

January 1, 2011

The Year of Decision

2011 New Year Message

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Japan now stands at a critical crossroad of growth and decline.

Will Japan be able to develop new systems and reemerge as a country brimming with vitality, or will it hesitate in transforming itself and slide down the slope of uninterrupted decline? This will be the year of decision. Very little time remains. The government must take a hard and close look at its responsibilities. Unless decisions are made and actions taken, there can be no bright future for Japan.

1. Two Major Challenges Facing Japan

(1) Rapidly Shrinking Population and Aging of Society

As has been widely pointed out, Japan is experiencing a shrinkage of population and the aging of society at rates never before seen in the world. Japan's population was 90 million in 1955 and peaked at nearly 128 million in 2007. Thereafter, the population began to decrease and is projected to fall to around 90 million in 2055 (based on medium fertility and mortality assumptions). In other words, Japan's population took 50 years to increase by 38 million, but will decrease by 38 million over the next 50 years. As is evident from this, Japan has entered an era of rapid population decline.

Additionally, the aging of society poses serious problems. Demographic data point to a dramatic shift in the structure of society in terms of the ratio of the working-age population to the elderly. In 1970, each elderly member of society was supported by 10 working-age individuals. This number was down to five by around 1990 and, today it has fallen to three. Projections indicate that by around 2025, Japan will have only two working-age individuals to support each elderly person. By around 2050, this is expected to reach a 1:1 ratio.

A brief review of demographic trends is enough to tell us that the systems based on the assumptions of continued population growth and ample supplies of labor have already become dysfunctional. Japan must be mindful of this

fact and must avoid placing unduly heavy burdens on the working-age population. It is absolutely essential for Japan to develop systems that will distribute the burdens of supporting society evenly among various generations and among a broad range of people.

(2)The Advance of Globalization

Globalization is advancing at a rapid speed. What this implies is that countries and regions throughout the world will compete with increasing intensity to create systems and business environments that companies find attractive. This signifies a global competition for stimulating corporate activity and attracting vigorous companies as the source of wealth.

The first aspect of this competition involves corporate taxes and related corporate laws and systems. Most symbolically, this competition takes the form of lowering corporate tax rates. The government of Japan, in its FY2011 Tax Reform (Main Points) adopted at a cabinet meeting last December, finalized its decision to lower the effective corporate tax rate by 5 percent. Following necessary legislative revisions, the tax rate will be lowered to around 35 percent. The problem is that even this new rate will not be a particularly attractive one as compared to tax rates of about 30 percent in European countries and 25 percent in East Asian nations. Moreover, corporate tax rates are not the only factor taken into consideration by companies when choosing a site for their activities. Other important considerations include the rate of corporate contributions to social security premiums, various aspects of company laws affecting such matters as mergers and business combinations, and various regulations affecting business activities in general. Intense international competition is emerging in the development of systems that affect the regulation of corporate activities.

Secondly, the establishment of economic partnership agreements (EPA) is beginning to have an important impact on the competitive position of companies. Today, there are more than 180 free trade agreements (FTA) throughout the world, more than half of which were established during the past 10 years. In a significant related development, bilateral and regional EPAs and FTAs are now being expanded to form larger inter-regional agreements. Since last year, the question of whether or not to join the Trans-Pacific Partnership (TPP) has emerged as an important issue in Japan. Currently, nine countries are participating in the TPP negotiations. In combination, these countries account for more than 25 percent of global GDP and trade. Moreover, there is an increasing possibility that other countries will join the negotiations. Of further importance is the fact that TPP constitutes a high-quality and in-depth EPA that allows for no exceptions to free trade. In a very significant way, TPP symbolizes the expansion and growing depth of globalization. For Japanese companies, the question of what types of EPAs the government concludes has come to stand as a critical issue in maintaining their international competitiveness.

2. Three Key Policies That Must Be Decided This Year

“Shrinking population and the aging of society” and the “advance of globalization” will force Japan to make some urgent decisions.

The first among these decisions pertains to the fundamental revision of the tax system in the context of fiscal rehabilitation. Given the significant changes in population structure, the tax system in which the burden is primarily borne by the working-age population through income taxes is approaching its limits. Today we see that globalization has triggered international competition in lowering corporate tax rates. In this environment, Japan can no longer avoid a full discussion of the raising of consumption taxes as a mechanism for sharing the fiscal burden by all generations. Japan faces a critical and urgent need to determine the path that it will take to fiscal rehabilitation. The first step in the discussion must be to clearly define the principles of taxation in the new society that Japan envisions. Next, definite conclusions must be reached on the systematization and revision of core taxes, including personal income tax, corporate taxes, property taxes, and consumption tax.

