Adam Posen: Good afternoon, ladies and gentlemen. Welcome back. Welcome back from your break and welcome back to the Peterson Institute for International Economics. We are coming up on the keynote and it is a highlight as well as a keynote of our conference today. It’s my pleasure to be hosting a man who is genuinely a friend, but also someone I genuinely admire, Heizo Takenaka. If this was Japan, and probably among the Japan specials in the room, he’s someone like Kissinger or Summers, you can say he needs no introduction.

Heizo is senior research fellow at the Japan Center for Economic Research. He is professor and director of the Global Security Research Institute at Keio. But, of course, this is only a part of what Heizo has represented for Japanese Economic Policy. In 2001, under the previous reform-minded Prime Minister Junichiro Koizumi, Heizo Takenaka became the Minister for Economic and Fiscal Policy and the Chair at the Council on Economic and Fiscal Policy and steered macro-policy and over the next five-and-a-half years, they were quite active five-and-a-half years.

Professor Takenaka spearheaded Japan’s economic reform. He was moved into the Minister for Financial Services as well. In the next year—and we can date to then, finally, the ending of Japan’s banking crisis—I had the privilege to be involved in some of the discussions and analysis and the communications between Heizo and his then counterpart Glenn Hubbard. And I can just say that Heizo is someone who combines—as many people in this room do, but few of us can always succeed—the desire to do the right thing and economic policy, the desire to base it on good economic analysis and the ability to carry it through. And Heizo has done that repeatedly.

He has a very distinguished academic career. He started his academic career as a visiting scholar at both Harvard and University of Pennsylvania. Of course, his most important prior appointment was—Heizo Takenaka was a visiting fellow here at the Institute for International Economics in 1989 and I commend Fred Bergsten who clearly has an eye
Heizo is going to speak to us. I keep referring to him by his first name because he’s known that way to all his friends, but the distinguished former minister Professor Takenaka will speak to us about assessing and where we are and where we’re going to be on structural reform in Japan. This is not merely an academic exercise. As many of you know, Professor Takenaka is the most important outside adviser to the Abe government on issues of economic reform and we’re very grateful to be able to welcome him back. Thank you.

Heizo Takenaka: Well, thank you very much for the nice introduction, Adam and good afternoon, ladies and gentlemen. I’m Heizo Takenaka. It is my great pleasure to be here. If possible, I’d like to express my sincere gratitude to all people in PIIE whose effort made this conference possible and all others parties for taking time from their schedule. I’m very honored to have an opportunity to make a presentation on the economic policy of Japan and its implications.

Very fortunately, in the past two years or so, we have more opportunities than before to discuss Japan’s economic policy in a constructive manner like this conference. Very honestly, I feel a little bit handicapped today because Fred Bergsten, Adam Posen, another excellent American economist to have that special talent to speak in a very exciting manner even if the content is not so exciting. Still, the Japanese economist is likely to have another special talent to speak very monotonously even when topic is interesting. So, I may be handicapped.

As what I mentioned about, well, I had a very good experience as a visiting fellow 25 years ago here at the IIE. If my speech is good, this is owing to the training here in this IIE. If my speech is not so good, there’s something wrong about the training speech I made at the IIE. Well, fortunately, two years ago, two years and three months ago, we had a very special Prime Minister named Abe. Before that, 14 years ago, we had another special leader named Koizumi. I worked under him for nearly six years. He was a very unique and special Prime Minister. Koizumi was a very special unique Prime Minister in the history of Japanese politics.

How unique was he? He nominated me as a Minister. How unique he was. And also, he supported my policy for a long time. As you know, after the bursting of the bubble of the economy in the late 80s, the Japanese economy had been stagnant, but under Koizumi, Japan promoted some bold economic reform like the disposal of nonperforming loan in the banking sector and the privatization of Japan post, Japan highway, and so on, and then Japanese economy was revitalized. But after Koizumi stepped
down in the year 2006, the momentum of the reform explicitly declined. The economic performance of Japan again got worse.

However, anyway, as I mentioned, two years and three months ago, we had a new Prime Minister again, Prime Minister Abe, and he started the new economic policy package, so-called “Abenomics”. Under Abenomics, I’d like to say, Japanese economy had been changing distinctly. Anyway, so, I’d like to discuss first what happened to the Japanese economy and the content of Abenomics, also I’ll discuss what has happened to the Japanese economy from now.

Let me briefly review the recent trend of the Japanese economy. Before Prime Minister Abe took office, the Japanese economy was in the negative growth. The growth rate in the second half of 2012 was minus 2% or so but in the fiscal year of 2013, the first year of Abenomics, the growth rate increased to positive 2%. This was a big change. As a result, the stock price in Japan increased by 57% in 2013. This was the highest increase among OECD countries. In that year US economy was also good, almost finishing the adjustment or balance sheet of the household sector. So, gross rate of the stock price was 28% or so here in the United States. But Japan gross rate of 57%, about double of that of the United States.

