

Improving the Foundation for Revitalization of the Japanese Economy

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Keidanren

1. Introduction

- Business and consumer sentiment has improved rapidly since the inauguration of the second Abe cabinet.
- The government should live up to its pledge to make Japan the most favorable country for business, stimulate "expectations" throughout the real economy, and transform those expectations into a "realization".

2. Monetary and Fiscal Policy: Appraisals and Challenges

(1) Bold monetary policy

- Unprecedented easing by the Bank of Japan has had a huge impact on the market. The stage is now being set for a shift to a more proactive stance by the corporate sector.
- The government and BOJ should take concerted action to rein in any sharp fluctuations in the exchange rate.

(2) Flexible fiscal policy

- The government's 15-month budget deserves approval as a timely and appropriate response aimed at putting the economy back on a firm growth track.
- However, the fiscal situation remains extremely bleak. The government should set forth a clear policy vision for fiscal restructuring.

3. Growth Strategies That Will Make Japan the Most Favorable Country For Businesses

(1) Columns of the Growth Strategy

Growth Strategy

Improving foundation to ensure level playing field internationally

Cultivation and development of industries and business ventures that contribute solutions to the challenges confronting Japan

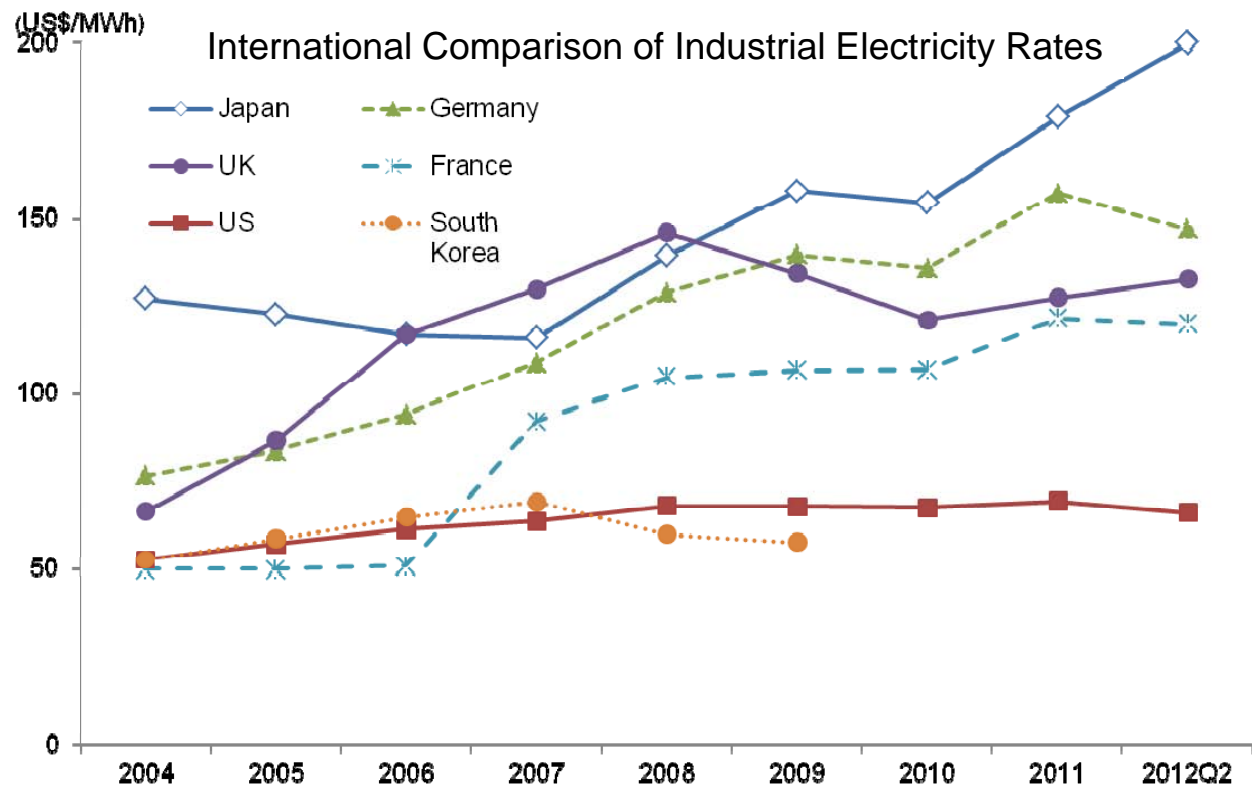
Regulatory reforms that generate new goods and services

To achieve this, devote consideration to **five policy challenges** that are closely associated with investment profitability.

