve. The average annual growth rate has dropped to the 1 percent level, far lower than the latent growth capacity of the Japanese economy. Because the current business cycle centers around this low trend line, the downturn is especially severe.

Resuscitation of the economy does not mean undergoing a cyclical business recovery but rather pushing up the trend line. Through structural reforms the United States overcame its own lost 1970s and 1980s, and from the early 1990s onward it succeeded in raising the growth trend line considerably. Structural reform efforts for the purpose of resuscitating the economy cannot stop at simply adding on more measures to stimulate aggregate demand. Enough support must be given to demand to keep the

economy from deteriorating, but aggregate demand measures greater than that are not necessary. The crux of the matter is not aggregate demand but the structures of supply and demand.

The major adjustment factors with which Japan must cope are the bad loans of financial institutions resulting from past policy failures, as well as intense global competition (more specifically, cost management competition amid an intensified price war for standardized, mass-produced industrial goods), the high-tech paradigm shift (shift toward information technology and knowledge intensive industry), and the aging population. None of these problems can be solved by simply increasing aggregate demand; they must be tackled by reinvigorating the structures of supply and demand.

**Expansion of direct domestic investment at a time of worldwide scrambling for high-grade foreign capital is a historic Japanese policy change**

Among the proposed structural reforms are: 1) liquidation of bad loans as soon as possible; 2) augmentation and development of the securities and capital markets, that form the framework supplying "risk money" in support of entrepreneurs who are willing to take risks; 3) revision of the tax system to one that, breaking from egalitarianism, rewards and encourages venture enterprise; 4) decreasing employment mismatch and providing education and job training to secure workers needed in new fields of industry (that is, breaking away from the idea that launching new public works projects will absorb unemployment); 5) improvement of the environment for utilizing and expanding direct domestic investment; and 6) raising the labor participation rate by working to realize the ideal of a society without barriers of age and gender and to secure continuous improvement in labor productivity through the efforts described in 4).

Here are some revealing figures on direct domestic investment. In 1998, direct domestic investment made up only 3 percent of internal gross capital formation in Japan, compared with 10.9 percent among the major industrial nations on the average, 12.8 percent in the United States, 25.7 percent in Britain, and 12.9 percent

in China. The comparison shows how much Japan lags behind in this age of exploding global direct investment and the worldwide scramble for high-grade overseas capital. We need to examine the delay in enacting reform from a global perspective.

The resuscitation of the U.S. economy was made possible partly by high-grade capital, management know-how, and technology brought together into the United States from all over the world in the wake of direct domestic investment. Under the policy of fostering industry after the war, Japan sought for years to keep out foreign capital in order to establish the potential of its own industry.

This year's White Paper on International Trade calls for "expansion of direct domestic investment" as a major policy. This marks a historic policy shift by the Ministry of International Trade and Industry (now the Ministry of Economy, Trade and Industry). The Japanese government must explain to its people in detail why such a fundamental change has become necessary. We need to realize that direct investment policy is now an extremely strategic, important dimension of public policy in many countries.

**It is crucial to raise the rate of participation in the labor force, increase labor productivity, and strengthen the securities and capital markets**

Japan must increase its labor participation rate and its labor productivity because the size of its productive population has already begun to decrease and is expected to drop sharply hereafter. Productivity has to rise continually in the economy as a whole in order to bolster the growth trend line. The general standard of living is calculated by multiplying labor productivity by the rate of labor participation. Labor productivity is determined by training level of the labor force as well as by the capital equipment ratio (capital-labor ratio). The rate of labor participation, if left to take its natural course, will decline quickly because of the aging population and low birth rate. To prevent its decline it is necessary to revise current systems and practices that require workers to retire at sixty years old or so, as well as build a framework that encourages the greater utilization of women's abilities in society.



Fostering the securities and capital markets is an indispensable management task in any mature economy. The bank-centered economy was effective when Japan's economy was developing, but today it is now a major impediment for Japan, which has reached a phase of maturity. Settling the issue of the bad loans is important in order to prevent the bank system from becoming a deflation-triggering factor. Risk money, however, cannot be generated by the bank (indirect financing) system.

I urge the Junichiro Koizumi government to pursue a "strategic" approach to structural reform.



# University-Business Partnerships a Key Issue for Japan

*Kiyonori Sakakibara*

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The recently announced plan to launch 1,000 university-based venture businesses is ambitious and welcome, for developing liaisons between universities and business is a key priority for Japan today. Not only for venture business, but in other ways, it is desirable that society benefit from the fruits of university research. Nevertheless, a number of knotty dilemmas, such as ownership of research resources originating in universities, remain unresolved. As a first step, greater efforts to publicize the work of university research institutes should be encouraged in order to assure transparency of ownership rights.

## **Institutional frameworks ill-equipped to deal with issues of research resource ownership**

In Japan, ownership of research resources is not clear. Institutional rules and frameworks regarding such ownership are rarely established at university or national research centers, or even at such special government corporations as the Institute of Physical and Chemical Research (Riken). This is the background against which cases like the charges of economic espionage made in spring 2001 against Japanese scientists for allegedly stealing genetic research materials can occur.

Let me give an example in the case of Japanese universities. Major Japanese corporations often support research at a national university under "research donations," a rubric found to be most convenient from the viewpoint of the professors there. Universities treat these research donations as "proxy funds" and any discoveries made using these funds belong, pro forma, to the university, not to the funding corporation. What can happen when a discovery made using proxy funds, let us say by Professor A, who is affiliated with University B which received a research donation from Corporation C? In Japan, the rights to the discovery belong to Professor A. Corporation C may apply for a patent at his discretion. If Corporation C has foreign operations and a rival company claims that the patent application procedure is flawed, Corporation C could probably not win the patent.

Thus, while research-business partnerships and university-based ventured businesses are much talked about, the system governing ownership of research discoveries and the research data generated through that research remains undefined in Japan. Returning to the above example, after 1978 each national university established an "invention committee," which requires that the head of the institution be notified when members of its faculty or staff make discoveries. But even today, the invention committees at most universities are not consulted about patents related to the discoveries.

