

January 8, 1998

Our Commitment to Revitalize the Japanese Economy

1998 New Year Statement

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Introduction

During 1997 the inexorable deterioration in business conditions, instability in the financial system and the Asian currency crisis combined to corner the Japanese economy in a very serious predicament. The government responded with the announcement of an "Emergency Economic Policy Package: Reforming Japan for the 21st Century," and has decided to implement corporate and personal income tax cuts. The Liberal Democratic Party has also put together the financial stabilization measures. For the business community, 1997 proved to be a year of loss of confidence, both within Japan and abroad, because of the management failure in numerous corporations and the "sokaiya" payoff scandals.

The year 1998 will be the crucial year for the success of structural reform in Japan. It should also be a year in which both the private and public sectors arise to build a firm foundation for a bright and successful 21st century by overcoming the vestiges of the bubble economy and by going forward with administrative reform and other reforms. As corporate executives, the revitalization of the Japanese economy lays in front of us as our greatest challenge. As such, we should commit to a broad range of objectives which include, shift of initiatives from the public sector to the private sector, the abandonment of "look-alike" management style, and realization of creative management based on independent corporate initiative.

1. Efforts toward Building an Open Market Economy: Free, Fair and Global

Last year, the Japan Association of Corporate Executives announced its "Manifesto for a Market-Oriented Economy" and formulated an action program

for the realization of fair and efficient market structures. We are now on the process to implement this program. During the same period, the government unveiled its the six reforms. The front-runner of these reforms, Financial System Reform (the Japanese Big Bang) is scheduled to be launched on April 1, 1998 with the principles of "Free, Fair and Global". These are principals which we also share.

Standing at this critical juncture, we must act decisively to make an appropriate contribution to the world economy, and in particular to the Asian economy by utilizing its full growth potential, achieving higher standards of living, and widely opening our market to the world.

We look back to the success of Thatcherism and Reaganomics in the 1970s and 1980s. Japan should learn many valuable lessons from the process by which the economies of the United States and the United Kingdom regained their vibrancy and growth. The success of these programs rested in great part on bold moves to tax cuts and deregulation which led to the realization of "small government" and the vitalization of the private sector.

2. Tax Cuts and Deregulation as the Main Pillars: Speedy and Bold

The first pillar of action in the pursuit of further reform is a fundamental reformation of Japan's tax system. The government's six reforms cannot reach fruition without this reform. The most important requirement is to reform both corporate and personal income tax systems toward an incentive-based structure. As specifically, Japan should reach a decision to reduce the corporate effective tax rate to 40 percent before the end of the current calendar year to and embark on an actual reduction program in fiscal year 1999. To achieve this tax cut, it will be necessary to restructure local corporate taxes concurrently. With regard to personal income taxes, the first step to be taken should be to render the special 2 trillion yen tax cuts, which was announced in December, permanent. Following this, Japan should commit itself to establish a flatter graduated tax rate as well as reducing the maximum tax rate to 40 percent, or at the same level as corporate taxes.

The goal of rectifying the government's fiscal balances can be ultimately achieved only when the economy has been fully revitalized through these reforms including the tax system.

The second pillar must consist of a powerful program to reduce and to abolish various regulations. Although a gradual progress has been made, and the

Japanese economy is beginning to enjoy the results of deregulation, efforts have been far from sufficient. While there is widespread support for the general principle of deregulation, Japan stands paralyzed by strident opposition to the details of implementation. Unless the government and private sectors arise to break through this impasse, the high-cost structure of the Japanese economy will fail to be rectified. Japan must act speedily to review the "division of labor" between the public and private sectors, and this review must be carried out with the principle, "what the private sector is capable of handling should be left to its responsibility". At the present time, in terms of gross output, the regulated sectors of the Japanese economy outweigh the dynamic sectors which are endowed with international competitiveness at a ratio of approximately two to one. Japan must act with due speed to reverse this ratio. In order to achieve this objective, it will be necessary in the very least to implement before the close of the century the series of three recommendations submitted by the Administrative Reform Commission's Subcommittee on Deregulation. Moreover, it is necessary to review basic and specific laws, and the government subsidization system. The third pillar of reform is the development of market infrastructures which will promote broad confidence in the market and which will allow the market to function. The most important elements in such a framework would include the establishment of well-defined rules of fair competition and the timely and accurate disclosure of information. Parallel to this, Japan must act quickly to upgrade the powers of its surveillance institutions and to establish proper judicial procedures for coping with illegal activities.

