

Initiatives toward the Revitalization of Japan

November 21, 2011

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1. Coping with a stalled recovery

vicious circle of deflation, weak demands, low investments, and income decline

- Being caught up in a scenario of the shrinking equilibrium and gradual decline, the economy has the pretense of endurance. No increases in incomes and sales volumes in nominal terms creates a feeling of being trapped.
- Unless the economy shifts to the creation and expansion of value added, it will never escape from the scenario of the shrinking equilibrium and gradual decline.

<Management based on enduring the situation approaches its limit>

< Japan's nominal GDP >

First quarter of 2008

¥ 517 trillion

(on a yearly basis)

Second quarter of 2011

¥ 462 trillion

(on a yearly basis)

Decrease of the nominal GDP by ¥ 50 trillion

Continued deflation
→ Decline of the anticipated growth rate

Slumping domestic consumption

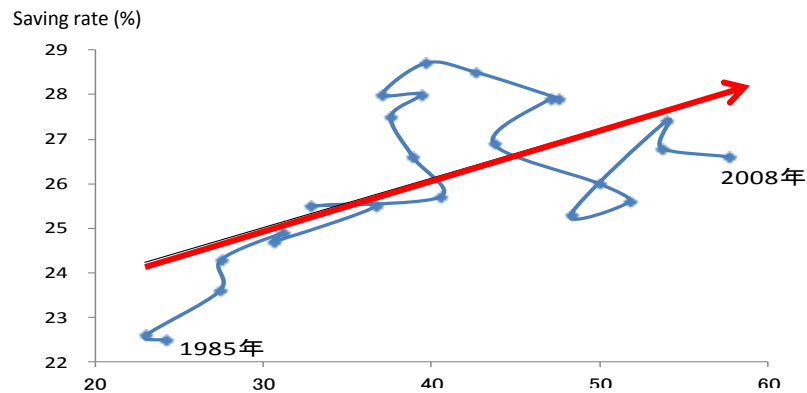
Increased anxiety about the future

A downward spiral of the shrinking equilibrium and gradual decline

< Consumers also endure due to anxiety about the future >

- In Japan, the household savings rate has increased, in line with the growing number of people who feel anxiety about their post-retirement.
- There is a tendency that the people who feel anxiety about their post-retirement will add about 2 to 3 million yen to their amount of savings
→ The anxiety about their old age income leads to restrained consumption (consumption in endurance).

Relationship between the saving rate and "insecurity about old age"



(Source) "Family budget survey" by the Ministry of Internal Affairs and Communications and "Opinion survey on people's lives" by the Cabinet Office

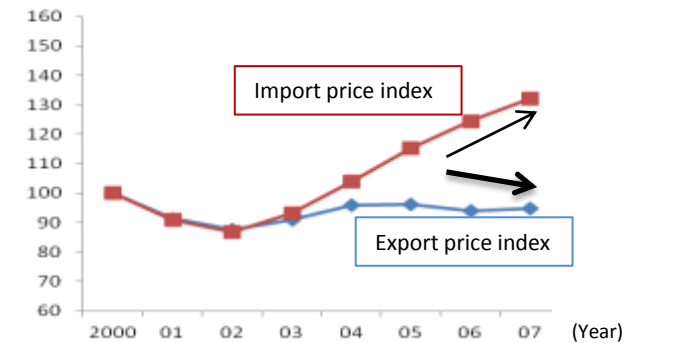
- During the recovery trend beginning from 2002, the compensation of employees and private investment were restrained, and domestic demand could not be a powerful driving force.

- In Japan, the import price index increases, but the export price index is on a downward trend (Worsening terms of trade).
→ Being caught up in a competition of pretended endurance

"Enduring" corporate management
→ Stagnation in value added

→ There is a possibility that the ability to expand and create value added (ability of price shift) is low in current Japanese industries.