### **Discussion needed regarding protection for university research discoveries under intellectual property rights**

We need first of all to discuss the pros and cons of strong protection of university research discoveries under the principles of intellectual property rights. In the past, discoveries were announced at academic symposia or in academic journals, where they found their way into the public domain and were accessible to everyone. But universities in the United States, which became aware of the considerable economic value of discoveries made under their aegis, began at a certain point to patent these discoveries. In such cases, the rights to the discoveries belonged to the university, not personally to the researcher.

Such moves were initially criticized, and with good reason, be-

cause public or private, universities receive public monies and are esteemed public institutions. It was natural for the universities to be the targets of criticism, since patents allow a personal monopoly under certain conditions. In fact, studies showed that private-sector corporations considered academic symposia or journals to be the most useful source for obtaining information on discoveries announced by universities.

At any rate, the financial mechanism, whereby partnerships between academia and business are promoted, universities supported by generous corporate funding make discoveries and then assume the rights to or benefit financially from those discoveries, is well-developed especially in the United States and has made the universities powerful forces. Considering the proper role of a university, of course, this does not necessarily mean that American universities are the ideal, and many take people issue with the matter even in the United States.

### **Establishing transparency in ownership rights**

What specific steps can be taken in Japan for the time being? One approach is to establish a rule stipulating that resources generated during the research process in principle belong to the university, just as they do in the case of private-sector companies. This must be clearly stated in employment contracts, as well as cases where rights may be transferred. The important point is to state who owns university research resources and clarify ownership as much as possible. This must be premised on full disclosure of university professors' activities.

The Japanese university system, which is essentially unsupervised, is unacceptable. Institutions are currently incapable of dealing with international disputes over intellectual property rights, nor can they keep track entirely of the movements of research personnel. If the plan for creating 1,000 university-based venture businesses goes through under such conditions, utter chaos is bound to result.

At American and British universities where research-business liaisons are quite fruitful, commercialization of research discoveries is encouraged. Still, the universities impose clear restrictions on the outside use of their resources. These restrictions vary, de-

pending on the country and on the university, but all require university personnel to disclose their activities. When restrictions are imposed on outside activities, this is often done by limiting the time which personnel may spend on such activities, say one day a week or 13 days per quarter. This is the so-called "one-day rule" or "13-day rule." We in Japan often hear of this rule, in, for example, the introduction of a "Stanford University professor who is engaged in consulting work one day a week."

Such an introduction may be misleading, because personnel engaged in consulting one day a week must necessarily spend the rest of their time on their university duties, a strict and clear imposition of control. This is a major difference with Japan, where although supervision may exist, it remains a pro forma convention.

**No sound academic-business partnership can be established over the long term based on notions of preestablished harmony**

Regarding the issue of conflicts of interest, Japanese universities still lack procedures for requiring their employees to disclose potential or actual conflicts of interest at regular intervals. Based on my experience of teaching at universities abroad, I can see clearly that Japanese universities lack proper institutional controls and even a minimum level of systematic order. Universities in other countries impose strict control on their personnel's outside activities because they are well aware that conflicts of interest are always present in academic-business partnerships which involve profit-seeking corporations and universities operating for the public good. Attempting to establish partnerships on the basis of the notion of preestablished harmony, as is done in Japan, will do nothing to take care of conflict of interest issues and in the long run will fail to promote healthy partnerships.

University-business liaisons are an urgent challenge for Japan and measures that will take rapid effect are needed. Although reform should begin with what is practicable as soon as possible, the more essential issues of principle should be discussed in detail and at length. The reforms needed at universities in Japan should not be half-baked; thorough discussion of the essential issues at stake is indispensable.

# The Case for a Policy to Redevelop Our Cities

*Minoru Mori*

*President and CEO of  
Mori Building Co., Ltd.*

Compared to other global leading cities, Tokyo's competitiveness and attractiveness has been declining year by year. Homes and offices are cramped, and the average commute for people traveling to Tokyo business centers is 70 minutes each way. Tokyo also lacks adequate roads, parks, and hospitals, and existing amenities are not just lagging behind European and American cities but also other Asian cities. If the situation remains unchanged, Japan could well become a dropout even in the face of a world economic recovery.

## **Urban redevelopment can revitalize industrial structure, lifestyle, and social structure**

However, the situation is not without hope. Fundamentally reorganizing the urban structure of low-rise sprawl, consolidating small parcels of land into larger plots and using vacant airspace more efficiently could give citizens of Tokyo more spacious living quarters and more free time. Cities represent a major frontier for investment, and at the same time, redeveloping urban centers can change the industrial and social structure and people's attitudes toward how they live.

Investment should be concentrated in urban centers to fully

draw on the economic potential and be based on a grand design for compact, highly centralized, but comfortable living environments. I call this the "Urban New Deal Policy," and within the Economic Strategy Council, an advisory panel to the prime minister, I have been recommending that urban redevelopment be considered a matter of national strategy.

**Hand-in-hand information technology and urban redevelopment: essentials for comfort**

Information technology has been singled out as a strategic national policy. How can this be linked to urban redevelopment? Once developed, IT is beneficial and makes life more convenient, allowing vast amounts of information to be transmitted quickly. But genuinely important information and thoughts can only be achieved appropriately through face-to-face meetings. Cities are above all places that make human interaction, exchange of information, and sharing of thoughts possible.

Truly attractive cities are those in which leaders in various fields get together with their peers, to open up opportunities for new ideas and new business models. Creating such cities is essential for revitalizing and renewing Japan's strength. In this sense, IT and urban redevelopment go hand in hand and are essential for the creation of a comfortable lifestyle.

World history demonstrates that in every era, prosperous civilizations have built great cities that prospered for many generations and created urban cultures and lifestyles. Those cities also played the role of catalysts for attractive societies and information exchange in business as well as tourism.

With an aging population and a declining birthrate, Japan cannot hope to enjoy the same strong economic growth as in the past. Today, as individuals hold vast pools of financial assets totaling 1,400 trillion yen, we have one last chance to lay the foundations of a prosperous urban lifestyle for the future. Good quality social and the urban infrastructure stock we build today will serve as a firm groundwork for the mature society to come.



