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Post-Crisis World Order and the Reconstruction of Japan

Chairman's Message at the Fiscal 2009 Annual Meeting

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Introduction

Referred to as an “unprecedented” and “once in a century” event, the global financial and economic crisis that was spawned in 2008 literally sent the world economy into a simultaneous recession overnight and has had an extremely serious impact on Japan's real economy. In my message to last year's annual meeting, I pointed to the growing instability in the international financial and capital markets and shared my concerns regarding the outlook for the Japanese economy. In the Oct.-Dec. quarter of 2008, the Japanese economy contracted at an annualized rate of 12.1% in real terms, registering the largest double-digit negative growth since the first oil crisis. I dare say that no one could have anticipated this outcome when I was addressing the annual meeting last year.

Starting with the so-called “Lehman shock” of September 2008, the world around us was turned upside-down in a few short months. An explosive chain reaction of crisis starting with the precipitous downturn in the fortunes of the export industries that led the Japanese economy, the subsequent cutback in capital investment, the rapid adjustment in employment whose burden has been primarily borne by contingent workers, and the stagnation of consumption reflecting the deterioration in consumer confidence have cast a thick pall of uncertainty and insecurity over the Japanese people.

The first thing that we must do is to eliminate these feelings of uncertainty and insecurity as soon as possible. At the same time, however, we must remain mindful of the sources of that palpable sense of impasse that lies beneath this uncertainty and insecurity. Specifically, these include widespread uncertainty regarding the future of the pension and social security systems; the distortions that arise from the systems, practices and industrial structures that have been left unattended and unable to cope with the changes brought on by globalization, declining birth rates and the aging of

society; and a deep-seated mistrust of a political situation characterized by growing chaos and confusion. Therefore, emergency economic packages, no matter how high they are stacked, are powerless to totally eliminate the people's sense of uncertainty and insecurity. What we need to do now is to present a very clear medium- to long-term vision of Japan (*kuni no katachi*) and to take bold action for the realization of this vision through the resolution of the structural problems that beset our nation.

Turning our eyes to the world, there is a very important lesson to be gleaned from the current financial and economic crisis. Remember that this crisis has occurred in an increasingly globalized economy and society characterized by growing and deepening cooperation and partnership. This crisis is a clear warning of how completely inadequate the current system (framework) is in the prevention and solution of such new global challenges. What this means is that we have entered a new age in which the foundations of global governance must be rebuilt into a system where a common awareness is shared not only by the developed countries but also by all countries and regions of the world, including the newly industrializing and developing countries. While a diversity of opinions may exist, the key is to respond to problems and challenges in a spirit of harmony and cooperation.

Japan is a country poor in resources, yet it stands as the world's second largest economy. The trust and high expectations that the world has for Japan were nurtured over many years, and Japan must not allow this to be undermined. For this purpose, it must play a positive role in the stage of international cooperation. It must strongly demonstrate its readiness to contribute to the world by willingly accepting its fair share of the burden, while at the same time pursuing its national interest. Unfortunately, what prevails in Japan are shortsighted and inward-looking discussions that are closed to the outside world. The conditions of political instability that have persisted under the current financial and economic crisis undermine any hope that Japan may engage with the world and play a leadership role in the solution of the present problems. Viewed from the outside world, it is becoming increasingly difficult to determine what exactly can be expected of Japan. I cannot allay my own fears that this will only lend added momentum to "Japan passing" in the international arena.

From this perspective, the present crisis provides us with an excellent opportunity for mounting reforms aimed at "creating a new Japan" and "taking the initiative in building a new world order." The year 2009 must be used by Japan for preparing for such endeavors. Today, as I enter my second term as chairman of Keizai Doyukai, I would like to address you with these issues in mind.

1. Economic Measures as True Investments in the Future

What must Japan do to take the initiative in playing a positive role in the post-crisis world? Among all the developed countries, the crisis has had the greatest negative impact on Japan. As such, the first step for Japan must be to overcome its own present economic crisis. The economy must be brought back to a new path of growth, and Japan must lead the way in the recovery of the global economy. The government of Prime Minister Aso has responded to the crisis with a series of emergency economic measures. Considering the precipitous downturn in the real economy that has exceeded all expectations, some amount of fiscal stimulus is unavoidable for preventing the economy from going into a free-fall.

But are these emergency measures “wise spending” that constitute true investments in the future? I believe this question must be very carefully examined and meticulously reviewed. Let us call to mind the large-scale stimulus packages that were implemented by the Obuchi Cabinet. It is unclear from medium- to long-term perspectives, whether those massive investments in public projects really benefited or revitalized the Japanese economy and society. On the other hand, what is very clear and tangible is the huge debt that was generated by these programs, which resulted in the extremely strained fiscal conditions that burden us today.