Also, in labor market a full employment was realized. Job offer-applicant ratio which was 0.24 after the Lehman shock that increased to 1.1. Recently, especially in the Tokyo area, this ratio, job offer-applicant ratio is higher than 1.6. At least in the first year of Abe administration, I can say that Abenomics was successful, or I’d like to say fully successful in the first year. However, in April last year the consumption tax rate was increased from 5% to 8%. This took a heavy toll, especially on the household spending, hitting the Japanese economy bigger than anticipated.

The growth rate in the second quarter last year was minus 6% annually also in the third quarter minus 2%. Consequently, the growth rate throughout the year 2014 was almost 0%. Anyway, tax hike have led the Japanese economy to the negative growth for two consecutive quarters. Under such circumstances, Prime Minister Abe decided to postpone another round of tax increase that was originally planned in October this year. An important point is that this tax hike was decided by the former administration under DPJ before the birth of Abe administration. Therefore, it has nothing to do with Abenomics.

I’ve been consistently against the tax hike because deflation mindset of the people had not completely disappeared and at the said circumstances, tax rate should not be raised. So, I felt happy with the Prime Minister’s decision and welcomed it. Prime Minister also decided to ask the people whether the people support the Prime Minister’s idea or not. This was the
reason why that was dissolved and the election was held in December last year. As you know, Prime Minister Abe won the landslide victory, obtaining two-thirds majority in the lower house of the Diet. It is quite rare in Japan the ruling party get two-thirds of majority for two consecutive elections.

The last year’s election was the one to ask the population to vote for or vote against Abenomics for government economy policy. So, now, Prime Minister Abe was given another four years to lead the nation stably. So, we’re now watching very carefully how in what way he will make use of his solid and stable political power and how to allocate his political capital in economic policy and diplomatic policy.

Now then what elements of Abenomics? Maybe, you already understand the framework. Are they moving ahead smoothly or not? As you know, Abenomics consist of three policies or three laws. The other day, Prime Minister Abe was asked by one journalist. “How high or low the score of the current situation of Abenomics is?” If Prime Minister himself [inaudible 00:11:44] case, I used to be in the political field for five to six years or so. In this case, politicians are supposed to answer in the following way, “Well this kind of evaluation should be done by the people, not a politician or a political leader.” It’s to accept that in a sincerely manner. This is a very usual pattern of politicians.

However, Prime Minister Abe is sometimes very frank and he at that time answered very frankly, “The current score is 67 out of 100, 67 out of 100. What do you think of this?” I think this is a very reasonable judgment. Maybe Prime Minister tried to say that the first arrow, the monetary policy expansion was well done, so this is okay, but the second arrow, a flexible fiscal policy and the third arrow, a growth strategy of only half of the story or stumbling a little bit along the way. So, 1 plus 0.5 plus 0.5, so two-thirds, 67 out of 100.

Considering the time constraints, I have not discussed much about the first arrow or monetary policy. Basically, a governor [inaudible 00:13:13] Bank of Japan is doing well I think. Last year as I mentioned, GDP growth rate was around 0% because of tax hike. However, the Japanese surplus increased by 9% which was almost equal to that of the United States. This is mostly because of the effort of the monetary policy, the Bank of Japan. From here on, anyway, Abe administration has required two important policy efforts. One, is to draw a persuasive road map for fiscal consolidation. The second arrow has two parts. In the short run fiscal expansion should be done but in the midterm, fiscal consolidation is needed.
So, in this regard, the role of the [inaudible 00:14:04] economic fiscal policy is very important. The Prime Minister promised to clarify this roadmap for fiscal consolidation by the summer of this year when he developed Diet last year. In this process, the most important fact is not the tax hike in my understanding but a reform of social security expenditures that account for 30% of the total government expenditures. How much effort [inaudible 00:14:38] for Abe government is to strengthen its growth strategy? The third arrow growth strategy. This is exactly the most important and attention-grabbing task. I will discuss some details of Abe’s growth strategy.

In the morning session, I heard that Mr. Kuwahara discussed the importance of corporate governance. Of course, this is one of the most important issue because in the case of Japan, the business opening ratio is quite raw. It is about half of that of the United States. At the same time, [inaudible 00:15:13] closing ratio is raw, about half of that of the United States. The metabolism of the industry is low. In order to enhance the metabolism of the society, metabolism of the industry, the role of corporate governance is very important, I think.

But anyway, the total scheme of the gross strategy, maybe you know Professor Hamada of Yale University. He is a very famous professor and he’s now a mentor to Prime Minister. Two years ago, he scored three arrows and concluded as follows, the first arrow margin expansion is good so graded A. The second fiscal policy half-done but half not yet. So, graded B. But the score of the third arrow growth strategy, that’s very bad so score is E. A-B-E. Abe. That’s what the conclusion of Professor Hamada.

However, we should be really careful. This kind of comparison or third arrow is not very clear in my understanding it is because initiative of the growth strategy has made long term initiatives. Whereas the first and second arrow are related to the demand side of the company, mostly related to the demand society. On the contrary, growth strategy, the package of the structural reforms. This is related mostly to the surplus side of the economy. In this regard, we need some patience to evaluate the growth strategy.