**Compact high-rise cities integrating work, housing, recreation, education, caregiving, and leisure**

To revitalize and boost the attractiveness of urban centers, it is vital to consolidate small plots of land into larger parcels and to build high-rise buildings, while retaining and effectively increasing sufficient open space. Efficient land use should free up space for open green areas, thereby improve the urban environment, create compact, integrated high-rise cities which incorporate areas for work, housing, entertainment, education, caregiving, and relaxation.

Efficient land use would double the space available to individuals for housing and daily activities, and they could, simultaneously, enjoy more free time by living closer to their work place. People could spend more time with their families or on hobbies or studying. This would help create more diverse lifestyles, stimulate new demand for consumption and services and invigorate urban-based development such as entertainment, culture, education, and information that will propel the Japanese economy in the future.

Earthquake-resistant high-rise construction technology has made great strides in recent years, allowing safe buildings to be erected at a reasonable cost. In today's environmentally-conscious times, it is not sustainable nor acceptable to continue the custom of "scrap-and-build" over a relatively short time cycle which has long been widely accepted in Japanese cities.

Now that buildings can be constructed to last 100 or 200 years, we also need to develop appropriate new attitudes to living in such spaces. Rather than clinging to the traditional ideal of single-family homes on tiny lots, people will be able to enjoy higher standards of comfort if they choose to live in urban settings where facilities, open spaces and the total environment are shared efficiently.

**The "Urban New Deal Policy" implemented through projects currently underway**

All of the above is not simply a pipe dream. Through the Atago Green Hills and Roppongi Hills development projects, Mori Build-

ing Company. is currently engaged in works to put into actuality the "Urban New Deal Policy" I have just described.

The Atago Green Hills project, scheduled for completion in October 2001, is designed to preserve the lush greenery of the historic Atagoyama Hills area. The mix-use complex harmoniously combines Seishoji, a Buddhist temple standing on the site, with twin high-rise buildings for office space and residences. Furthermore, Roppongi Hills, which is now under construction to be completed in spring 2003, is based on the concept of a "cultural heart for Tokyo." The complex is an integrated, mix-use development with a 54-story office building, 800 residency units, a panoramic art museum 200 meters above the ground, a hotel, cinema complex, retail shops, a broadcasting center and other urban amenities, and will also offer open spaces through the preservation of the gardens of the ancient *daimyo* (feudal lord) estate of the Mohri family.

Each of these projects has been designed to make the optimum use of existing local features and offer a rich and varied urban living experience. The projects have been praised as genuine models of urban redevelopment, and we hope that they will provide the impetus for the creation of an affluent environment and fulfilling lifestyle in a comfortable urban setting.

# Is It Really in Japan's Best Interests?

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On May 2, 2001, U.S. President George W. Bush announced a new missile defense program. The Junichiro Koizumi administration thus far has gone little beyond showing “understanding” of the program, while at the same time continuing with joint Japan-U.S. technological research on theater missile defense. In the not-so-distant future, however, Japan will be pressed to commit itself to a clearer position regarding the missile defense program.

What stance should Japan take? Any serious discussion of this question must involve evaluation of the new defense program from the viewpoint of Japan's national interest. How will the program be useful? Will it be technologically feasible? How much will it cost? What impact will it have on international politics and security? Japan must judge the program comprehensively, bearing these questions in mind.

**The program is aimed partly at defending the United States and its allies from attacks using weapons of mass destruction and ballistic missiles launched by “rogue” countries**

Why does the Bush administration give such high priority to missile defense? We may suggest five main reasons.

First, an effective missile defense system will defend the United States and its allies from attacks by “rogue” countries using weapons of mass destruction and ballistic missiles.

Second, President Bush and his advisors seem to feel a moral obligation to unilaterally reduce its nuclear arms to the minimum necessary level for assuring the security of the United States and its allies. This is the eminent reason the Bush administration has cited for its promotion of the missile defense program. After all, since the Cold War came to an end, Russia’s nuclear weapons no longer pose a serious threat to the security of the United States and its allies, while real danger lurks in the proliferation of weapons of mass destruction and the missiles that carry them as warheads of such “rogue” countries as Iraq and the Democratic People’s Republic of Korea.

Third, since the end of the Cold War—until the recent terrorist attacks—the United States enjoyed a singularly fortunate security environment in which virtually no direct threat to its homeland was thought to exist. The U.S. assertion of the need for a missile defense system, which often seemed excessively adamant from the viewpoint of other countries, was surely derived from its fervent desire to make that historically rare situation as permanent as possible. Given its geographic situation, bound on east and west by oceans and on north and south by states that are not militarily strong, the only kind of attack on the United States that might inflict large-scale damage within its borders would be that launched by weapons of mass destruction or by missiles. It can be assumed that the emphasis being placed by the Bush administration on the missile defense program stems from the intent to either eliminate or considerably reduce such exterior threats.

Fourth is the overwhelming superiority of the United States in high-tech conventional weaponry. American political scientist Kenneth Waltz has asserted that, in a world of nuclear weaponry, it is possible for a country with less than half the economic power of the strongest country to be a great power, but in a world of conventional arms, without nuclear weaponry, only countries with economic power on a par with the strongest country can become great powers. An effective missile defense program would theo-

retically be able to negate the destructive power of nuclear and other weapons of mass destruction. In other words, a world that is virtually free of nuclear threats could be realized. China and Russia would be unable to resist the United States using military power and American hegemony around the world would become solidly established for the long term. This is probably the kind of situation that the Bush administration aspires to achieve.

The profit-seeking motives of the U.S. arms industry, furthermore, should not be overlooked. Defense-related industries are a traditionally strong support base of the Republican Party. The prospect of the new missile defense program, which is expected to require tens of billions of dollars to develop, is appealing indeed to corporations that have faced increased cutbacks in military budgets since the end of the Cold War.

**The idea of the missile defense program per se would serve the interests of Japan's security policy, the basic principle of which is "exclusively defense-oriented defense"**

In what way, then, will the Bush administration's new missile defense program be beneficial to Japan?