(Year 2000 = 100)

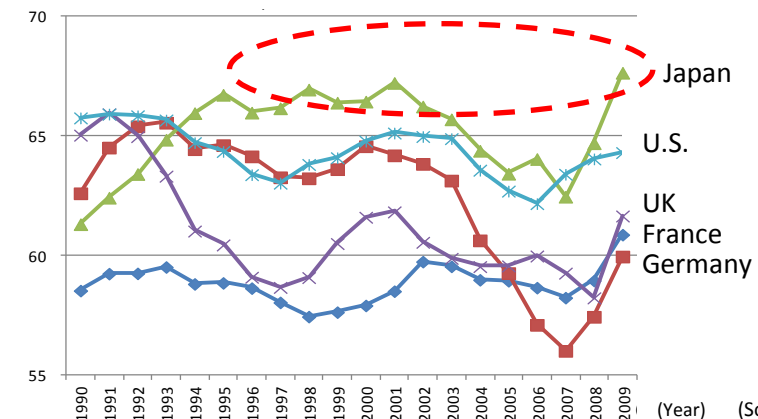


(Source) IMF International Financial Statistics

Worsening employment situation
→ Decline in labor income

- There is a view that even though the compensation of employees remains low, the labor share stays at a high level.
→ Failure to expand value added

(Labor share = Compensation of employees / National income: %)



(Year) (Source) OECD "National Accounts"

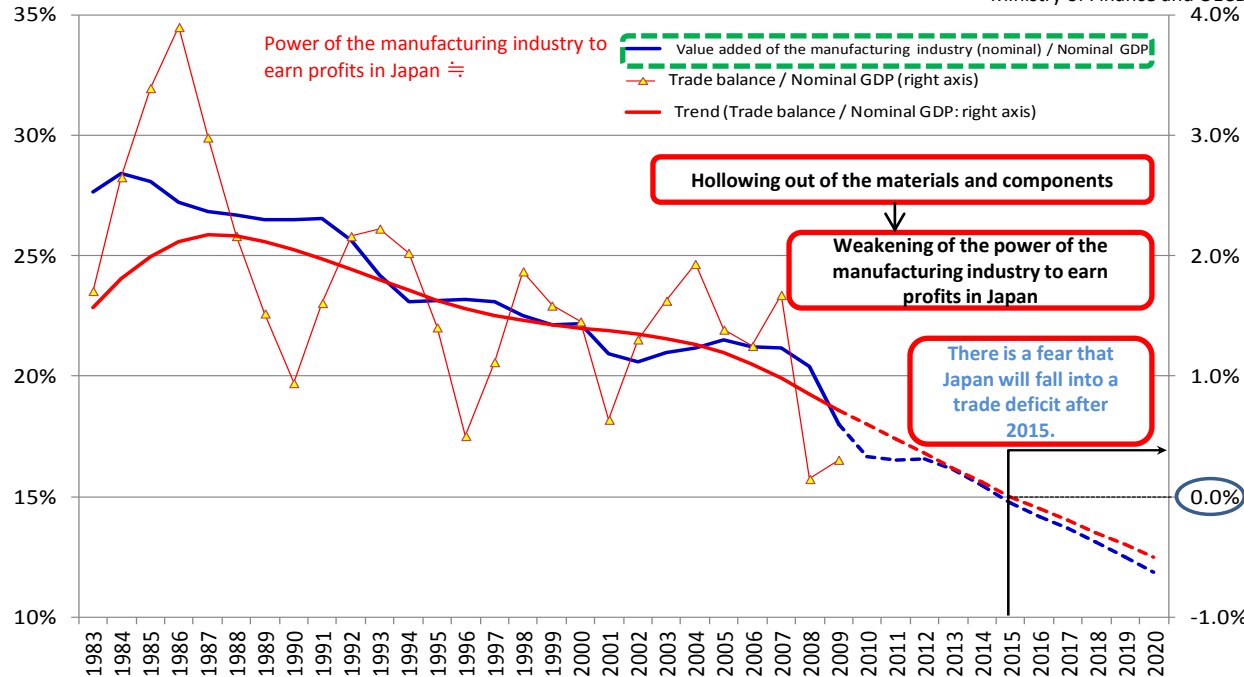
2. A risk scenario if we leave the shrinking equilibrium and gradual decline unsolved

