

**Toward “Japan 2.0”
No Future without Breaking with Convention**

2016 New Year Message

Yoshimitsu Kobayashi
Chairman, Keizai Doyukai

1. Opening New Pathways

Keizai Doyukai will celebrate the 70th year of its founding in 2016.

On April 30, 1946, 83 far-sighted business leaders came together to form Keizai Doyukai. They were motivated by the belief that “the Japanese people must discard their old robes...to erect a completely new order.”¹ Keizai Doyukai has preserved and passed down this commitment. And now, seventy years later, I stand before you as chairman of Keizai Doyukai with an urgent sense that Japan has no future unless we break with convention.

We are in the midst of the rising tide of globalization, the IT revolution, and socialization, and Japan must once again discard its old robes. In order to build a completely new “Japan 2.0” during the five years beginning in 2016, Japan has no choice but to implement bold reforms.

Now is the time for us as corporate executives to break down the barriers in our minds. Let us make 2016 a year for opening new pathways to the future.

2. Overcoming the Crisis of Sustainability

Sustainability is the central pillar of “Japan 2.0.”

As going concerns, businesses are expected to continuously supply society with needed products and services, and to maintain and expand employment. In actual fact, however, it is not easy for businesses exposed to harsh competition to practice sustainable management. The same is true for society. It is challenging to realize a sustainable society when all aspects of our environment are undergoing major changes.

I believe there are three prerequisites critical to overcoming the crisis of sustainability and advancing toward a sustainable society.

¹ “The Japanese people must discard their old robes, and they must weather the current storm of economic, moral and ideological ruin and confusion to erect a completely new order.” (*Mission Statement at Founding of Keizai Doyukai*, April 30, 1946)

First, economic sustainability requires the acceleration of management innovation and growth strategies.

Second, fiscal sustainability requires a new round of comprehensive social security and tax reform.

Third, a sustainable earth requires the achievement of net-zero greenhouse gas emissions.

To respond to these challenges and to make steady progress, we need strong leadership and thorough discussion among all involved. At this point, the importance of the *individual* should be highlighted once again. Against the backdrop of increased globalization, two very difficult negotiations were concluded during 2015. One was for the Paris Agreement signed by 196 countries and regions of the world at the 21st Session of the Conference of the Parties to the United Nations Framework Convention on Climate Change (COP 21). The second was the negotiations for the Trans-Pacific Partnership (TPP) Agreement involving twelve countries. In both cases, discussions were extended beyond the scheduled session, and the agreements reached were, from my perspective, very significant.

Reaching a basic agreement in the TPP negotiations was particularly noteworthy. This is because Japan showed leadership in multilateral negotiations, a rare case in Japan's postwar economic diplomacy. The twelve TPP member countries of the rapidly growing Asia-Pacific region represent a highly diverse group of nations. In addition to functioning under different political systems, they are dissimilar in terms of economic structure, economic scale, and stage of economic development. They also adhere to different values, as reflected in their cultures, histories, and religions. It was, therefore, a truly epochal achievement that the twelve nations were able to reach agreement on establishing 21st-century rules in a broad range of fields. The agreement extends to 30 chapters and covers not only tariffs on merchandise trade but also such matters as the liberalization of services and investment, intellectual property, electronic commerce, discipline of state-owned enterprises, and the environment. To participate in the negotiations, the Japanese government established the TPP Headquarters, and under the leadership of the prime minister, the minister of state in charge of TPP negotiations was appointed to coordinate and unify all government ministries and agencies. The best and the brightest were then brought together from these ministries and agencies. I understand this level of commitment is unprecedented in Japan's multilateral economic negotiations.

These successes provide us with a key for overcoming the crisis of sustainability. *Individuals* armed with a clear vision and willpower must come together to create self-directed *groups* that take the initiative in solving problems. Solutions are developed by overcoming the conflicts of interest between individuals and organizations, businesses and society, and nations and the world.

3. Accelerating Management Innovation and Growth Strategies

The Japanese economy has recovered to the point where it has nearly overcome deflation. However, to achieve fiscal consolidation, the economy must set itself on a sustained growth track. As corporate executives, we must have a sense of urgency in promoting management innovation while the government must create an environment for accelerating growth strategies.