It was the beginning of the year 2000 that the Schrader administration in Germany implemented the labor market reform and it was 10 years later that the reform had begun to generate tangible results. In the similar way, the growth strategy takes time. Anyway, the reputation of the growth strategy was not very good at least at the beginning of its stage. However, in my understanding, the situation had been changing a little bit.
Last year, that summer, the second round of growth strategy was announced from the government. Right after that, [inaudible 00:17:48] highly appreciated the growth strategy of Prime Minister Abe. This article said that Abe is driving in a thousand thick nails to the Japanese economy and society. This article also said that Abe’s policy could be even compared to Meiji restoration which initiated the modernization of Japan 150 year ago. Very honestly speaking, this is an exaggeration, even I think that way, but anyway, Economist Magazine appreciated Abe’s growth strategy.

However, very interestingly, right after that, Financial Times published an article that criticized Abe’s growth plan. This article said that the plan itself was not so bad. However, these plans cannot be fulfilled because of the political difficulties. What do you think of that? Actually in the last election last year, many reformers were elected as Diet members. It’s a good news. At the same time, many politicians who were against the reform were also elected as members. It is true. So, these two different views are suggesting that [inaudible 00:19:19] is dependent on the incoming leadership by Prime Minister Abe towards the reform.

Now then I’d like to discuss a little bit that some notable policies to enhance Japan’s growth potential, the contents of the third arrow. In January last year, Prime Minister Abe was invited to Davos meeting to deliver a keynote speech of the opening session, and in the 44 to 45 year history of Davos meeting, this was the first time that Japan’s Prime Minister was asked to deliver keynote address. Prime Minister Abe gave a very decisive, before all the economic leaders, regarding how to realize the economic reform of Japan. We call this as Abe’s Davos promise. He raised many points but four important points we should notice. Promises are important. One is deregulation. Well, deregulation is always anywhere anytime. It’s very difficult. You might understand. It’s because so-called “investor interest group” are against deregulation using their strong political power. Especially in Japan, there are these so called “bedrock” regulations. A typical example of these bedrock regulation is that, you know that, usual business corporations are prohibited to enter agricultural businesses in Japan. To be accurate the businesses are prohibited to own farmland. They can borrow farmland but they cannot own the farmland.

Another example is that there is a strong constraint regarding height of building even in the center part of Tokyo. This regulation in floor-area ratio will be lifted soon in, especially economic zones, but anyway, we have this kind of bedrock regulation. Also, it is very difficult for foreigners to get resident status when they’re in Japan and for your information, in the past 35-36 years, no medical school was not
established in Japan. The newest medical school in Japan was the one in [inaudible 00:22:04] University that established in 1979. New medical school not approved to establish because of the very strong objection of the association of medical doctors.

But anyway, Prime Minister said in Davos meeting, by using the framework of special economic zone, the government will make a breakthrough to all bedrock regulations in two years. It’s a very strong message. Special economic zone, I personally proposed in the policy board to establish this special economic zone and Prime Minister Abe employed that. Now, last year, six areas already designated as special economic zone. I’d like to discuss later on a little bit in the panel discussion with Adam.

The second promise is the corporate tax cut. Japan’s corporate tax rate, effective corporate tax rate is about 35%. That is as high as that of the United States. In the case of Hong Kong and Singapore, it is 17%. Korea, 25%. England, 24%. Prime Minister Cameron promised in the same Davos meeting to cut the British corporate tax rate from 24% to 20%. But anyway, Abe promised then the government so far decided to reduce from 35% to 31% or 32%. This is a very small reduction, but anyway, this kind of process had started. That’s the second promise.

The third promise was, he said, it is very important to make use of female labor in the situation that the total population is declining and the demography is aging. In order to realize the increase of labor participation ratio of female. Foreign labor will play an important role to support housework and elderly care. He explicitly said Japan will accept the foreign labor. Very interestingly still, according to the public opinion survey, more than 90% of the Japanese people are against to accept immigration. So, Prime Minister Abe said, “Oh, just ignore immigration, just guest workers.” But anyway, in some social economic zone, we’ll accept some foreign laborers to support housework or elderly care.

And the fourth promise, this is also very important from the viewpoint of foreign investors, that must be the reform of the government pension investment fund. The Japanese government has a huge amount of pension fund. It reaches one trillion US dollars. This [inaudible 00:25:00] obviously maybe the largest fund in the world. However, the investment portfolio of this money is very rigidly degraded in Japan. About 60% of this money was automatically invested in JGB and this portfolio of share of investment of stock market to us was limited to only 12%. This 12% will be increased to 25% from this year. This will have a very positive impact to stimulate the market, I think.
Anyway, so this year, 2015, is a very important year as a touchstone of new stage of Abenomics, I believe so. Here, I would like to mention a little bit naïve topic, this is a naïve topic. I think there are some Japanese bureaucrats from Minister of Finance, METI, et cetera, but this is about Abe’s style. Abe’s style of policy making. Well, in my understanding, the Abe government is very much department of METI. Ratio of economy toward the industry better than MOF. For a long time MOF bureaucrat had been impressing a lot to the past government but Abe’s style is a little bit different. He made the use of the power of bureaucrat of METI. This is reflected in the personal allocation of the Prime Minister’s office.