■ The Japanese economy faces two risks: (1) Hollowing out of industries due to a strong yen and (2) Macroeconomic impasse due to current account deficit

<Adverse effect of the hollowing out>

- If the current strong yen continues, there is a fear that the overseas transfer of whole supply chains (including the materials sector) will progress rapidly (complete hollowing out of the industries).
→ The result of the structural change is that industries will not easily come back to Japan even if the yen weakens in the future.
- If the speed of overseas production transfer sharply accelerates, there is a possibility that the speed of development of new domestic business and industries cannot catch up with the speed of the overseas transfer. (When the domestic automobile industry hollows out, it is expected that the labor absorption by the service industry will not be able to catch up and the jobs of about 600,000 people will be lost.)
- If the hollowing out continues, it is feared that Japan will fall into a trade deficit in the middle of the 2010s. Further, if the nuclear power stations cannot be restarted for the time being, Japan will fall into a trade deficit in the next year due to increases in fuel imports for thermal power generation.

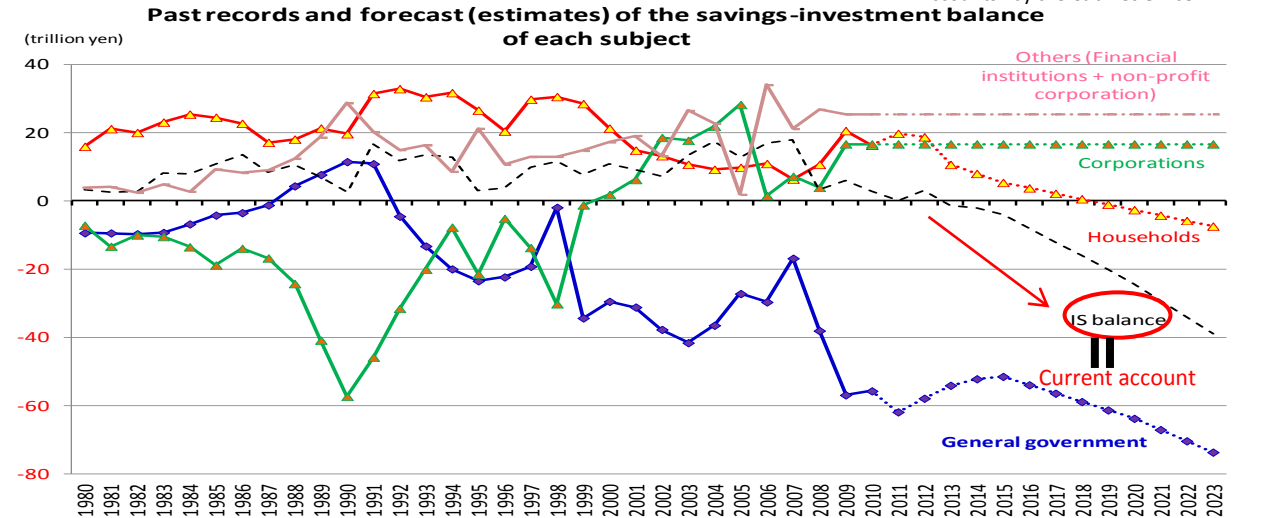
Anticipated transition of the trade balance (Source) Prepared by the data of the Ministry of Finance and OECD



<Macroeconomic impasse>

- It is feared that the savings-investment balance will fall into a deficit in the late 2010s at the earliest.