Nonetheless, given increased global uncertainty due to the slowdown of emerging economies and the spread of terrorism, navigating these waters will present significant difficulties. Signs of tremendous change are now beginning to appear as the fourth industrial revolution takes hold, driven by the Internet of Things, artificial intelligence, big data, and robotics. Japan must bring together its knowledge and wisdom to transform this revolution into a new engine for growth. At the same time, we must overcome the upheavals that this revolution will bring to society and employment.

Thus the role to be played by corporate executives is set to expand. Now is the time for us to break down the barriers in our minds, and to bid farewell to outdated conventions and practices. It is no exaggeration to say that if we do not have the courage to accomplish this, we are not fit to take responsibility for management innovation as corporate executives.

In the domestic economy, the progress toward business consolidation and reorganization is slow. Each industry is crowded with participants, and excess competition leads to battles of attrition, causing productivity and international competitiveness to suffer. As corporate executives, our first task is to take the initiative to change this situation. Our individual companies will seek to optimize capital efficiency by maintaining awareness of the cost of capital in their management. We will exercise bold leadership in M&A and business reorganization and aim to make the leap to creating new businesses and industrial structures that can take the lead in global markets.

The second task is to use advanced technologies as a lever to renovate management and to contribute to the solution of global problems. We will endeavor to create an ecosystem that is conducive to increased investment in innovation and the creation of new businesses and start-ups. Avoiding closed innovation, we will instead promote open innovation within industries, across industries, and in the framework of cooperation between business, academia, and the government. We will be open to collaborating with domestic and international universities and research institutions as well as with start-ups, and will have the courage to dismantle existing businesses and business models. Without fear, we will take on the challenge of disruptive innovation that results in the creation of new value.

The third task is to create new organizations and foster a culture that is supportive of such changes. To attract excellent human resources from inside and outside of Japan, we will restructure the personnel systems and strategies of our corporations. At the same time, we will promote diversity by recruiting without regard to gender, nationality, and other factors. We will also

take radical measures to correct the negative aspects of Japan's labor practices, such as long labor hours, and will endeavor to transform productivity.

Based on our commitment to these three tasks, we request the government to fully implement the content of the *Japan Revitalization Strategy* as revised in 2015. Additionally, we call for the government to accelerate the three changes detailed below.

First, the development of growth-oriented corporate tax reforms should be further expedited. Concrete measures should be taken to promote industrial regeneration and to improve locational competitiveness. This means setting a roadmap to lowering the effective corporate tax rate to 25 percent in line with international standards. To cover the reduction in tax revenues, the scope of size-based business taxes should be expanded, along with the introduction of higher property taxes.

Second, a system of highly skilled professional workers should be introduced. Reforms should be adopted as soon as possible to change the style of work, including reforms that will allow people to change jobs without experiencing a period of unemployment.

Third, the TPP Agreement should be ratified quickly and smoothly. Furthermore, efforts should be made for the speedy conclusion of mega-free trade agreement negotiations, such as the Japan-EU Economic Partnership Agreement and the Regional Comprehensive Economic Partnership.

4. Implementing a New Round of Comprehensive Social Security and Tax Reform

In the area of fiscal consolidation, Japan has made an international commitment to achieve a primary surplus by fiscal 2020. However, this is only the first milestone on the road to fiscal rehabilitation. The challenge that lies beyond is to reduce outstanding government debt, and the largest problem that stands in the way of that goal is the social security system, whose sustainability is in doubt.

The top priority in achieving a primary surplus is to raise the consumption tax rate to 10 percent in April 2017 as stipulated by law. A decision has been made to introduce a reduced consumption tax rate for certain goods, which will lower government revenues by about 1 trillion yen; the government should therefore act speedily to secure stable sources of revenue to cover this shortfall. In other words, revenue-oriented reforms are required. Meanwhile, the plan-do-check-act (PDCA) cycle for the government's Plan to Advance Economic and Fiscal Revitalization starting from fiscal 2016 should be implemented repeatedly and without fail. However, reducing the deficit in the primary balance to within 1 percent of GDP by fiscal 2018 and achieving a surplus by fiscal 2020 will also require reforms to ensure carefully managed spending. Specifically, measures should be in place to avoid unwise spending

of the higher tax revenues resulting from acceleration of growth strategies, and nothing should be considered sacred when reducing government expenditure.