The fourth pillar of action in the pursuit of further reform consists of measures aimed at sharing prosperity with the Asian economies, and establishing Japan as a true partner to these nations. In the first instance, it is urgently required for Japan to act speedily to make the necessary adjustments in its economic system so as to promote the expansion of its imports, which will allow Japan to emerge as the core market for Asia. Given this framework, a strong yen will come to play the role of the key currency for Asia.

These four pillars of action require speedy and bold execution. Japan must not repeat the error of pinning its hopes on belated and incomprehensive measures which are introduced long after the best opportunities for action have been lost.

3. Management Must Play a Leadership Role in Reform

During 1998, we will be facing two immediate challenges of extreme importance. First, the redemption of confidence in Japanese corporations, both in Japan and abroad. Second, the business community must take the initiative in reforming itself to purge the remaining vestiges of the bubble economy, as well as to respond to the challenge of building new bridges to the 21st century.

Regarding the first challenge of regaining confidence, needless to say, management must cleave to the principle of accountability and adhere faithfully to a high code of ethics as it steers the course of the company placed under its charge. By the same token, management must act swiftly to establish a well-rooted framework for corporate governance. Specifically, managers must develop a higher awareness of the principle of accountability, boards of directors must be opened up to a growing number of external directors, the function and powers of auditors must be bolstered, and full disclosure based on mark-to-market accounting standards must be pursued.

The second challenge is the challenge of self-reform. It should be realized that economic globalization and the reduction and removal of government regulations are the spawning grounds of a myriad new business opportunities. Whether or not a company rises to the challenge of these emerging opportunities lies squarely on the shoulders of its management. Indeed, these are the days in which management must play a leadership role in reform. We believe that managers who fail to respond to this challenge and who fail to provide this much needed leadership will inevitably be driven from the market, as will the companies which they head. Management must lend a serious ear to the voice of the market as embodied in such phenomena as the "selling of Japan Incorporated" and the "Japan premium" which were rampant last year. Finally, managers must feel themselves to be personally responsible for upgrading the market's evaluation of their companies.

The "bubble hangover" can be seen in its most representative form in the urgent need to stabilize and to revitalize the financial system. In this regard, it should be understood that relevant policy measures are already in place. Henceforth, success or failure in this undertaking will depend on the ability of management to take decisive action. In a real sense, crisis is the bearer of new opportunities. As the reform of the financial system gets under way, it is our hope that managers

will embark on the path to fundamental management reform while carefully identifying the functions and responsibilities which they themselves must bear. Certainly, the need for fundamental management reform is not limited to financial institutions. Rather, this constitutes a challenge common to all companies. Finally, we pledge ourselves to the principle of self-responsibility and the process of creative destruction as we step forward to accept the challenge of acting as a major driving force in the expansion of the "dynamic Japan."

Conclusion

During 1998, speedy and bold actions must be taken to bring a final settlement to the bubble economy as represented by the crisis in Japan's financial system. At the same time, this should be a year for preparing a firm foundation on which a fresh era of economic growth and new bridges to a bright and hopeful 21st century can be anchored.

Japan must now simultaneously pursue seven major reform initiatives consisting of the government's six reforms program and the revamping of the nation's tax system, as well as the settlement of the bubble economy. By no means will this be an easy task. However, it should be realized that the implementation of reform is a race against time. In this regard, we are firmly convinced that the Japanese economy and society are endowed with the necessary strength to withstand the pressures of a higher pace of reform needed to open the way to a brighter 21st century.

As the balance shifts from the public to the private sector, it is indeed now that the private sector is coming up to bat. And of course the private sector is none other than the vast conglomeration of individuals and companies.

The Japan Association of Corporate Executives re-recognize its role as the front-runner of the private sector. We are committed to taking positive and firm actions for the revitalization of the Japanese economy.

At the beginning of a new year, we renew our commitment and focus our efforts on making the new year a meaningful one.