Missile defense, which is by nature a defensive system, would suit the basic principle of Japan's "exclusively defense-oriented" security policy. If this defensive weaponry really had the capacity to render the weapons of mass destruction and missiles of other countries powerless, it would have great appeal for Japan. Such protection could eventually eliminate the need for the U.S. nuclear umbrella, an arrangement that would resolve the awkward dilemma Japan has long struggled with as an advocate of nuclear disarmament also in need of protection from nuclear threats. In addition, Japan would acquire all kinds of new technology and enjoy great economic advantages spinning off from development of the system. Tokyo's active cooperation in the program would deepen Japan-U.S. ties and have favorable effect on the bilateral alliance. If Japan were reluctant to support the program, on the other hand, it would have to prepare itself for friction in its relations with the United States.

**Japan will have to be ready to bear huge financial costs amounting to trillions of yen**

The new missile defense program also poses some serious problems for Japan, preeminent among which is the enormous financial investment it would have to shoulder. Currently the outlines of the program are not concrete and an accurate calculation of the development costs is impossible, but some observers estimate that trillions of yen would be required of Japan alone. Having been forced to reduce its defense budget in recent years, Japan needs to consider carefully whether the financial burden of missile defense might actually work to promote the nation's defense capability as a whole. Japanese should not forget, moreover, that the technological wherewithal for the new program has still not been clearly defined and that even in the United States, quite a few specialists doubt its feasibility.

Second, China and Russia are strongly opposed to the program. The danger that the two countries would react to the program by strengthening their nuclear arms and offensive missile systems, exacerbating Japan's security environment, cannot be dismissed. Japan's active participation in such a program could seriously undermine relations between Japan and China.

Third, the deployment of a missile defense system might make Japan even more dependent upon the United States for its security. Japanese Defense Agency Director-General Gen Nakatani has stated that Japan would operate the theater missile defense system on its own. In reality, however, Japan must depend on the United States for intelligence about immediate missile attack threats, at least for the time being.

Fourth, the new missile defense program would blur the distinction between theater missile defense and the national missile defense programs. The new program features interception of missiles immediately after their launching. Although not a problem as long as the program is in the development stage, once such a system were actually deployed, Japan would be forced to reconsider its policy concerning the ban on the exercise of the right of collective self-defense.

Taking the above points into full consideration Japan should

formulate its position on the new missile defense program autonomously and in accordance with its national interests. The idea of missile defense per se suits Japan's needs well, but it needs to consider carefully the feasibility of realizing such a program and assess both its merits and its drawbacks. The motivations of the United States, the ramifications for the Japan-U.S. alliance, and the implications for regional and global security must all be kept in mind. It is not appropriate to discuss either support of or opposition to the program for passive reasons, such as opposition by China or reluctance to incur the displeasure in Washington.





# Reforms Needed to Encourage Remaining Productive Throughout Life

*Atsushi Seike*

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As the birthrate continues to decline and the population ages, the outlay for social security—pensions, health care, and nursing care—will inevitably rise. Under the system that sets the retirement age at 60 today, the cost of supporting retirees is borne mainly by the working population under 60, making the per person total tax and social security burden very high. Cutting back radically on pension, health care, and nursing care benefits, on the other hand, runs counter to pursuit of affluence toward which society aspires.

## **Using to full advantage the potential of senior workers is thwarted by the mandatory retirement**

In such a scenario, policies are needed that would allow seniors willing and able to work to do so as long as possible. If the older population remains active, they will also pay social security premiums and taxes, thus broadening the base for contributing to social security expenses, which are increasing as the population ages. But the current social system impedes the promotion of employment for older persons, which is the best case scenario over the long term, and the mandatory retirement system is a typical barrier.

This system, where individuals are forced to retire at a specific

age regardless of their willingness to work and ability to perform, runs counter to the nature of the society of the future. In fact, empirical studies of labor economics show that the mandatory retirement system lowers the labor force participation rate among older people. And even if individuals do find a post-mandatory retirement job, the possibility of working in a post where they will be able to use their accumulated experience is lower than if they have not been through mandatory retirement. In the future, a society where people are active throughout their lifetimes will be necessary, and to achieve this the mandatory retirement system, which discourages older people from using their abilities, should be abolished.

**Fundamental revisions are needed in the restrictions on income imposed on seniors after retirement**

Another factor that discourages seniors from continuing to work is the public pension system itself. Since the government policy of promoting the employment of older individuals is aimed partly at broadening the taxpayer base in order to foot social security expenses, a pension system impeding employment in the later years is incompatible in terms of policy. The public pension system, in particular the government-managed pension plan for corporate employees, must be changed to encourage elders to work and use their abilities to the full.

Again, labor economics studies show that the employee pension system saps motivation to work among seniors and that if they do work, they have fewer chances of utilizing their abilities on the job. This occurs in two ways. First, since most retirees feel their pension benefits are sufficient for meeting their living expenses, they feel less need to work. Retirement is a positive development in that it gives individuals more freedom, and pensions are good insofar as they allow people who want to retire to have that freedom.

Second is the restriction on earnings concurrent with receiving employee pension benefits. Under the current employee pension system, retirees have the right to receive a pension, but if they continue to work their pension benefits are reduced in proportion

to their earnings. In other words, the system imposes a de facto penalty on older people who work.

As a result, elders who want to work may give up on the idea, or if they do work, they may be tempted to take a job that pays on a level that will not unduly affect their pension benefits rather than a position where they can exercise their capacities to the full. In fact, it has been demonstrated that older workers tend to work only up to the maximum level of work-related income so that their pension benefits are cut by no more than 20 percent.

The United States, too, had formerly imposed earnings tests where social security benefits are concerned. The detrimental effect of this policy on retirees taking post-retirement jobs became an issue and the earnings test was abolished in January 2001. Japan should also undertake a fundamental reevaluation of its earnings test system, which impedes older people from using their job-related abilities.

Some may question why older people earning high incomes through work should receive pension benefits at all. In such cases, income can be redistributed by taxing these individuals on their total income from pension benefits and employment. To achieve this, preferential measures, such as treating pension benefits as temporary income and deductions granted for pensions, should be abolished simultaneously and taxed in the same way as employment income.

### **More opportunities should be available for investing in personal development throughout life**

The mandatory retirement adopted by corporations and the public pension system should be reformed to allow willing and able seniors to work as fully as they can. The prerequisite for this, however, is that individuals have abilities that make it worthwhile for companies to hire them. This means that individuals should invest in personal development from a young age, endeavoring to acquire work skills that are in demand.

