

April 24, 1997

## **Structural Reforms to Enhance Initiatives of the Private Sector**

Chairman's Address for the 1997 Annual Meeting

Jiro Ushio

Chairman, Keizai Doyukai

### **1. Introduction**

#### **● Hostage Case in Peru**

I was greatly impressed by the leadership of President Fujimori which enabled the hostage crisis in Peru to be resolved. Without succumbing to the demands of the terrorists, and with a determination to free the hostages safely, President Fujimori had confidence in his people to successfully execute the rescue operation. President Fujimori's posture to resolutely observe certain principles was supported by the international community. Viewed in the context of a global perspective, I have felt a divergence between the ideals shared in the world and those of Japanese society which is homogenous and still relatively closed. It is important that Japan does not forget the lessons learned from this incident. With moves towards globalization, Japan as a nation with the second largest economy should therefore bear this learning experience in mind.

#### **● Structural Reforms are Underway**

##### **A Revitalized Japanese Economy**

Sectors showing growth in the Japanese economy have continued to increase and the structural reform of Japanese society is finally underway. The government has announced that including periods of zero growth, the Japanese economy has continued to grow for 43 consecutive months making it on par with the period known as the 1959 Iwato Boom. In a mature economy, we certainly

cannot expect to have the high rate of growth we experienced during the 1960s. Furthermore, during the course of structural reform it is unlikely that all industries and firms will reap the benefits of economic growth. Nevertheless, considering that Japan's growth rate of 3.6% in 1996 was the highest among all OECD countries, the Japanese economy is steadfast.

### **Vitalization initiated by the Private Sector**

With a brighter economy and the correction of an over-appreciated yen, it is now necessary to accelerate the shift from the economic initiative of the government to the private sector in order to invigorate the economy. To accomplish this, it is essential that the various reforms, which are already in process, comprehensively and swiftly proceed. From this viewpoint, we strongly support "the Six Reforms" advocated by the Hashimoto Administration and will endeavor to cooperate with their realization.

## **2. Full-Scale Implementation of Structural Reform**

### **<The Structural Reform of Public Finance - an Overhaul of the Erstwhile System>**

#### **● Inadequate Fiscal Reforms in the 1997 Budget**

I believe it is important to make progress in structural reform more visible to the public. It is regrettable that although structural reform of the public finance system was advocated, this was not reflected in the 1997 budget. While the old system continues to remain intact it will be difficult to implement reform of the public finance system.

#### **● Eradicating the Old System**

**\*Balanced Growth among Regions**

**\*Equal Distribution of Income**

**\*Budget Compilation by the Cabinet**

**\*Sharp Cut in Total Expenditure**

The budget for the fiscal year 1998 is to be positioned as a symbol of the beginning of reform. The state of our national finance is now beyond the limit where deficits can be managed with traditional fiscal measures. We must begin to take resolute steps to discard outdated measures. The government must promulgate a decisive design for 21st century Japan through "the Six Reforms," and then create a new public finance system consistent with these reforms. In other words, with the prevailing trend to shift from "the government to private sector" and from "government regulations to market initiative," we should also aim towards the "independence of regions", but not "balanced growth among regions", as well as "prosperous social economies led by the initiative of citizens", not just "equal distribution of income". It is only possible to compile such budgets under the leadership of the Cabinet. In concrete terms, a sharp cut in the total expenditure of the central and local governments is essential, and modulated cuts in respective items of the annual expenditures must also be carried out. Needless to say, with this, not only public investment but all sanctuaries such as grants-in-aid or subsidies to local governments, ODA, defense, social welfare, and education must be removed, and all expenditures should be radically reviewed in light of the new reforms. Concerning administrative reform, aiming at the realization of "small government", which will streamline and make the work of the central and local governments more effective, the basic concept of "let the private sector manage as much as possible" must be adhered to.

### **<Reform of the Financial System -Dismantling the Convoy System>**

- **The Financial Big Bang**
- **Accomplishments will be the Responsibility of Business Leaders**
- **Retreat from the Convoy Fleet System**

Keeping in mind the current reform of the financial system, the executives of private financial institutions should take tangible measures to ensure their survival. The establishment of the New Hokkaido Bank, and measures taken by Nippon Credit Bank including the tie-up with a foreign bank, closure of subsidiary companies, and sales of assets, are the results of practical decisions made by the executives. These decisions will pave the way for reform of the financial system. Further, following the revision of the Foreign Exchange Control Law, effective from April next year, various bills pertaining to the reforms will be

proposed indicating the full-scale commencement of the Big Bang in the Japanese financial system. Under such circumstances, the executives of financial institutions will face a difficult situation in which they must grasp business opportunities in an uncertain environment and as responsible business people they will have to disclose accurate information to "stakeholders" such as investors, employees, and customers. The conventional convoy fleet system, or practice of the Ministry of Finance controlling and protecting the interests of financial institutes, must cease. If the Big Bang is to successfully create user-oriented, efficient and attractive financial markets, the judgment and efforts of responsible business persons is essential. In this sense, 1997 and 1998 will be very important years for the financial industry.

- **Belated Reform of the Taxation System**

From the outset of the financial Big Bang, it is imperative that the postal savings, financial investment and loans program are simultaneously reformed.

Furthermore, it is also essential to proceed with reform of the taxation system. If the liberalization of the system of international capital transactions is not carried out in harmony with the reform of the taxation system related to financial transactions, there is concern that there will be a hollowing out of financial markets. We have moved beyond the time in which arguments based on the need to secure revenue for the government at a certain level were valid.

Decisions should be made without delay from the global and overall viewpoint in order to be in time for the effectuation of the revised law in April next year.