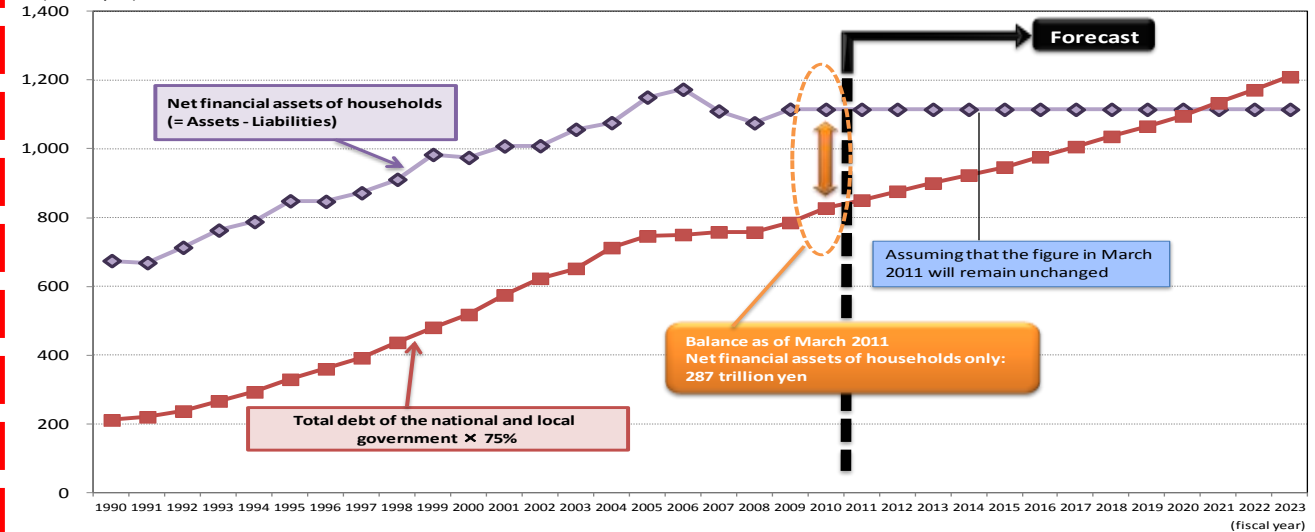
(Source) Prepared on the basis of the "National Accounts" by the Cabinet Office



*IS balance and current account / Current balance = Household IS balance + Corporate IS balance + General government IS balance

- There is a fear that domestic investors will no longer be able to purchase Japanese government bonds.

Transition of the net financial assets of households and the public debt of the national and local government



(Source) Statistics on flow of funds (Bank of Japan), Basic financial-related data (Ministry of Finance) and Medium- to long-term economic and fiscal assets (August 2011, Cabinet Office)

Disappearance of ability to purchase JBGs in stocks and flows

Current account falling into a deficit
Personal financial assets < Government debt



Raid Japan-selling

Rising long-term interest rates (plummeting prices of government bonds) → budget inflexibility
High inflation
Sharp yen depreciation (industries will not come back to Japan after the "hollowing out of industries by the roots")



Significant Pain to people's lives

Hardship of economically-disadvantaged people (plummeting value of pension assets)
High unemployment rate
Rising mortgage loan interest rates

3. “Defensive” countermeasures against the industrial hollowing out and proper management of the macro economy (ad hoc measures until a future shift to yen depreciation)

In order to cope with the present situation until a future shift to yen depreciation, we need “defensive” countermeasures against the industrial hollowing out and proper management of the macro economy.

“Defensive” countermeasures against industrial hollowing out (avoidance of rapid hollowing out)

- (1) Every possible measure will be taken on a multi-year basis against a strong yen and support for domestic industrial locations. In addition, we will endeavor to revitalize the domestic market through such measures as a review of vehicle tax.
- (2) In order to ensure an international equal footing for the domestic business environment, we will take such measures as the reduction of the corporate effective tax rate and promotion of economic partnership, while clarifying time frames.

Development of global standard investment and business environment

(1) Normalization of corporate public burdens

- ✓ Reduction of the corporate effective tax rate
- ✓ Alleviation of equipment investment tax (a fixed asset tax on depreciation assets) which is internationally uncommon
- ✓ Normalization of the corporate burden of social insurance premiums

(2) Promotion of high-level economic partnership

- ✓ Promotion of high-level economic partnership with major trade and investment partners (including TPP, FTA between Japan, China and South Korea, FTA between Japan and the EU and EIA)
- ✓ Promotion of policies to make Japan Asia’s center for business