The ratio of government debt to GDP stands at 233.8 percent. To bring this under control, I believe we need a new round of comprehensive social security and tax reform. We have long known that the birthrate is declining and the population aging at an accelerated pace. The government's response has been to develop a program for achieving two goals simultaneously. One goal is to expand and stabilize social security programs while securing stable financing for such programs. The second goal is to improve the fiscal balance. In August 2012, eight laws for comprehensive social security and tax reform were enacted and specific reforms are now being implemented based on those laws.

However, quantitative analysis of Japan's demographic trends and changes in the fiscal structure leads us to the inevitable conclusion that the comprehensive reform program launched in 2012 simply is not enough to create and maintain a sustainable social security system. In terms of demographic structure, Japan's working-age population peaked in 1995 at 87.26 million people and fell to 76.93 million in 2015. This is equivalent to an 11.8 percent decrease over 20 years. On the other hand, the population of people aged 65 and older increased from 18.28 million to 33.87 million. This is an increase of 85.3 percent. During the 20 years ending in 2035, the working-age population is projected to further decrease by 17.4 percent, while the population of people aged 65 and older is projected to increase by 10.2 percent.²

The trends in government spending are as follows. A comparison of the fiscal 1995 initial budget and the fiscal 2016 budget approved by the Cabinet at the end of 2015 indicates that social security spending increased from 13.9 trillion yen to 32.0 trillion yen over the 20-year period. During the same period, debt-servicing costs increased from 13.2 trillion yen to 23.6 trillion yen. The combined increase in these two items exceeds the total increase in the government budget during the same period, which amounted to 25.7 trillion yen.

The burdens and benefits of Japan's social security system are shared among generations through taxes and premiums. However, the structural problems of Japan's population and fiscal system are becoming increasingly serious and intractable. The simple truth is that the social security system has no future if we remain on the current path.

Let us rethink the social security system from the perspective of creating a society where future generations can have a brighter outlook. Basically, people enjoy economic utility through the act of consumption. During the 20-year period between fiscal 1995 and fiscal 2014, nominal consumer spending

² Population estimates of the National Institute of Population and Social Security Research (based on birth and death rate medians).

increased from 275 trillion yen to 286 trillion yen. This translates to an increase of 4.2 percent. At the same time, disposable income decreased from 300 trillion yen to 289 trillion yen. This is a decrease of 3.7 percent.³ On a macroeconomic level, consumption propensity is nearly 1, and it is difficult to hope for any further increase. If we want to boost utility in the future and realize sustained economic growth, it will therefore be necessary to keep the decrease in disposable income at a minimum.

Let us consider why disposable income decreased by 11 trillion yen during the past 20 years. Starting with household income, we observe that employee compensation dropped by 18 trillion yen. During the same period, pension and other benefits increased by 27 trillion yen, and property income receipts decreased by 16 trillion yen. Next, let us look at the social security contributions of households. Social security premium payments increased by 13 trillion yen. This makes it very clear that working-age generations suffered a particularly large drop in disposable income.

These numbers point to an undeniable conclusion. Under the basic policy of avoiding any further increase in the burden of the working-age generations, there is no way to promote fiscal consolidation without implementing a new round of comprehensive social security and tax reform.

5. Achieving Net-Zero Greenhouse Gas Emissions

The Paris Agreement was adopted at COP 21 held in December 2015 as a new framework for addressing climate change after 2020. A total of 196 countries and regions have joined the Agreement, including China and the United States, which are the largest emitters of greenhouse gases. I believe this is a historic advance indicating the possibilities of cooperation. The entire world has come to share a sense of urgency and is moving toward a solution to the problem on a truly global scale.

The next challenge is for participating countries and regions to ratify the Paris Agreement. Then comes the challenge of implementing concrete measures to realize its goals. It is noteworthy that the Agreement has adopted the ambitious goal of achieving net-zero emissions in the second half of the 21st century. However, it will be difficult to achieve this goal if the world remains on the same path as today. Therefore, it is absolutely essential for governments, businesses, citizens, and all other actors in the countries and regions involved to pursue more innovative initiatives under the new framework. In particular, I believe the world will be watching how Japan as a developed country will contribute to the international community by performing its responsibilities in this vital area.

Japan has pledged to the world to reduce emissions by 26 percent between 2013 and 2030. This is predicated on 2030 projections for Japan's electric power mix, according to which nuclear power will supply 20–22 percent and

³ SNA, revised figures.

renewable energy will supply 22–24 percent (both of these being zero-emission power sources that do not generate greenhouse gases). Meanwhile, energy conservation will reduce consumption by approximately 17 percent. Achievement of these goals requires a revolution in the energy sector as well.