So the staff, assistant, secretary to prime ministers and most them are former working METI bureaucrat. Not MOF bureaucrat. And this must be a little bit connected with the fact that his father was the minister of METI and not minister of MOF. And he had a rival at that time, a political rival, Mister Takeshita and Mister Miyazawa, most of them were minister of finance. This is not my opinion. This is an opinion by some journalist maybe.

But anyway, more importantly, Prime Minister Abe’s economic policy or ideas sometimes conflict with the MOF idea. MOF tends to focus mostly tax hike for fiscal consolidation, but Mr. Abe also understand the importance of fiscal consolidation but he wants to improve macroeconomic environment first and he believes this will also contribute a lot to fiscal rehabilitation. I, of course, personally support the Prime Minister’s idea. Anyway, Prime Minister Abe is dependent of METI rather than MOF. However, from hereon, Abe administration need more cooperation with MOF bureaucrat than before for realizing the fiscal consolidation. This is a very important for Abe administration from now.

Well, anyway, I’d like to mention one thing and that is the population issue, demographic issue. Well, the total population started declining starting 2005, so in the past 10 years or so, the Japanese population didn’t increase and declined a little bit. We sometimes would use population bonus and the population onus. Well under the situation, the progressive increasing, we have some merits. It is gradually easy to activate the economy but on the situation when the population is declining, sometimes it is difficult.

We have some difficulties. For example, the burden of fiscal burden, especially social needs, et cetera, et cetera. Well, now, we are in the process of population onus. In the past we had a population bonus and very interestingly, all neighboring countries will quite soon going to the stage of population onus including China, Korea, Hong Kong, et cetera, et cetera. So, it is very important for all Asian countries to mirror each other best practices and in that sense Japan policy must be very important.
showing some good example. Good example, bad examples, we have many but it is very important to have very solid attitude to have a good discussion with the neighboring countries regarding this population related issues.

Anyway, as I mentioned, the Japanese economy is changing a lot in the Abenomics. Finally, I’d like to mention one important factor, that is, that the Olympic games which will be held in the year 2020. This will provide a further chance for the development of the Japanese economy. Just 51 years ago, we hosted the formal Olympic Games in Tokyo. At that time, I was a middle school student living in the local area so I couldn’t understand what happened in that time, but it is quite true that I found that the framework of the current Japan, the framework of the current Tokyo was created at that time.

For example, maybe you know that we have very special elaborate train system, Shinkansen system. Shinkansen was opened only nine days before the Olympic Games, nine days before the Olympic Games, and there are some you know established hotels in Tokyo. New Otani, Tokyo Place Hotel, Capital Tokyo Hotel were opened in the year of Olympic game. And another famous hotel, Hotel Okura, Okura was opened two years before the Olympic Games. Also, we have some good examples of the business development, economic development, business industrial development.

Well, at that time, some people saw that, well, we are going to accept many VIPs from foreign countries; this is maybe the first time after the Second World War. VIP. So, security business could be very, very important, promising, and one company was established two years before the Olympic games. It was Nihon Keibi Hosho, the current name is Secom. Secom is the largest security company in Japan but at the very beginning, when it was established two years before the Olympic Games, the number of workers were only two. There were only two workers, very small company. But now the security are developing a lot and at this moment 500,000 people are now working in this security business. From 2 to 500,000 this industry developed.

The Olympic Games started this kind of opportunity. So, taking this opportunity of hosting Olympic Games, it is very important for Japan to promote both economic reform comprehensively. Now, in Asia, there exist about 500 million middle income people, the population of middle income people is 500 million. But, it is estimated to become 3.5 times in the coming 5, 6 years or so. Maybe there we’ll have another more chance to come to Japan, have a business in Japan, making use of ORCC et cetera, et cetera. So, this will provide a very good chance for the development of the Japanese economy.
Well, anyway, as was mentioned by Adam, time flies like an arrow. I came here for the first time 25 years ago, but many things have changed. Time flies like an arrow, it is a very important message. So, my hope is three arrows will fly like time. Thank you very much I appreciate your comments.

Adam Posen: 

Thank you very much for giving us a training course on how to give a speech. We know you are in infinite demand and have to leave at 1:30 sharp so let me start right in and then we’ll turn to our distinguished audience. I must admit, as wonderful as your speech was, as much as I back it, I was quite shocked and disappointed that you made no mention of agricultural reform and Trans-Pacific Partnership.

Heizo Takenaka: Oh.

Adam Posen: And given that Prime Minister Abe is supposed to be making a visit here in a few weeks and that the primary objective from the US government side of that visit is to have concluded the bilateral aspect of the US-Japan negotiations over to TPP as then the domino for the rest of them. I’m quite shocked.

And moreover, just to put the point kind of more forcefully, I was there for the thrilling speech in Davos by Prime Minister Abe in January 2013, excuse me, 2014. You know, it was terrific, but part of his being the drill bit of reform was explicitly to take on agricultural and to promote TPP as well as promoting inward investment in Japan, something we talked about this morning. So, I’m going to give you a chance to make good. Explain to me why that wasn’t important or why that was an oversight.

Heizo Takenaka: Well, Adam, you always create a very stimulating question and very important question, I appreciate that. Well, TPP, because of time constraints, I didn’t talk much about agricultural reform but it is a very good chance for me to speak what’s happening in Japan in this field, the reform on this field. Have you ever heard of Zenchu? Zenchu is the national union of agricultural cooperatives.