Labor economic studies also suggest that individuals can achieve a longer working life by acquiring higher levels of ability through higher education and (in other respects, such as) devot-

ing time and resources to maintaining good health. People need to invest in themselves so that they are able to work to the best of their ability when they are older.

Until now, employee education and training has been undertaken mainly by enterprises, and skill-development programs tend to focus on younger people. With careers growing longer on the one hand and periods of secure employment becoming shorter, however, individuals need to keep themselves employable when enterprises trim their work forces and they reenter the labor market looking for a new job. This means acquiring useful skills, even if they must learn through programs outside the company. Given that current employers are not willing to provide and pay for skill development training that would benefit other companies, individuals must pay at least part of the cost themselves. They may have to enroll in outside training programs to take advantage of chances to acquire new skills and knowledge.

Accordingly, it is important to create an environment that will allow public vocational training facilities to offer a wider range of programs and (to) make it easier for private sector training organizations to operate. Another vital aspect is providing public funds to assist individuals paying for training out of their own pockets, but, since skill development is a form of personal investment, assistance should take the form of loans rather than subsidies. Today, steps must be taken to provide more opportunities for individuals to invest in personal development throughout their lives.

# The Fight for Collective Security

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The September 11 terrorist attacks on the United States posed a major problem for the global system of the twenty-first century, because depending on how the world community's response, the new century could be overshadowed by terrorism and fear. It was deemed essential to bring to justice the individuals and groups responsible for these terrorist acts and to eradicate their organizations, networks, and funds to ensure that such acts would not be repeated. And if certain countries supported the activities of such groups, they had to be identified as responsible and steps taken to make it impossible for them to offer further support.

## **Not just a fight for self-defense but for the collective security of the world community**

Although little need be said to justify the legitimacy of this fight to eradicate terrorism, in legal terms the action represents the right to self-defense of all responsible nations in the international community, including Japan, and is considered an action to guarantee collective security. For Japan, this means starting from the realization that twenty of its nationals were intentionally killed. If this kind of terrorist network is allowed to exist, there is a very strong risk that Japanese lives will once again be imperiled, so our action is one of self-defense.

Further, in terms of the international community as a whole, as UN Security Council resolution No. 1368 states, terrorism is a threat to global peace and safety. In that sense, a fight in self-defense by many countries is already part of the battle for collective security of the global community.

At this point, it is formalistic to argue [—as some are doing in Japan—] that there needed be a UN resolution that would state in more strongly worded language that this is a fight for collective security and that UN member countries should take strong measures. Most of the countries preparing to join the fight against the terrorist acts perpetrated, including China and Russia, are not that particular about the need for a pro forma UN resolution, although it is desirable for the UN to draw up resolutions as needed, as in the case of the one adopted at the end of September freezing the funds of terrorist organizations. However, it is incorrect to assume that no moves toward collective security cannot be taken in the absence of such resolutions. In any case, we should be more aware that the fight against terrorism being waged by the countries of the world, including Japan, under the leadership of the United States, is a fight in self-defense as well as a battle for the sake of the collective security of the world community.

**The “Basic Policy” and “Immediate Measures” are praiseworthy**  
In his policy speech at the Diet on September 27, prime minister Junichiro Koizumi stated that “I talked with President Bush of the United States on September 25 and we are agreed on the need for all the world’s countries to band together and take a firm stand in combating terrorism. I further conveyed to President Bush that Japan offers the United States its strong support and will take all measures possible in response to the terrorist acts. Terrorism is Japan’s problem too. We will take effective measures against the threat on our own initiative as well, working in cooperation with the international community.”

This is indeed the correct approach, although it must be said that the Koizumi Cabinet’s response immediately after the events of September 11 was initially somewhat weak. Some of the points on which the Cabinet may be faulted are the fact that prime min-

ister Koizumi failed to hold a press conference stressing a firm stand against terrorism immediately after the tragedy, and that a memorial ceremony for the victims only took place only on September 20. Holding the ceremony was certainly a positive undertaking, but it should have been held earlier. However, the Basic Policy and the Immediate Measures, announced on September 19, are excellent and deserve strong praise. In addition to paving the way for Japan's Self-Defense Forces to provide medical, transport, and supply assistance, the measures were comprehensive as they also included domestic security (providing security for U.S. military bases, as well as other important facilities, in Japan), information-gathering activities by Maritime Self-Defense Force ships, and so on.

### **Japan already acting in self-defense and toward collective security with many countries**

These measures were appropriate, because even if there had been no debate over the Constitution relating to security it was obvious that, given the country's actual capability, these should be Japan's main activities. They were not decided upon because they were all Japan could do within the scope of restrictions imposed by the Constitution. When Japanese really think of what their country can do in the fight against terrorism, medical and rear-echelon logistical support, domestic security and information-gathering are the areas where its actions will be the most effective.

In my view, Japan is already taking part in self-defense and collective security together with many other countries. The contention that such actions are linked with military action and, therefore, the same as exercising the right to collective self-defense, which is forbidden by the Constitution, is a quibbling argument at best. Such a pointless argument should never be allowed to impede the effectiveness of Japan's actions.

### **The vital issue now is defeating terrorism**

Some, especially within the ruling Liberal Democratic Party, complain that the Koizumi Cabinet's response, with the prime minister taking the initiative, is "undemocratic" or "makes light of the

Diet." This is an utterly disgraceful attitude that fails to show any understanding of the concept of leadership in an emergency. After all, is not prime minister Koizumi the leader of the LDP?

In the future, Japan's security policies will not focus solely on the fight against terrorism. However, the vital issue at the moment is that the international community must defeat terrorism.

The United States forces began bombing Afghanistan on October 7. In Japan, the special measures law on counter-terrorism was enacted and the prime minister declared that "the framework allowing Japan to cooperate with the international community at its own initiative is in place at last." The aim of the new law, however, is not to support the United States. The issue, which must be squarely faced, is self-defense as a democratic nation.