(2) Five Policy Challenges to Ensure Level Playing Field Internationally

a. Containing Energy Costs through Energy and Environmental Policies

Current Status and Issues	Specific Policy Actions Required
<ul style="list-style-type: none"> • Efforts to restart the nation's nuclear plants are still stalled. In addition to uncertainties surrounding the supply of electric power, the nation faces huge increases in the cost of imported fuels as well as a heightened burden of costs associated with energy-saving measures during periods of peak demand. • This state of affairs will add momentum to the uptrend in the cost burden associated with the feed-in tariff scheme and the carbon tax as global warming countermeasure. 	<ul style="list-style-type: none"> • Establish a clearer policy vision for stable supplies of electric power within the next three to five years. • Speed up the nuclear plant restart process. • Apply smoothly environmental impact assessments for the construction or expansion of coal-fired plants. • Formulate global warming countermeasures and medium-range targets that are in balance with energy policies. • Review and revise the feed-in tariff scheme and the carbon tax as global warming countermeasure.

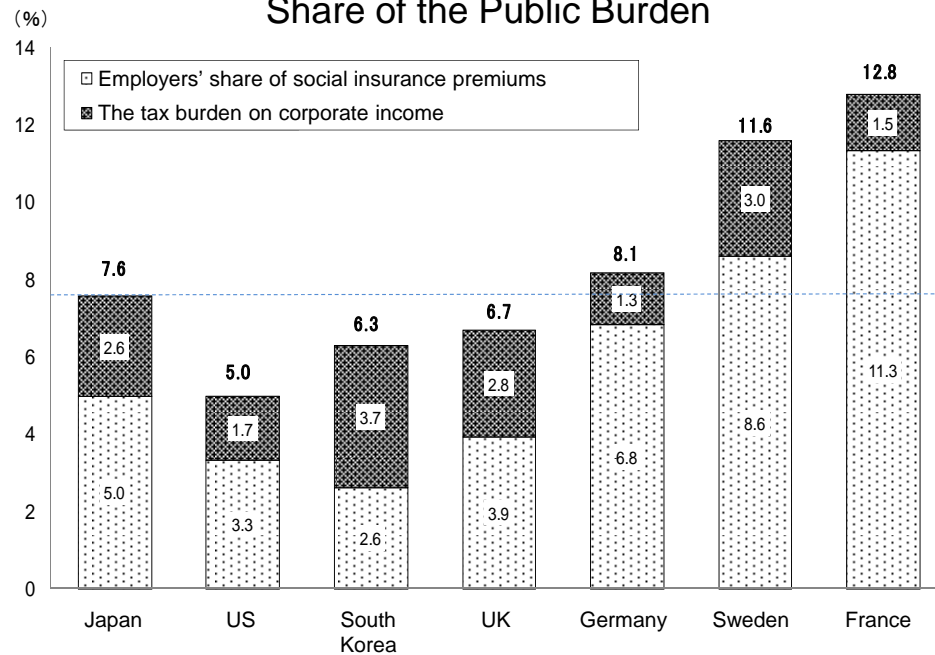


Note: Prices for the US are prices before taxes.
 Source: OECD/IEA, "Energy Prices and Taxes," Volume 2012 Issue 4.

b. Tackling the Continuously Increasing Social Insurance Burden in the Aging Society

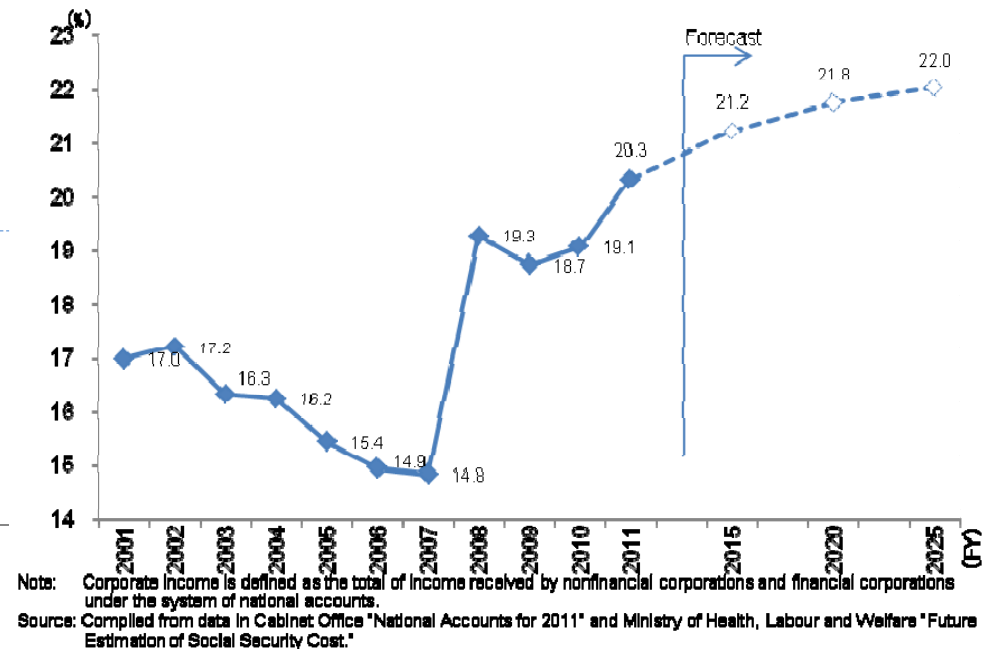
Current Status and Issues	Specific Policy Actions Required
<ul style="list-style-type: none"> • The uptrend in the cost of social security benefits has not been brought under control and thus poses an increasingly heavy burden to current generations and corporations. • Social insurance premiums have been rising year on year and will have the effect of capping wage increases and the expansion of employment. 	<ul style="list-style-type: none"> • Seek further improvements in the efficiency and prioritization relating social security benefits. • Increase the tax-funded share of the elderly health-care and nursing-care costs, which are forms of income redistribution and intergenerational support.