Adam Posen: [Inaudible 00:36:38] 82.

Heizo Takenaka: National union of agricultural cooperatives. This had keeping very strong political power to be against the TPP and is, in a sense, a symbol of very obsolete agriculture system of Japan and Prime Minister Abe boldly decided to abolish the power of Zenchu. This is a very big political fire, I think. Please imagine that US president is fighting National Rifle Association. Yes. And in the sense of atmosphere on TPP, especially in the field [inaudible 00:37:23] that we changed dramatically. But still
I agree but Prime Minister Abe still said the TPP is an important pillar of Abenomics and he is ready to fight against this kind of political power and actually this is [inaudible 00:37:44].

Well this is the political negotiation you saw. I’m not sure what kind of negotiation is now done but I am relatively optimistic about the process of TPP because both United States and Japan are beneficiaries of this TPP. So, it will take some time to make a political arrangement but well this is advancing especially from the Japan side. The power of Zenchu will be decreased dramatically from now or it will become in that sense become easier for that. My [inaudible 00:38:26] what would happen to the US side?

Many Japanese policy makers are warning about the situation of the US government. There is the conflict between the president and the congress, et cetera, et cetera. So, I think, as I said I am optimistic [inaudible 00:38:46] negotiate. Especially I’m optimistic to the decision making of the Japanese government but I’m not very sure about what will happen to the US side.

Adam Posen: Speaking frankly, the divisions within the US government are not good news for the US or for the world economy. But the one issue on which the US government congress and the Obama administration have hopes of getting bipartisan agreement, in the next six months or a year, is on TPA and TPP. And we’ve seen quite a lot of bipartisan outreach and there are clearly people in the Democratic party, but an increasing number of people in the Republican party, in the House, who are skeptical and there are many issues on the table.

But as we’re going to be discussing following your remarks in the session, both the national security arguments and the bottom-line economic arguments were made compelling and there is a cross the aisle very large group of legislators and very strong backing by the President. So, I think, you know, we went through the stands a while ago when President Obama went to Tokyo and there was supposed to be a deal and Prime Minister Abe didn’t quite do the deal and now we’re hearing it again. I think the only way we get forward is a US-Japan agreement which then leads to enough on the table from everyone else in TPP to make it worth approval.

But I am convinced that this administration is taking this issue much seriously, much more seriously and putting more political weight on it than they have any other international economic issue to date. Now, that’s not, you’ll notice, the most winning endorsement of their international economic policy to date, but on this issue I feel comfortable. Thank you. Others in this audience can obviously disagree or agree.
Heizo, let me ask you another question. You made reference to this new remarks. A year-and-a-half ago, you know, I come to Japan, I get to hear you talk, you were very influentially pushing this idea of special economic zones and there again it was something that echoed with various American reform efforts, things we’re seeing in Europe and at the time you were pushing them, it sounded to me reading your remarks and others in the debate, it sounded very promising. It was about really, like you said, with medical schools, it was about liberalizing zoning and labor laws in Osaka and Tokyo and major urban centers and really pushing things forward in the services sector.

Over the last year, it seems like some think tank—it wasn’t us—managed to have a big influence by publishing reports saying all these towns and the rest of Japan are going to shut down in the next 20 years because there’s no population growth. And then suddenly all these people in the Diet said, let’s call [inaudible 00:41:43] on Hokkaido a special economic and send money there. And my being overly cynical, has the special economic zones process been hijacked by old LDP pork barrel politics?  

Heizo Takenaka: Okay. Thank you very much. In January this year, we had a panel discussion, the Davos meeting, and at that time, I remember you gave this kind of criticism and I didn’t have a chance to respond to that at that time so let me respond. Well, it’s possible the new special economic zone is very much different from the past special economic zone. Well, at the current economic zone, new economic zoning like that. We’ll assume the Tokyo area. Well, the so called regional conference, the special conference established and in this regional conference, the minister of special economic zone will attend representing the central government. And the governor-mayor will attend representing regional government and some will be representing the public sector joining them.

So, from the central [inaudible 00:42:55] from the regional [inaudible 00:42:55] of the private sector this [inaudible 00:42:58] regional conference. This can play just like the miniature government. They can decide everything by then. So, this is quite unique administrative system in the history of Japanese politics. And so, still, in my impression, the mayors and government are a little bit reluctant to promote a reform, but in this case Prime Minister and Minister of special economic zone are urging them and in this case, the deregulation will advance. A very different way compared with the past special economic zone and there is the very famous example.

The small city, Yabu Citu in Hyogo Prefecture, just a small city but its mayor is very eager to change the agriculture system and this is now providing a very good opportunity as a business to invest in this agriculture. This is changing. So looking at what’s happening in Yabu
City, some other cities are now are raising hand to become special economic zone so it has just started only 10 months or so still but it’s moving, I think, and yes, I must say important example is medical school.

Medical school will be established but in the Tokyo special economic size term, [inaudible 00:44:25] some area of Tokyo in the Kanagawa Prefecture at the area but additionally, we put Narita City in Chiba Prefecture. The reason is quite simple. There’s one university planning to establish a medical school here near Narita Airport. This is the beginning maybe of also the medical tourism also. Well, still, still medical association is against that but I’m very confident that the new medical school will be approved.