The discussions leading to the FY2011 Tax Reform avoided any debate pertaining to the consumption tax. With no clear outlook for fundamental reform, the discussions focused on lowering the corporate tax rate and finding sources of revenue to cover the resulting shortfall. As a result, any effort to envision the future structure of Japan’s tax system points to the real possibility that this latest tax reform program contains significant distortions. We believe that the traditional practice of simplistic annual tax reform discussions should not be repeated in the future. Instead, this must be the year in which definite conclusions are reached on fundamental tax reform—conclusions that must be fully reflected and implemented in the FY2012 Tax Reform.

Secondly, Japan must embark on building social security systems that can withstand the pressures of its shrinking population and the aging of society. This calls for comprehensive reform of the pension, health care, and nursing care systems. It is obvious that both the health insurance system and the pension system have come to their limits where the working-age population cannot by itself continue to support the elderly. New systems must be designed to ensure sustainability, and the transition to these new systems must be undertaken as quickly as possible. Ten years have passed since the introduction of the nursing care insurance system. It is now necessary to review the performance of the system and to make modifications from the perspective of ensuring sustainability. In 2012, Japan’s baby-boom generation (born 1947–1949) will start to join the ranks of the elderly and to become eligible for pensions, and by 2024 all the baby-boomers will have reached the age of 75. Even if necessary legislation were to be drafted this year and enacted at the 2012 Ordinary Session of the Diet, implementation of any revision would not begin until 2013. The time remaining is short. It is absolutely essential for Japan to reach definite conclusions on the revision of its social security systems during the current year.

Thirdly, Japan must commit itself to active engagement in economic partnership agreements. In the global market, Japanese companies enjoy a branding advantage derived from the fact that their business activities are centered in Japan. However, in order for Japanese companies to continue developing their businesses in Japan, it is critically important for the competitive conditions that underlie their business activities in Japan to be at least comparable to those overseas or to provide some form of comparative advantage. From this perspective, the conclusion of new economic partnership agreements has an extremely vital role to play in improving Japan's basic competitive conditions. In particular, TPP will prove to be an important touchstone in this regard. Given that the United States is aiming to conclude the negotiations by November 2011, it is very likely that concrete progress in the negotiations will be made during the current year. Japan must formally join the TPP negotiations without delay. Otherwise, there is a real danger that the hollowing out of Japanese industries will be accelerated. Japan must make every effort to participate in the TPP negotiations, involve itself in the rule-making process, and contribute positively to the negotiations in order to ensure that the TPP agreement is a meaningful one for Japan. Unless Japan makes a firm decision to participate in the negotiations during the first half of 2011, Japanese industries and companies will find themselves seriously handicapped.

We fully recognize that many fear that participation in TPP threatens the future of Japan's agriculture. However, the problems of Japan's agriculture are unrelated to and do not originate in economic partnership agreements. The most important challenge is to resolve the numerous fundamental problems that are endemic to Japanese agriculture, such as low productivity, the aging of the agricultural population, a shortage of farmers, and high government subsidies. If these problems are left unattended, the burden placed on the general population will only increase with no real prospect for revitalizing the agricultural sector. We believe that it is critically important to deepen the discussions of agricultural reform with the objective of effectively utilizing competition to promote the industrialization of the agricultural sector and the strengthening of its international competitiveness.

3. Bipartisan Consensus Building

For all of the above reasons, 2011 stands as an extremely important year of decision with critical ramifications for the future of Japan. These are vital decisions for which members of the Diet will ultimately have to accept responsibility. The Japanese political system has entered a period of regime change characterized by a split in the control of the upper and lower houses. This makes it vitally important to establish a mechanism for bipartisan consensus building. What is critically required of politics is to arrive at a conclusion and to achieve results. The public is beginning to turn its back on politics, where turmoil continues over parliamentary scheduling, scandals, and gaffes. Japan is in dire need of earnest political debate concerning the future of the country—a debate that must be engaged in from the perspective of the nation.

We strongly urge the members of the Diet to form bipartisan study groups with experts and to without further delay reach conclusions on each of the three issues of “fundamental tax reform and fiscal rehabilitation,” “reform of social security systems,” and “strategies for economic partnership agreements.” Furthermore, faced with these critical policy choices that will affect the very existence and destiny of the nation, we hope that each individual politician will rise above their party affiliations to act for the resolution of these problems in accordance with their conscience and from the perspective of the nation as a whole.

4. Determination of Business Leaders

The quest for affluence has been one of the most natural pursuits throughout human history. As business leaders, we believe that one of our important responsibilities to society is to contribute to the realization of affluence by obtaining and accumulating wealth through the creation of value by our companies. For companies to create value through competition and to realize wealth, business leaders must constantly strive to increase their corporate value by improving productivity and promoting the process of eliminating unprofitable businesses and initiating new endeavors.

As we are appealing to the government to improve the competitive environment, business leaders must be mindful that such an appeal carries with it the heavy responsibility of achieving growth and sharing the fruits of such growth with society. It is with this awareness that we must form our resolution for the New Year.