# Openness Is the Best Option

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Discussions of the best course for Japan for the new century are invariably argued in excessively broad and sweeping terms. "But it's much more complex than that!" is the inevitable reaction. Discussion in extremes can sometimes nevertheless, be useful. It helps organize conditions according to ideal type. Japan currently stands at a critical juncture, at which it badly needs to adopt a fundamental course to guide it in the coming decades. Here, I would like to set forth the options in the economic and foreign policy realms as I see them, hoping that this perspective will stimulate further discussion on the subject.

## **Globalization has many merits in terms of economic efficiency and fairness**

To be active in responding to globalization? Or to be passive? To maintain traditional Japanese economic practices and frameworks? Or to pursue reform? These are the questions.

Partly occasioned by the disappointments of the World Trade Organization meeting in Seattle in late 1999, anti-globalist sentiment has been on the rise worldwide. In Japan, in opposition to the government's campaign to advance structural reform aimed at deregulation, privatization, and the stimulation of market func-

tions, the movement to harbor established systems and practices is deep-rooted.

A proponent of globalization for my own part, I believe globalization has more advantages than otherwise in terms of economic efficiency and fairness.

In its postwar process of catching up with the developed countries, domestic and overseas liberalization combined with regulation-oriented approaches set the tone of the Japanese economy, setting it on the path to rapid growth. Once the catch-up process was complete, however, Japan began to reveal an embarrassing inability, both in the government and private sectors, to accommodate to the changed circumstances of economic growth, whether in responding to technological advances or in dealing with the aftermath of the overheated "bubble" economy.

This poor handling may stem from the difference in the importance of market competition between the catch-up process and the front-runner pursuit of further growth through trial and error. Or it may be because, due to different technological conditions, the economic system desirable for driving the era of information and computerization may be quite different from that which functioned dynamically in an era dominated by heavy and chemical industry.

The notion of turning its back on the world has never been an option for the Japanese economy. Japan has no choice but to resolutely meet the challenge of globalization in order to revitalize its economy.

**In the process of globalization, the industrial structure and people's lifestyles have to change in accordance with the transformation of the price structure**

Globalization will ultimately create a borderless economy, or at least push the world economy in that direction. In that case, the difference between domestic and international (tradable) goods will shrink, in theory leading to factor price equalization. That will further increase the efficiency of the economy, bring down the prices of the goods that are comparatively higher than in other countries, as well as restrain excessive overseas investment, which

will in turn prompt a rise in domestic investment opportunities and improvement in the national standard of living.

During that process, of course, the industrial structure and people's lifestyles must change in accordance with the transformation of the price structure. The increasing number of countries catching up with Japan will mean higher standards of living in those countries and Japan and a reciprocal expansion of their mutual markets, accompanied by appropriate foreign exchange adjustments. Like Japan in the past, developing countries will probably not appreciate their own currencies until full employment is achieved, and so it is likely that Japan will face tough industrial adjustments during that period.

Japan must further the process of industrial adjustments promptly, and in doing so, must strive to open its market wide and face competition squarely. To choose any other option would set the country on a demoralizing path of gradual economic decline.

Many argue that to permit free competition will ultimately result in unequal distribution of income. I would call for more attention to be focused on the unfair and unequal distribution of income that has been the result of regulations and customary practices that favor vested interests.

A look at wage premiums by industry after adjusting for factors of academic background and length of career, reveals that the premiums of the industries protected by government regulations are much higher than those in the industries that have tried hard to improve productivity in the face of fierce competition at home and abroad. Globalization will help to encourage information disclosure and expose hidden vested interests to healthy competition. In judging the fairness of income distribution, it is necessary to properly evaluate the element of risk taking, which is the true test of a front runner.

**While attaching importance to its alliance with the U.S. Japan should seek to cooperate with China and Asia as a whole**

China, it is increasingly certain, will be a world economic, political, and military power in the twenty-first century. Although rarely

referred to in Japan, the World Bank's estimation that China's gross domestic product in terms of purchasing power parity has surpassed that of Japan to become the second largest is well known in China.

The anti-hegemony clause in the Japan-China Treaty of Peace and Friendship may have been targeted at Japan at the time the treaty was signed in 1978. Today, it is obviously China, not Japan, that is capable of becoming a hegemonist power (regardless of whether or not it intends to do so). To risk oversimplification, I would venture to ask: Will Japan stress its alliance with the United States? Will it seek to cooperate with China and Asia as a whole? Will it opt for "splendid isolation"?

I personally believe that Japan's foreign policy should center on its relationship with the United States. The two countries share commitment to the principles of the market economy and liberal democracy and have achieved the ideals of both to a considerable degree. China, on the other hand, still maintains the single-party system and the future of its domestic system is not necessarily certain.

While I would advocate the strengthening of Japan-U.S. ties, this should not be done in such a way as to cast China as adversary. The future outlook of China in my view is such that from the standpoint of national interests Beijing will adopt a diplomacy of peace and coexistence with its door wide open to the outside in order to sustain its economic growth and to go on building its national strength. As its economy grows strong, respect for human rights and liberal democracy will progress there. Given its traditional acumen in international affairs, there is a good possibility that China may pursue amicable relations with the United States. Japan's turn to be isolated in the international community may come around again. For Beijing to choose a path to hegemony and isolation, on the contrary, would be an unhappy choice for Japan and other countries and the possibility of China's sound growth would also decrease by that much.

### **Japan should be ready to become fully open to the world**

Actual relations between Japan, the United States, and China may

experience complex turns and twists. Even in such cases, Japan's basic stance must be to hold fast to the market economy and liberal democracy. That is Japan's only choice, and to maintain that stance it is vital to build sufficient national strength, economically and politically.

At the same time, Japan will have to promote friendly ties with Korea, the ASEAN nations, Australia, New Zealand, Canada, and other countries, and welcome and facilitate EU and Russian contacts with Asia. Japan will thus have an important role to play contributing to the growth of Asia. With firm resolution Japan will have to be fully open to the global community, both in its economy and its foreign policy.



# The Time Has Come for Real Structural Reform

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Every time administrative reform is put on the agenda, re-assessment and reorganization of the government-affiliated corporations becomes a major issue. This is because the government, despite its strained fiscal situation, continues to pump trillions of yen into these bodies: special public corporations and “authorized” public corporations together receive an annual total of 5.3 trillion yen in the form of subsidies and other assistance, as well as a total of 24.4 trillion yen from the fiscal investment and loan program (known as *zaito*). Other reasons include their inefficient operation, the much-censured practice of *amakudari* that provides jobs to extend the careers—and influence—of high-ranking government officials, lack of management transparency, and the resultant accumulation of enormous debts that will have to be paid by Japanese of later generations. Awareness is gradually building, in fact, that reform of these special bodies is the key to treating deeply rooted weaknesses in the social and economic structure of the nation.