So, I’m also frustrated at the [inaudible 00:44:55] of that but this special command system is advancing. And the second point, this is a planning trend and some [inaudible 00:45:06] estimate there are 1,800 towns and cities in Japan and among them, 800 will disappear by the year 2040 because of the decline of the population. This is my estimate and some LGP members are demanding to give money, et cetera, et cetera, but Prime Minister is completely against that and at this moment, this kind of fiscal support will be done by the government so deregulation is the central [inaudible 00:45:43] of the structural reform.

So, of course we need more effort at this moment but anyway, at the special economic zone, the system is progressing slowly but steady. This is my understanding.

Adam Posen: Yeah. Yeah. You know, you’ve covered so much and you’ve done it so well and I also want to be clear we’re not back—certainly, at least, in this building—we’re not back to the 90s about, you know, Japan’s got all these problems and there’s nothing in the US. Your analogy to the NRA is apt. we have our own problems getting the medical industry and other services industry still allow international competition here so it’s great to hear you making strides on that.

I would, however, like to ask you to sort of put on one of your other hats. I mean, you do so much work within China. You do so much in the sort of economic security sphere. I’d like you to say a little bit about how you see Abenomics progressing in terms of where that puts us in sort of the triangle of US-China-Japan. I mean we’ve seen here and Fred Bergsten gave an excellent [inaudible 00:46:56] that I agreed with recently about the US should be playing from day 1 in the Asian infrastructure investment bank and now we’ve heard, I believe, that even the government of Japan has now said that they are prepared to join which was a bit of a surprise.
Do we view, should Beijing, view Abenomics as pushing Japan in a more strong confrontational perspective versus China? Or, is this something that compliments and deepens integration with China? How should the US view Abenomics in terms of what we think should be happening with economic governance.

Heizo Takenaka: Well, this is a very complicated issue but important issue…

Adam Posen: You’re the man. You’re the man.

Heizo Takenaka: Well, first of all, it is very important for Japan to strengthen our economy for Japanese but this will also help all Asian economy as I mentioned. Still the influence on Japanese economy development is very big. This is the first point. And Prime Minister Abe is also regarded as a kind of hawkish politician or rightist, et cetera, et cetera. But my observation is a little bit different. He’s a realist. He’s a realist actually. So, he also pays much attention to the [inaudible 00:48:23] specifically to China.

But as for AIB the Japanese government at the very beginning stage had been watching very carefully the decision making of the United States. At that time, in my observation, the US government’s President Obama persuaded European countries and other Asian countries, Australia, not to join AIB so Japanese government watched very carefully the movement of the US and the government had decided its position. But, our expectation was a little bit betrayed. Most influential European countries decided to join, so under such circumstances, very recently, Minister of Finance Mister Aso changed his [inaudible 00:49:14] a little bit. Still, we have not decided yet.

Well if the governance of this new bank is good in this case we should watch considering joining, et cetera, et cetera. So, in this sense, Japan has a very strong influence on Asian Development Bank. The governor of Asian Development Bank had been all Japanese [inaudible 00:49:39] minister of finance. In that sense, still, Japanese government have tendency to place more importance on the role of Asian Development Bank. Still not so much reluctant to join that but still my point is as for AIB Japanese government is watching carefully the backing of the US government but Fred Bergsten [inaudible 00:50:10] references are great so after going back to Japan, I’ll asked Prime Minister and the staff members to watch very carefully [inaudible 00:50:22].

Adam Posen: I will take a little credit that along with Fred, we’ve been the only ones out there in public saying this. You’ve been much too gracious and very accommodating. We have many distinguished guests and friends with us today. I’d like to open the floor to questions. As usual, I’d like to ask that the first couple of questions go to our outside guest and not to Peterson
Institute fellows Jessica’s here with a microphone upfront. There’s a standing mic at back. Please raise your hand if you wish to be recognized. Yeah, right there. If you can identify yourself, please.

Tobias Harris: Tobias Harris from Teneo Intelligence. I just want to go back to when you were talking about Abe’s style of leadership. Because I think there’s something very important there. It tells you how he uses his political capital, what his priorities are. You actually worked closely to the Prime Minister who had a very different style of leadership, much more confrontational, much more taking his interests head on and I’m just wondering if you could talk about some of the differences, what you think might actually work more. I mean, we’ve seen Abe and, you know, he was willing to compromise a little bit with [inaudible 00:51:28] he got something less than what the government I think while initially was still kind of moving things forward and I just wonder if you could talk what you think might be more effective. Would you like to see Abe more confrontation like Koizumi? I mean, what do you think can work more over the long term?

Heizo Takenaka: Well after the establishment of Abe government, he first focused to strengthen the monetary policy, then he established a new policy board named the Council on Industrial Competitiveness to discuss the growth strategy, et cetera, et cetera. And also, he established new [inaudible 00:52:09] to discuss education reform, et cetera, et cetera. But still in some area, Abe kept silent. Well, even in the case of Prime Minister, what can be done by Prime Minister is limited. So, he has some priorities and first of all, the monetary policy and then the growth strategy, et cetera, et cetera.