### **<Active Management of Firms with an Emphasis on Rate of Return on Equity [ROE]>**

- **Deepening Bipolarization**

A review of the current activities of enterprises, indicates that business results and stock-prices are becoming bipolarized by industry, and also by firms in the same industry. This means that financial markets have become increasingly critical in their evaluations of specific industries and firms.

## ● **Sectors of Growth will Continue to Increase**

Under the above circumstances, it is important to allow these sectors or firms to continue to dynamically grow and lead our economy as a whole. In this manner, it is expected that firms in slow-growth sectors, will also quickly increase their productivity and competitiveness and eventually join the growing group. Thus, the opening of the market and introduction of competition will lead to the dissolution of dual structures existing in the economy hitherto. The efforts that slow-growth sectors exert in the convergence process toward growth sectors are the source of vitality for economic growth. The most suitable policy to further encourage high-growth sectors is tax reductions. For the slow-growth sectors, deregulation and reform of the industrial structure and initiatives such as the financial Big Bang are the key points.

## ● **ROE**

Under the above circumstances, ROE (rate of return on equity) is an important index for management. Economies are progressing more and more towards globalization, freedom and openness, and enterprises are being assessed more critically by the market. An enterprise's profits (returns) are a primary means of evaluating a firm's performance. Emphasizing the importance of returns does not necessarily mean the interests of stakeholders such as employees or customers are not valued. On the contrary, it suggests that the interests of stakeholders must be protected, and by encouraging employee initiative, through the introduction of stock options and merit based wage systems while also satisfying customer needs, there will be increased returns which are sustainable for a long period of time. In other words, in contrast to erstwhile methods of management, we are entering an era with a new management style in which returns can be rewarded to stakeholders.

## **<Including Reform of the Taxation System>**

- **Reform of the Taxation System must not be Postponed**
- **"Revenue Neutral" is not True Reform**
- **The Highest Personal Tax Rate of 50%**
- **The Corporate Effective Tax Rate of 35%**
- **Tax Cuts to be Placed as the Target of "The Six Reforms"**

The vitality of the private sector forms the basis of a sound economy. In order to generate such vitality, the system of taxation must be restructured without delay. The support given to reforms such as "Reconstruction of Public Finance without Tax Increase", should not be confined merely to improving the balance between revenue and expenditure while postponing the reduction of tax. The financial reconstruction must be carried out comprehensively spanning both expenditure and revenue. If, the policy of the so-called "Revenue neutral" with just partial amendments does not lead to changes in whole taxation revenues system, then one cannot expect true reform to take place. If drastic cuts in revenues are made as a result of the new reforms, at least then Japan may be able to come closer to global standards by the year 2000. The rate of the highest bracket of individual taxes, including both national and local taxes, should be lowered to 50%, and the effective rate of corporate tax including both the national and local taxes should be lowered to 35%. Germany, which had the highest tax rates comparable with Japan, has been steadily preparing itself for tax reforms in order to cope with the new global era. For the vitalization of world economy, it is indispensable for Japan, the United States and Germany to establish markets based on a harmonized taxation system. In order to shift the source of demand to lead Japan's economy from the government to the private sector through reform of the taxation system towards global standards, the government must include tax reductions in "the Six Reforms" as a fundamental target.

### **3. Leadership of Business Executives to tackle New Problems**

The reform process to construct a renewed economy led by the private sector toward the 21st century is very demanding and private firms and societies have to tackle various problems arm in arm with each other. A key to a success is the leadership and posture shown by business executives.

### **Global Environmental Issues**

As we proceed to the 21st Century, the prevention of environmental disruption is a global issue for both developed and developing countries, and the achievement of "zero emission" is being advocated. In December this year, an international conference, "The 3rd Session of the Conference of Parties to the

United Nations Framework Convention on Climate Changes", is to be held in Kyoto. Japan as the host country has to sum up various opinions expressed by all participating countries, including those in the developing phase. Essentially, we have already reached the time to take action toward the achievement of "Zero Emission" in order to maintain the global environment. Consumption patterns which consist of mass production, mass consumption and mass abandonment that have been practiced since World War II are no longer feasible.

## **Employment Issues**

In addition, with the introduction of structural reform issues relating to employment problems must also be addressed. It is important that while corporate structural reform is carried out it allows management practices which place value on employees to continue. In the process of structural change in industries, the conditions required are the accelerated mobility of labor and individual efforts to increase the employability. Without limiting their responsibilities just to restructuring, business executives should endeavor to create new employment opportunities by improving productivity and developing new businesses. In short, executives are obliged to cope with the era of mega-competition, while maintaining the basic attitude of Japanese business; to treat people with respect. As for the government, all possible steps and actions should be taken to facilitate the shift of employment to different sectors and the expansion of unemployment insurance coverage.

## **4. Conclusion**

### **"Manifesto for a Market-Oriented Economy"**

#### **● Self-Awareness of the Private Sector**

In January this year we released "Manifesto for a Market-Oriented Economy - Action Program for Japan toward the 21st Century" with an emphasis on the role of the executives. However, in reality, there have been repeated incidents of misconduct that have damaged the confidence in management, which is a most important condition for the maintaining the well-being of the market. When the

historical transition of the leading player in the market economy from the government to the private sector is carried out, it is impossible to expect success unless the private sector is aware of the need to accept the ensuing responsibilities. In addition, there is a danger that such a situation may push back the reforms just started. The behaviors of us, the business executives, will determine the future direction of the economy and society of our country. The weight of our responsibility is immeasurable.

### **Social Responsibilities of the Management**

We must not only determine the direction of firms, but also to identify a new image of management. About 30 years ago, the late Mr. Kikawada, former Chairman of Keizai Doyukai, promulgated the need for management to assume social responsibilities. Once again, we are at a time when we must give consideration to our social responsibilities - an issue we inherited from our senior members - as individual members and as a whole association.