## **Relations between public and private, between national and local government must be reviewed**

In principle, public corporations exist in order to implement government policies. While streamlining of their management is clearly important, the basic approach in reforming these bodies

ought to begin with determining whether or not such implementation should be undertaken by the public sector in the first place. Relations between the public and private sectors and between the national and local governments must be reviewed before anything else. In other words, national policies themselves should be called into question, and therefore, the reform of government-affiliated corporations is essentially structural reform of the government.

Another reason for prompt action this time is that the Cabinet is headed by Junichiro Koizumi, who is an ardent advocate of reform. Without a tough—just plain stubborn—stance on reform like Koizumi's it would be impossible to change these government-run entities. Meanwhile, the reform of these corporations is a final step of the reorganization of central government ministries and agencies, which was enforced last year. The recent establishment of a new system of independent administrative institutions on the basis of critical assessment of existing special public corporations naturally prompts a drastic reorganization of such corporations.

**Tokyo Foundation's Policy Proposal for the Review of Individual Public Corporations was announced on November 21**

In December 2000, the Mori Cabinet adopted the Administrative Reform Outline, took up the public corporations issue as a key item on its agenda, decided what items were to be examined, and established a timetable. The Outline called for a thorough review of all 163 special and "authorized" public corporations. (In December 2001, the Cabinet approved reform plans to scrap 17 special public corporations, privatize 45 others, and reorganize 38 others into independent administrative institutions.)

The government is following an orthodox approach of first reviewing the projects of each public corporation first and then deciding what to do about the organization itself. At each juncture a report is published comparing the opinions of ministries and agencies with which the corporations are affiliated and those of the Administrative Reform Promotion Secretariat. Such an effort to maintain the transparency of the reform process is laudable. But considering that the review of public corporations projects means



the review of government policies, the Administrative Reform Outline blatantly lacked a mechanism for assessment by a third party of the review process.

We at the Tokyo Foundation keenly felt this lack, and judged it necessary to conduct research and present policy proposals from the standpoint of the private sector. We launched a project for that purpose and started organizing and analyzing materials, and gathered perspectives from opinion leaders, businesspeople, lawmakers, and executives of major corporations, among others. In the meantime, the government's August 10 announcement of its position concerning "the review of individual projects of public corporations" prompted the Foundation to publish an interim report on "the approach to reform" on August 14. We summed up the results of our research in the form of a "Policy Proposal: Tentative Plan for the Review of Individual Public Corporations", and briefed opinion leaders and representatives of the media on November 21.

### **The proposed direction for the reform is to scrap or privatize most of the public corporations**

The main points of the Tokyo Foundation's interim report of August 14 are outlined here, for these were the points used as specific guides in the review of the public corporations.

1) In principle there are two options, privatize or scrap. What can be done in the private sector should not be done by the public sector. What the local government can undertake should not be undertaken by the central government. The first criterion of the reform process is to ask whether the central government should be involved or not. Those projects that the central government should not undertake should be eliminated, or privatized, or left to the discretion of local government. Criterion two, even projects the central government should undertake, if there are alternative measures, should be eliminated, privatized, entrusted to the private sector, or left to the discretion of local government.

Criterion three, if there are no alternative measures, they should be scrapped if the cost is higher than the benefit. And criterion four, if the benefit is higher than the cost, public corporations in

charge of these projects should be either merged with independent administrative institutions that handle similar projects or reorganized into new independent administrative institutions, if there is no such institution.

2) Necessary measures (legal and financial measures, job placement of former staff and employees, etc.), procedures, and so forth, that will accompany the elimination and privatization of public corporations should be specified.

3) Only with the support of citizens can the reform be realized, so the reform process should always be kept transparent and the government should thoroughly fulfill the accountability to citizens.

4) A "Public Corporation Management Agency" will be set up within the Cabinet Office, to supervise and support independent administrative institutions, public-interest corporations, etc. In Japan all special and other public corporations are affiliated with particular ministries and agencies. They have served as an instrument for implementing the work of their ministries and agencies. While that has been considered the rational approach, the arrangement has caused many problems, such as collusive management of work resulting from the influence exercised by retired government officials who are re-employed in public corporation executive or honorary positions.

The November 21 policy proposal, "Tentative Plan for the Review of Individual Public Corporations," lists all the 163 special and other public corporations, giving their names, major projects, our assessment of these projects, our suggestion for abolition, privatization, etc., of each corporation, as well as remarks. We screened each corporation using the four criteria of the reform process described in the August 14 interim report, and made judgments not colored by political factors. The proposed direction for the reform was to scrap or privatize most of the public corporations. (For details, see the Tokyo Foundation website, <http://www.tkfd.or.jp/jp/research/index.html>)

Needless to say, this proposal faced stiff opposition from the public corporations in question, the ministries and agencies with which they are affiliated, the industries concerned, and the "tribe"

politicians who act as protectors and benefactors of specific industries. The general public itself has been skeptical of the proposal, a tendency that we also anticipated. People are accustomed to the existing system and the Foundation's proposal meant starting something totally new, so their concern is quite natural. This apprehension is largely due to lack of full and updated information about the real conditions of public corporations and the orientation of the reform.

### **The crux of reform is to reaffirm basic principles**

What became ever clearer when the proposal was presented was that the public corporations in question and their ministries and agencies and "tribe" politicians blindly believed that their projects could be entrusted to private enterprise or local government. They were and still are persuaded the work is something only the central government can properly handle. They also are opposed to the Tentative Plan's call for elimination or privatization of governmental financial institutions. They argue that because private financial institutions will not lend money to small and medium-sized enterprises, government-run financial institutions must be preserved, and they point out that, in fact, such institutions are playing a vigorous role at a time when business is sluggish.