The remaining problem, especially in the field of economic policy, is, for example, as I mentioned in my speech, the most important one is the reform of social security. That accounts for about 30% of the total expenditure of the government and also the demography is aging so from now on, social expenditures, pension expenditures, and medical care expenditures will explode almost every year. So, we are very fundamental comprehensive [inaudible 00:53:10] for social welfare system. But still there is some [inaudible 00:53:16] to reform that but it had been succeeded from the former government. There’s no new invention from the government under the leadership of Prime Minister Abe, this is the first one.

Another one is energy policy maybe. As I mentioned, this government is very much influenced by METI bureaucrat. And METI has been in charge of energy policy for a long time so the current energy policy that METI is responsible for the current situation. In that sense, you know, maybe from the viewpoint of the Prime Minister at this moment he may be reluctant to
have a [inaudible 00:54:01] but anyway we have [inaudible 00:54:03] problem about the nuclear power plant issue and also at this moment the energy price have been declining so in the short run, we had a bit of an opportunity but anyway, in the long run, what kind of energy [inaudible 00:54:19] strategy we should have?

Even considering obtaining the enough energy at the same time reducing the pollution, et cetera, et cetera. So these two policy efforts should be added in the new stage of Abenomics.

Tobias Harris: Thank you.

Adam Posen: Next question or comment? I’ll let the IIE hounds out if no one else speaks. Okay, Arthur.

Arthur Alexander: Thank you. Arthur Alexander from Georgetown. You spoke about that you were opposed to the consumption tax but you also are saying that fiscal consolidation is a very necessary new policy or new direction, perhaps working through social security reform, but are you looking at other policies for fiscal consolidation? Reducing corporate taxes, don’t want to raise the consumption tax again. What’s left? Where else can we go?

Heizo Takenaka: Okay. Thank you very much for raising very important question. Well, first of all, as I mentioned, the government is going to publish the roadmap for fiscal consolidation by the summer of this year. I have some personal recommendations. Well, under the Koizumi administration between year 2003-2007, we could reduce the primary deficit from 6% of GDP to 1% of GDP. So, if that policy were to be continued for one or two more years, Japan could be the primary surplus country.

At that time, we didn’t have any tax increase but we placed a cap on expenditures. The expenditures-GDP ratio should be constant. This placed a cap on expenditures. Under such circumstances, we stimulated the economy through the disposal of nonperforming loan and the privatization with Japan ports. This is the main scenario for fiscal consolidation.

Additionally, you are asking if there are some additional scheme or not. Yes, there are some I think. Well, in Japan where taxes are gathered by national tax agency and the social security tax is gathered by, what’s the name of that? Anyway, social security agency or something like that. Well, this should be integrated. In the case of national tax agency, they have a very excellent skill to gather in their long history, but in the case of social security office, well, they have some problems. This should be
integrated. By doing that, more revenue, in total, will be increased dramatically.

According to one estimate by an influential politician, Mister Asao, he raised the question in the Diet. If there is integration just like the Internal Revenue Service or like that, in this case, total revenue of the government will increase by 10 trillion yen. This is almost equal to the total amount of corporate tax experiment. Well, I’m not sure this calculation is accurate or not but anyway, it is recommended to have Internal Revenue Service like organization. This is I think the most important.

Another recommendation is the government still own a huge amount of asset. This should be sold out and now so-called “concession process” has started. Concession means as place [inaudible 00:58:26] of the airport. The airport is owned, held by the government but the right to operate this operation would be right to be sold to the private sector. In the case of Japan, Sendai Airport is now under concession and quite soon, Kansai Airport—oh, this is a huge amount of concession—this will also start. This in the sense that recycling of the infrastructure in capital.

This will also play a very important role especially the regional government. We discussed that already the regional economy declining but regional government owns a huge amount of asset. They can sell that. So, there’s two strongly recommended to realize the fiscal rehabilitation to restore consolidation besides the very orthodox ways to stimulate the economy.

Adam Posen: Fred?

Fred Bergsten: Fred Bergsten from the Institute. Heizo, great to see you. Thanks for coming back. Let me ask you a more fundamental question about fiscal consolidation. Why do you care?

Heizo Takenaka: Okay.

Fred Bergsten: Japan, has, as is well known, Japan has by far the highest debt to GDP ratio of any country in the OECD.

Heizo Takenaka: Mm-hmm.

Fred Bergsten: Much higher than Greece but it doesn’t seem to have caused you any problems. You yourself oppose a second stage of the tax decrease.

Heizo Takenaka: Mm-hmm.
Fred Bergsten: Rightly, I would say. Totally with you on that. But why do you worry? Demonstrably, this huge level and buildup of debt has not had adverse effects on the Japanese economy. Is that a wrong assessment and if it’s not, why do you worry?

Adam Posen: Let me give you 10 seconds more before you respond to that. A slightly less provocative version of that statement would be our colleague Joe Gagnon who has argued that there’s a very big distinction to be made between economies where you can print your own currency and economies where you can’t. And Japan of course has huge domestic savings on its own currency and so even if maybe Greece shouldn’t take a lesson from Japan, Japan may have certain degrees of freedom that Greece doesn’t. That [inaudible 01:00:45] to give you more time.