(3) Sustainability of the social security and finance

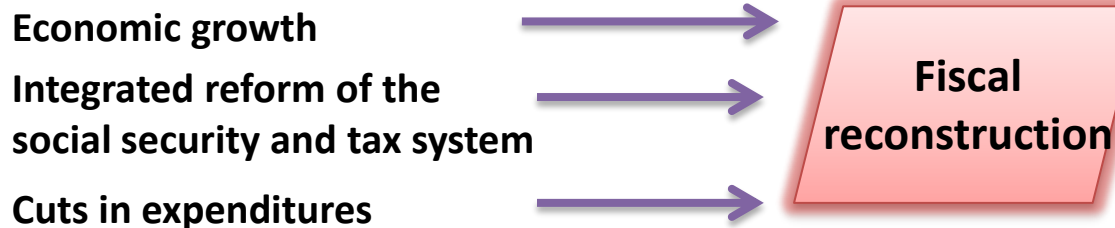
- ✓ Promotion of the integrated reform of the social security and tax system (Prioritization and functional strengthening of the social security benefits, gradual raises of the consumption tax rate and a new system for child-raising)

(4) Review of the energy policies and the measures against global warming

- ✓ Immediate electricity supply-demand measures
- ✓ Re-establishment of the energy structure which is safe, stable, inexpensive and environmentally friendly
- ✓ Re-examination of the measures against global warming along with the review of the energy policies, and establishment of a fair framework to deal with global warming

Proper macroeconomic management

- **Overcoming the deflation**
- **Correction of a one-sided strong yen and countermeasures against a rapid strong yen**



Simultaneous implementation of the three policies

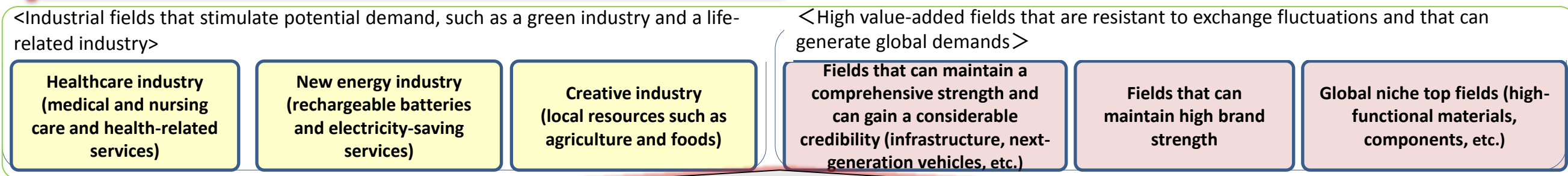
(Important points)

1. Macroeconomic management under a situation where the public burden increases
- In the short-term future, increases of the social security and tax burdens as well as energy prices are predicted. We expect a positive effect of the measures for economic growth including the reconstruction demand, economic partnership and reduction of the corporate effective tax rate.
→ It is essential that we must streamline the social security benefits, maximize the economic expansion effect of fiscal expenditures and steadily implement measures for economic growth.
2. Aggravation of the Euro debt issue and repercussions to the emerging countries
→ If the crisis turns into a reality, we must promptly respond to the situation in collaboration with other countries.
3. Expansion of income outflow due to increased fuel imports after the suspension of the nuclear power stations
→ It is important to maximize energy conservation and effective use of renewable energies and to restart the nuclear power stations whose safety is confirmed.

4. "Aggressive" countermeasures against the industrial hollowing out -Development of new industrial fields -

The main strategy is to achieve an economic shift, realizing development of new industrial fields and creation and expansion of new value added.