Prime Minister Aso recently announced his “Policy Package to Address Economic Crisis.” The section on “Growth Strategy – Investing for the Future” prioritizes three goals: “the low-carbon revolution,” “health, longevity and child-rearing,” and “realization of the potential of the Japanese economy and development of infrastructure to deal with the challenges of the 21st century.” We have long advocated the need for this type of policy selection and concentration. However, the process of selection and concentration has many additional requirements: clearly defined medium- and long-term vision and goals must be established; appropriate measures for the realization of these goals must be carefully selected; information on the effectiveness and results of individual measures must be made available to the public; and arrangements must be made to facilitate verification of the progress and results of these measures.

Keeping in mind the immense size of outstanding government debt and Japan’s fiscal conditions, it makes no sense to merely emphasize the scale of the fiscal stimulus package. Must we not also endeavor to maximize the impact of fiscal spending and tax cuts by promoting greater regulatory reform? Regulatory reform is about unleashing the energy and vitality that exists in the economy. Any ill-conceived program to re-apply or re-strengthen regulations will not only limit the effectiveness of economic measures but will also nip in the bud any progress that has been made toward medium- and long-term

revitalization of the economy.

There are other things just as important as maintaining the momentum in regulatory reform. Today, the entire program of structural reform is being challenged by strong headwinds critical of the excesses of market-oriented policies. It would be incorrect to criticize the structural reform program for being in the wrong. If anything, the problems we see today are rooted in the fact that the reforms were lukewarm and left half finished. As a result, the old systems, practices and vested interests remain intact, and satisfactory progress has not been made in the elimination of distortions. We should adhere to the position that building a sound economy and society under private-sector leadership, boldly implementing decentralization by transferring effective authority and fiscal resources to the regions, and promoting local initiative and creativity is the best way to create new industries that will serve Japan as new engines of growth and will contribute to revitalizing local and regional economies.

2. Question to Political Leadership: “A Vision of Japan” in the Post-Crisis World

We are calling on the political leadership to rebuild the political framework by dissolving the House of Representatives and holding a general election. While the upper and lower houses remain divided, futile political infighting continues in the total absence of the people, and the system is caught in a storm of growing mistrust of politics. The urgent challenge of escaping the clutches of economic crisis as soon as possible provides us with an excellent opportunity to present a clear vision of Japan in the post-crisis world as well as strategies for the realization of this vision. In the forthcoming general election, we earnestly hope that all political parties will publish a manifesto outlining their policy positions and will engage in real and substantive political debate with the people.

When formulating their manifestos, it is absolutely essential for political parties to start off by clearly defining their long-term vision of Japan. After all, what is the role of leaders who stand at the head of the nation and of organizations other than to enunciate a vision and philosophy that engenders courage and hope for the future among the people whom they lead? Building on this, leaders must direct those whom they lead to the functions expected of them and must motivate them to complete their tasks. I believe that one of the causes of the impasse that Japan finds itself in today is to be found in the utter failure of politicians to enunciate a vision and philosophy that resonates with the public and is accepted by them as being viable and compelling. A vision of Japan is a summarization of the ultimate destination of each individual that

can be reached by solving the problems facing Japan through the implementation of the various points of structural reform and growth strategies.

To present a vision that the people will find convincing and conducive to making a committed choice, the question of “Where is Japan headed” must address the following issues in easy-to-understand language. (1) Which of the following combinations should Japan choose: high tax burden and high social welfare; medium tax burden and medium social welfare; or low tax burden and low social welfare? To what extent should Japan tolerate intergenerational disparities in benefits and burden? (2) Should the government strictly control and regulate economic activities, or should the economy be left to the private sector as much as possible? Which of these two choices will result in greater vitality and affluence? (3) Should the central government exercise uniform control over the entire country, or should bold steps be taken to transfer effective authority and fiscal resources to local governments? Which of these two choices will result in better social services and greater local revitalization? (4) Regarding global warming, should emphasis be placed on medium-term activities involving large-scale investment in the prevention of global warming, or should emphasis be placed on long-term activities while accepting the possibility that damages caused by global warming may be intensified?

In formulating a manifesto, a clear picture of the future must first be defined. Having identified the destination to be pursued, a manifesto must then set down the following in an unequivocal manner: specific policy issues to be addressed; specific goals to be achieved; sources of funding; specific timetable for the achievement of goals; and evidence of the political capacity and leadership to realize these goals.

3. Japan in the “New Era of Responsibility”

The leaders of the major countries of the world as well as the emerging countries have responded to the current global financial and economic crisis by exhibiting solidarity. They have made a strong commitment to overcoming the crisis through a united effort involving all members of the international community. This may be seen as the harbinger of the advent of a new age in international cooperation. Furthermore, the birth of the Obama Administration advocating the “New Era of Responsibility” portends significant changes in the approach to the resolution of global problems and challenges. The strengthening of the financial system and other initiatives for creating a new post-crisis world order have just begun, and Japan must take the initiative in engaging in this process.

Sadly, however, when we consider the role that Japan can play in the world, we are made painfully aware of the weakness of Japan's presence on the international stage and the absence of a Japanese "face" that can lead the world. On the other hand, it is obvious that Japan does have a very strong presence in various fields where it has been able to fully exploit its strengths and to gain the respect and trust of the people of the world. We must remember that Japan succeeded in becoming the world's second largest economy by making maximum use of its many strengths and advantages. In preparation for the dawn of a new era, now is the time for Japan to further hone these unchallenged strengths and to utilize these in contributing to the world and in pursuing its own national interest.