Heizo Takenaka: Thank you for the question raised, Adam. If I say my answer in one word, there is sustainability problem. Sustainability problem. Industrialization is not sustainable in my understanding. Well as you mentioned, JGB government bond GDP ratio is exceeding 200% in Japan. It’s higher than Greece but still this is financed but still this is increasing. JGB government bond-GDP ratio is exploding. So, we cannot continue this situation. We can’t explain it in a different way.

For example, while you say that Japan is a country of high savings but maybe you know that last year the household savings rate of Japan became negative reflecting the demographic change, aging of the society. The deficit of the government means the negative savings in the public sector. But this negative savings had been financed by the high positive savings of the private sector, but private sector savings, or to be specific, household savings rate is now becoming negative. Still, corporate sector has some savings, so the situation is not sustainable considering the demographic change.

Of course, we should consider another important fact. The Minister of Finance and the government always say the gross debt. It doesn’t consider net debt. Net debt is not so big at this moment in Japan. So, still we have some room, some time to improve the situation. But still, I’d like to say that, finally, the situation is not sustainable. We cannot continue this situation for a longer time. So, we need some time for preparation. This is the reason why we should start a very serious discussion on the road map of fiscal consolidation. You are not frustrated yet?

Adam Posen: It’s fascinating. Fred’s always worry about our trade deficits but has never worried about Japan’s. But I think let me follow up on that just briefly, Heizo. Because—well, no but they are linked, Fred. That’s the point. You and I actually were together, not that my opinion matters like yours, but you and I were together in terms of fiscal monetary policy and late night
As Charles Horioka two decades ago, Japan’s demographics mean household saving is going down. Japan starts running a trade deficit, we’ve seen that. And, you know, depending on how you calculate, you have roughly 10 to 12 years of continued trade deficits before you run out of cumulated net foreign assets and so that in a sense could be your sustainability constraint. And so, the question is, I know you’re not stipulating this specifically that, but you know, I know you recognize that issue. Why would you not want to say, “Okay, given the bad choices, we’re going to have to consolidate at some point”? Why wouldn’t you want to spread it out over more years and start now versus as you say, waiting and preparing and having to do it later? I mean, that’s just the question. The question is why did you choose to postpone and therefore presumably have to do the same consolidation in a shorter span of time rather than advocating starting it early?

Heizo Takenaka: Well, everything depended on expectation of the market. Well, it’s very difficult to put a [inaudible 01:04:45] to what kind of expectations are held by the market people but the government should avoid some kind of risk considering the [inaudible 01:05:01] dramatically. Once expectation is changed, it is very difficult to correct that. So, it is safe. It must be safe for the government that [inaudible 01:05:14] to provide the very persuasive scenario or road map for the fiscal consolidation and this is my basic idea and also we can’t say [inaudible 01:05:27] way well now household savings did not follow concept. This is stock concept. Now, household sector in Japan is carrying one third and 400 trillion yen of asset, right? And now our government debt is roughly 1000 trillion gross. That’s gross, gross concept. So the [inaudible 01:05:58] 400 trillion yen and every year, the government is issuing bond about 40 trillion yen so assuming, it’s very simple calculations. This kind of thing can continue maybe 10 years or so, five to ten years, but that’s it. So, there’s a reason why the government should make some preparations for fiscal rehabilitation. I’m afraid we are not past [inaudible 01:06:28] yet.

Adam Posen: I am, though. Where you have a hard stop at 1:30 so the last question, turn to Jacob.

Jason Kirkegaard: Jason Kirkegaard from the Peterson Institute. So, in the interest of time, I have a one-word question. Immigration.
Heizo Takenaka: Okay.

Jason Kirkegaard: Is that part of Abenomics? Should it be? And what are the prospects and scale thereof?

Heizo Takenaka: Okay. At this moment, immigration, accepting immigration is not part of Abenomics. As I mentioned in my speech, Prime Minister himself used the term, “This is not immigration, this is accepting the guest workers.” However, very interesting opinion in our society. Well, right after the Second World War, the total population, Korean population living in Japan was exceeding the Korean population in Seoul. Can you believe that? Seoul at that time, one million population city. One million and 20% were Japanese and 80% were Korean.

But at that time in Japan more than 800 Southern Korean people were there. It depended on definition of growth. So, for example, there’s a very famous professional wrestler in Japan, Rikidozan. He was from Korea and there is a very famous baseball player, homerun king, Sadaharu Oh. His father was from Taiwan and many singers, many comedians, are mostly from [inaudible 01:08:04] Korea, China, or Taiwan origin.

So, Japan is not so homogenous country. We have been accepting Chinese, Koreans, Taiwanese, and we have been creating the current pop culture. So, this king of opinion should be shared by people. If we just kind of be in a shell by the people, the people’s attitude will change but at this moment, as I mentioned, according to the public opinion, more than 90% of the Japanese are against immigration. It will take more time.

Adam Posen: Thank you very much. Minister, you continue to lead intellectually as well as politically. We’re very grateful that you came back here to share that with us.