"Aggressive" countermeasures against the industrial hollowing out



Development of new industries that can generate employment and development of overseas markets

1. Development of new industries that can stimulate potential demands <ul style="list-style-type: none"> ✓ Examination of a new support framework (concentrated implementation of policies (such as tax, finance and relaxation of regulations) for the new industrial fields) ✓ Review of social regulations, etc. 	2. Generation of global demands <ul style="list-style-type: none"> ✓ Development of overseas markets including the export of infrastructure and Cool Japan ✓ Formulation of global rules through economic partnership ✓ Return of overseas profits ✓ Support for overseas development of small and medium enterprises 	3. Innovation <ul style="list-style-type: none"> ✓ Support for business start-ups and ventures ✓ Development of future pioneering technologies ✓ Support for technological development and technological succession in manufacturing companies, etc.
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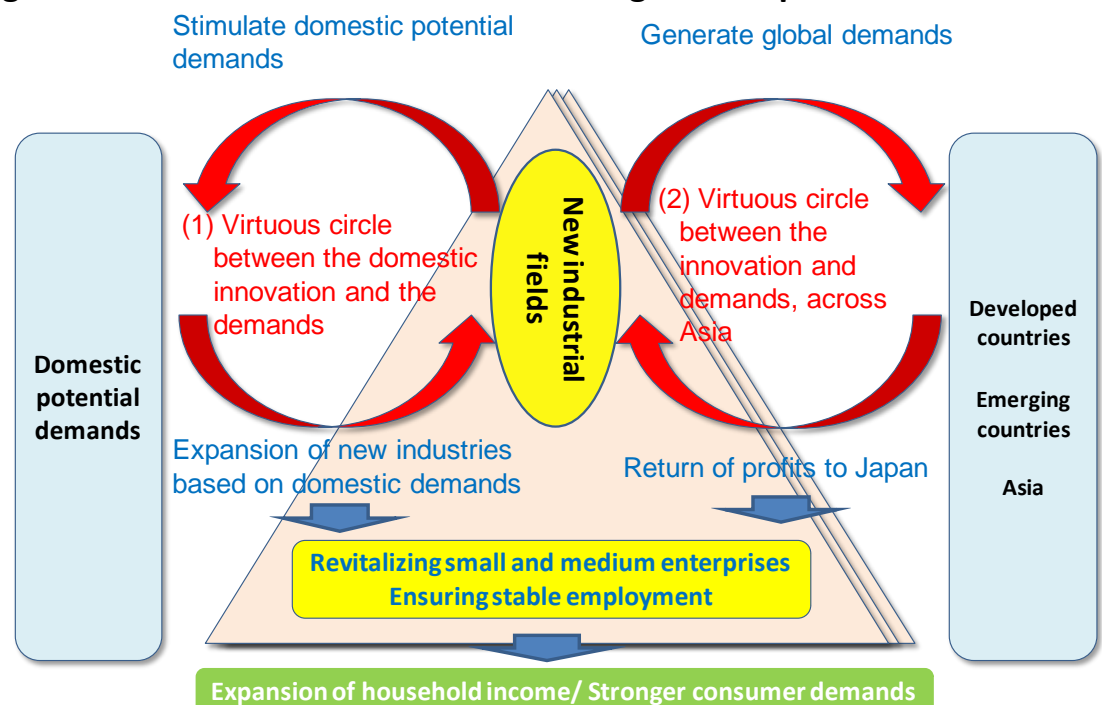
Promotion of effective use of the valuable financial assets of the people

- ✓ Promotion of overseas M&A and procurement of resources (leveraging on the strong yen)
- ✓ Supply of risk monies from pension funds, etc.

Cultivation of human resources that support the shift in industrial structure

- ✓ Reform of the education and employment system in order to develop world-class human resources and a middle class
- ✓ Expansion of occupational training programs to eliminate mismatch in employment
- ✓ Realization of flexible ways of working, which are suitable to new industrial fields

<Image of the economical revitalization through development of new industries>



<Social conversion that supports development of new industrial fields and the shift in industrial structure>

- Wages commensurate with productivity + entry of women and elderly people into the labor market
- Increase of the whole household income and expansion of the total compensation as a result of double income
- Restoration of broad-based middle class households

(Policy direction)

- Reform the seniority-based wage system and the employment system into more flexible ones → Eliminate the employment mismatch Prevent industrial hollowing out
- Allow the private sector to participate in nursing care and child care, through a system reform → Expand employment, including employment of women Raise the wage level
- Provide new services in health care, etc