One of the contributions that Japan can make relates to Asia to which the world continues to look with high expectations of growth. Specifically, Japan can contribute to building an Asian economic sphere that is founded on a sound and solid market framework. Home to approximately 60% of the global population, Asia continues to attract attention of the world as the most promising growth center with its emerging countries led by China and India. However, hidden in the shadows of rapid growth lurk many risks, and it can scarcely be denied that these risks can exert a very significant negative impact on today's globalized world economy. The Asian region is also home to many countries that are destabilized by poverty and conflict. Over a period of many years, Japan has nurtured relations of trust in this region through programs of economic assistance and cooperation that have covered a wide range of fields that extend from infrastructure development to technical assistance and human resource development. Japan should play a greater leadership role in the Asian region where numerous opportunities and risks intersect in resolving the problems it faces and establishing orders. While maintaining relations of co-existence and mutual prosperity, Japan should exercise its leadership in promoting the further development of this region and ensuring the stable growth of the world economy.

Global warming presents Japan with another important opportunity for contributing to the international community. Japan can be proud of the advanced environmental technologies that it has developed as well as its traditional lifestyle of living in harmony with nature. By making maximum use of these capabilities, I believe Japan can take the initiative and leadership in the resolution of the problems of global warming.

COP15 (15th Conference of the Parties to the United Nations Framework Convention on Climate Change) will be held in Denmark (Copenhagen) in December of this year with the goal of arriving at an agreement on the post-Kyoto Protocol framework. Given the conflicting national interests, there is no guarantee that COP15 will be able to reach a meaningful agreement. However, we should know that any delay in the establishment

of the framework and the implementation of global warming prevention activities would only increase the eventual economic impact of global warming.

As the world moves toward a post-Kyoto Protocol framework, various countries are beginning to express concern that Japan is adopting a passive stance on global warming. On the domestic front, the discussions that accompanied the establishment of Japan's medium-term goals tended to only emphasize the cost of achieving the goals and the impact on GDP and there are also serious concerns being voiced that Japan may not be able to adopt meaningful and challenging goals for the reduction of greenhouse gas emissions. Throughout all of these discussions, we must remain mindful of the potential risks of doing nothing. It is my conviction that global warming prevention activities present us with a transformational opportunity that must not be lost, an opportunity for creating a 21st century "low-carbon society" through technological innovation and lifestyle changes implemented from a long-term perspective. Therefore, now is the time for Japan to come forward with meaningful and challenging medium-term reduction goals and to thereby take the initiative in concluding a new international agreement.

4. "New Style of Japanese Management" Is Being Tested

I have shared with you my thoughts on our "expectations for political leadership" regarding "a vision of Japan" and "economic revitalization." We must not, however, forget that the realization of these matters rests in part on the corporate sector, a leading entity in the private sector. Therefore, as I mentioned in the Keizai Doyukai's Basic Guidelines for Activities, we have decided to put greater emphasis on committee activities for clarifying a vision of Japan. Furthermore, I strongly believe that the true worth of the "new style of Japanese management" that I have been advocating since taking office is being put to the test in the current economic crisis. Japanese companies in general and companies in export-oriented industries in particular are now in the midst of a very difficult period. To overcome these difficulties and to emerge from the crisis, companies must not seek to take the easy path of depending solely on the government's economic stimulus packages. Rather, they must pursue the path of steady and persistent self-generated efforts. First and foremost, they must commit to improving their strengths. Next, while upholding high moral standards, they must develop and supply new products and services that respond to the emerging needs of customers and society.

Where are the new seeds of economic growth to be found? As we consider this question, we must look to the global challenges of realizing a low-carbon society, responding to the needs of longevity and an aging society and coping with poverty and disease as social needs that can be resolved through technological innovation and the development

of new business models. For this, we need to add renewed momentum to the promotion of value-creating CSR. The overwhelming strengths and advantages enjoyed by Japanese companies and industries as a whole must be brought to bear in the realization of this objective. It is my firm conviction that the pursuit of these activities will lead to the reconstruction of the Japanese economy and the enhancement of Japan's presence in the international community.

Conclusion

Keizai Doyukai was founded in the spirit of, "We stand ready as members of the business community to dedicate all our efforts to the reconstruction of the Japanese economy by all means." As we face the current crisis, we must recall the conditions that surrounded our predecessors and the aspirations that propelled them forward. With them as our exemplars, we must do all that is within our powers as corporate executives to overcome the current crisis and to contribute to the reconstruction of Japan. The year before us will no doubt be a year of challenges fraught with many moments of truth. During this period, Keizai Doyukai will engage in continuous discussions on "building a new Japan" and "building a new world order." We will make known our views both in Japan and throughout the world, and we ourselves will take actions. I call on all members of Keizai Doyukai to participate actively in these undertakings.