What immediate steps have to be taken to meet the 2030 goals? Nuclear power plants whose safety has been confirmed should be brought back on line as quickly as possible. Research and development in renewable energy and energy conservation must be accelerated. These are absolutely essential measures. Next, Japan needs a long-term vision that extends beyond 2030 so it can contribute to the world by leading the development and spread of new energy sources that are safer, cheaper, more stable, and more environmentally friendly.

Needless to say, businesses must be at the forefront of these efforts. This means increasing investment in energy conservation, energy generation, and low-emission equipment. Businesses must also promote the proliferation of related technologies, products, services, and infrastructure both in Japan and abroad, and accept the challenge of accelerating innovation.

6. Taking the First Step toward “Japan 2.0”

Keizai Doyukai, an action-oriented policy group that spearheads social and institutional reforms, will mark its 70th anniversary on April 30. This year, with only five years left to 2021, we will take our first step toward “Japan 2.0.”

First of all, we will move forward in our discussion of statistics that provide the foundations for various policies and for obtaining a fuller picture of economic utility, which cannot be properly captured in GDP figures. For example, our grasp of corporate investment activities has to go beyond conventional domestic capital investment. We need to gain a more accurate picture of domestic and international M&A, acquisition of tangible and intangible assets, human resource development, R&D, and other activities in terms of investment related to capital, labor, and innovation. In a mature society where material needs have largely been met, it is essential to gain a deeper understanding of the fusion and interaction between two dissimilar types of economies. One is the real economy characterized by “weight” and represented by goods, and the other is the virtual economy that is “weightless” and represented by ICT.

In light of these objectives, a symposium commemorating the 70th anniversary of Keizai Doyukai will be held this fall, timed to coincide with the publication of the *Seventy Year History of Keizai Doyukai*. At the symposium, we plan to release Keizai Doyukai’s new vision for the economy and society to be pursued under “Japan 2.0.” This will be based on the recommendations and proposals that our various committees and others will be putting together by this summer.

This March will mark the fifth anniversary of the Great East Japan Earthquake. During the period since the earthquake, Keizai Doyukai has supported specialized upper secondary schools and other institutions as part of its IPPO IPPO NIPPON reconstruction support project. With the passage of five years, this project will come to an end in the fall as initially planned.

Meanwhile, regional revitalization has emerged as a new challenge, and with this in mind, Keizai Doyukai will continue to visit areas affected by the earthquake, as well as the frontlines of regional revitalization. In the course of these visits, we will exchange views with local governments and the business community, and examine the forms that long-term support and cooperation can take from the perspective of these localities.

As chairman of Keizai Doyukai, I look forward to participating more actively in private economic diplomacy. In the past, our overseas inspection and research missions have been separately organized by country, region, or policy committee. In addition to these, this year we will dispatch three chairman's missions in the spring, summer, and fall. The purpose of these missions will be to deliver the chairman's messages to overseas audiences and to reinforce international economic exchange. We also expect that these missions will be helpful in formulating the Keizai Doyukai vision for the future.

The first of these missions will visit Israel in the spring. Israel is in the spotlight for leading the world in the ratio of R&D to GDP, as well as in start-ups and patents per capita, making it a start-up nation and innovation powerhouse. Our aim will be to interact with corporate executives, universities, think tanks, and government officials to directly learn about the basic principles and thinking that underlie these achievements.

In the summer, we will visit China with the fundamental objective of promoting mutual understanding and cooperation through private economic exchange between China and Japan. To that end, the mission will strive to gain a better grasp of the worrying economic slowdown in China, and to engage in even closer exchange with the corporate executives of state-owned enterprises and private businesses.

Finally, in the fall, we will visit the United States in the midst of the presidential election. Keeping in mind that we will be dispatching another mission after the inauguration of the new president next year, the aim of our visit this fall will be to reach across generations to deepen our ties with the US government, members of Congress, think tanks, and the business community.

The world is undergoing epochal transformations brought on by the rising tide of globalization, the IT revolution, and socialization. It is against this backdrop that we will be formulating our vision for the future under "Japan 2.0," and we intend to transmit that vision widely throughout Japan and the world.

###