That is a result, however, of the fact that all the ministries and agencies have relied on their own financial institutions, refusing the business of private banks. If they argue for the necessity of long-term, low-interest, and fixed loans as the reason for the continuation of governmental financial institutions, this could be done in the private sector. We would propose—at the expense of a considerable compromise—that the target of loans should be clearly defined and that the job be handled by private institutions while the government provides guarantees and subsidizes interest payments.

The crux of the reform is reaffirmation of basic principles. The existing public corporations system has been one in which demands are always overestimated, expenses are always underestimated, and the repayment of debts from borrowing enormous funds from the *zaito* and other governmental loan programs is

put off several years, or several decades, which means that later generations will be the ones stuck with the bill. Those currently in charge of such corporations should be called on to take responsibility. These corporations are not being run as business-like entities. The reform this time targets this system.

# Achieving Worthwhile Economic Policies

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A concise answer when asked how to rate economic policies of the Koizumi administration would probably go like this. The critical point to rate is how well methods for managing the new economic policies are implemented. One problem here is that the contents of these policies are not clear. So the big issue this year will be trying to maintain economic policy management techniques that were instituted last year. This means using economic policies that have real meaning.

**A lot of attention is being focused on the Koizumi administration at a time when the Japanese economy is hitting its worst slide since World War II**

The nation as a whole is watching with a lot of interest where the Koizumi administration is going with a great deal of attention being focused in particular on his economic policies. In a hard-pressed economy operating under the tough initial government bond restriction of 30 trillion yen, there is no lack of crucial issues such as road budgets and corporate problems to stir up a fiery response from ruling party members.

The fact that since the latter half of last year, the Japanese economy seems headed for its worst state since the end of World War II is the likely reason the Koizumi administration is the subject of so much recent attention. Certainly an administration that

has to manage the economy amidst ever louder cries for financial improvement, and a current outlook that still offers no escape from the delinquent stock-credit problem has created a delicate set of circumstances where handling of the economic and bad judgments will invite a flood of harsh criticism from the people.

**Biggest results from Koizumi economic policies are seen in methods rather than content**

Up till now the biggest results achieved by Koizumi economic policies has been in their application rather than content. Past administrations have reacted to each situation as it occurs, and the direction administration policies were taking was not clear. You might call it choosing the easiest course. The Japanese economy is headed for a major turning point and reacting to individual problems without an overall goal will simply make the nation's people more dissatisfied and insecure.

The Japanese people are steadily losing sight of where their economy is headed. Everyone knows that major reforms are needed but generations of prime ministers have been left powerless in the face of pressure from conservative elements, while the average citizen becomes more and more dissatisfied. The ever worsening economy however led to hopes that Prime Minister Koizumi might succeed where his predecessors failed.

Last year saw a ray of hope, in future Koizumi administration policy-making strategy. The cabinet issued clear government policy guidelines which were then adjusted by working with the ruling parties. The cabinet confronted a segment of the ruling party members who were opposing them and succeeded in moving ahead with their policies. A great many of the nation's people probably assumed that if Koizumi could continue in this way, then economic policy would be run from a position of power and influence rather than by "choosing the easiest course."

**First point: how to proceed with corporate reform and financial restructuring**

Notwithstanding those results, the same techniques used in those powerful frontal assaults on road and corporate problems could

have been used to resolve other problems. The critical issue from hereon is what to do to get worthwhile policies. These policies are a problem since they have not assumed a clear shape but future economic shifts will likely make the following 3 points extremely important.

Point 1: How to proceed with corporate/reform and financial institutional restructuring that came out last year. Due to the powerful resistance encountered last year, these reforms are still incomplete. It is vital that these reforms continue to be quietly and steadily implemented according to the scheduled reform process. The problem of roads which has been put off will probably see a lot of fiery debate but this problem has to be faced and dealt with firmly. The economy is in a constant state of flux and other major problems are constantly appearing but even still, shelving this problem for future consideration is a big mistake.

In financial restructuring and reform, the Koizumi cabinet has done well to treat this a major issue. However trying to stay within the reckless 30 trillion yen limit the administration imposed on itself at least speaks well for their strong desire for fiscal reform.

The problem is how to proceed in making fiscal structuring reforms from here onward. The fiscal issues involved in making these reforms a reality will take time. What is needed is fiscal reform planning such as presented by the Hashimoto Administration. This is a very big job, yet is a totally necessary process.

**Point 2: Responding to economic circumstances. The fiscal system will face major crises this year that involve big risks**

The second point is the problem of how to respond to future economic circumstances. For the next 6 months, the Koizumi administration will have to face its most troublesome opponent, which is the state of the economy. Considering the present fiscal situation, there is a large risk of a major crisis occurring this March or around September. Large scale economic failures are not only disastrous for directly involved parties such as clients but also can widen their effects to include the entire economy in terms of systemic fiscal risk or the nation's consumer awareness, etc.

The Koizumi administration must not be allowed to hide or

postpone dealing with these kind of risks. If widespread failure does occur they must consider what kind of emergency measures to take in response. What kind of options such as investing capital, nationalizing, special central bank funding are available as countermeasures? Crisis management simulations must be made from now on so that speedy responses will be available if needed.

Needless to say, what everyone wants most is for no fiscal failures to occur. However is the present state of fiscal insecurity, it is important to deal quickly with big problems when they happen. So even if large fiscal failure or bankruptcy does occur, dealing promptly and accurately with the problem will prevent its effects from spreading. This also provides a good opportunity to take action to take other drastic action that may be needed.

An important point to focus on is what economic measures will be taken when economic chaos occurs. The government must not yield in its basic stance of fiscal structuring reform yet must also be flexible enough to meet changing circumstances. In other words, we need them to take that narrow road between a rock and a hard place.

### **Point 3 : What new major economic reform issues to take up and how to deal with them**

The third point to focus on is what new issues in economic reform the Koizumi cabinet will take up this fiscal year and how they will deal with them.

Tax reform is currently getting a lot of attention. Probably another issue will be reviving the economy including ways to create employment and deal with the problem of jobs and manufacturers leaving Japan for overseas locations. Fiscal structure reform and dealing with delinquent stocks and bonds is a negative legacy from the past that has to be eliminated, and coming to grips with these problems brings hope for the future. That's a point to take notice of.





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