International Comparison of the Corporate Share of the Public Burden



Source: OECD (2009 data).

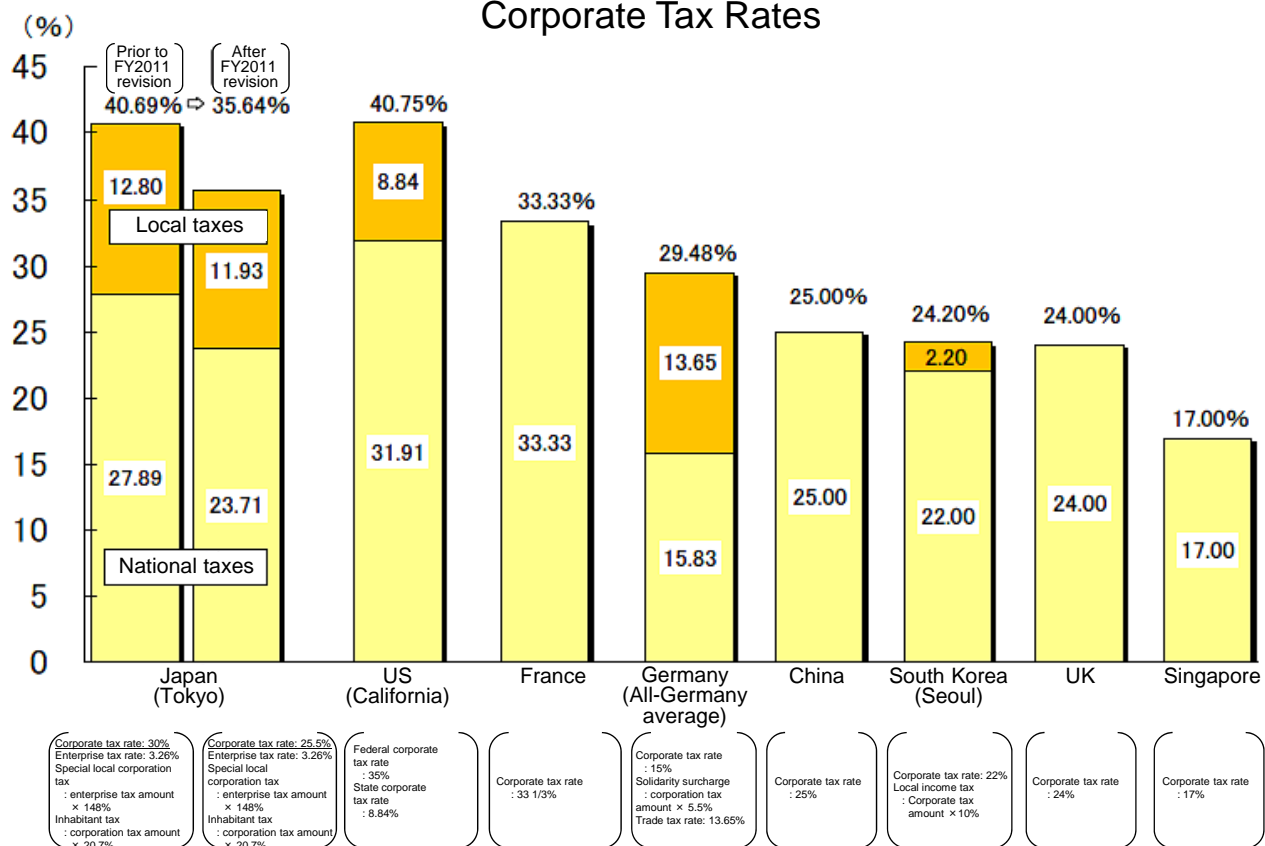
The Burden of Social Insurance Premiums on Corporate Income



c. Tackling the Higher Effective Corporate Tax Rates Compared with Those in Other Countries

Current Status and Issues	Specific Policy Actions Required
<ul style="list-style-type: none"> Up to FY2011, the effective corporate tax rate was 40.69%. Although it is scheduled to be reduced in several stages, to 35.64% by FY2015, it is still extremely high by international standards. 	<ul style="list-style-type: none"> Demonstrate a clearer policy vision for reduction of the rate to around 25%, in line with the average level for other Asian economies.

International Comparison of Effective Corporate Tax Rates

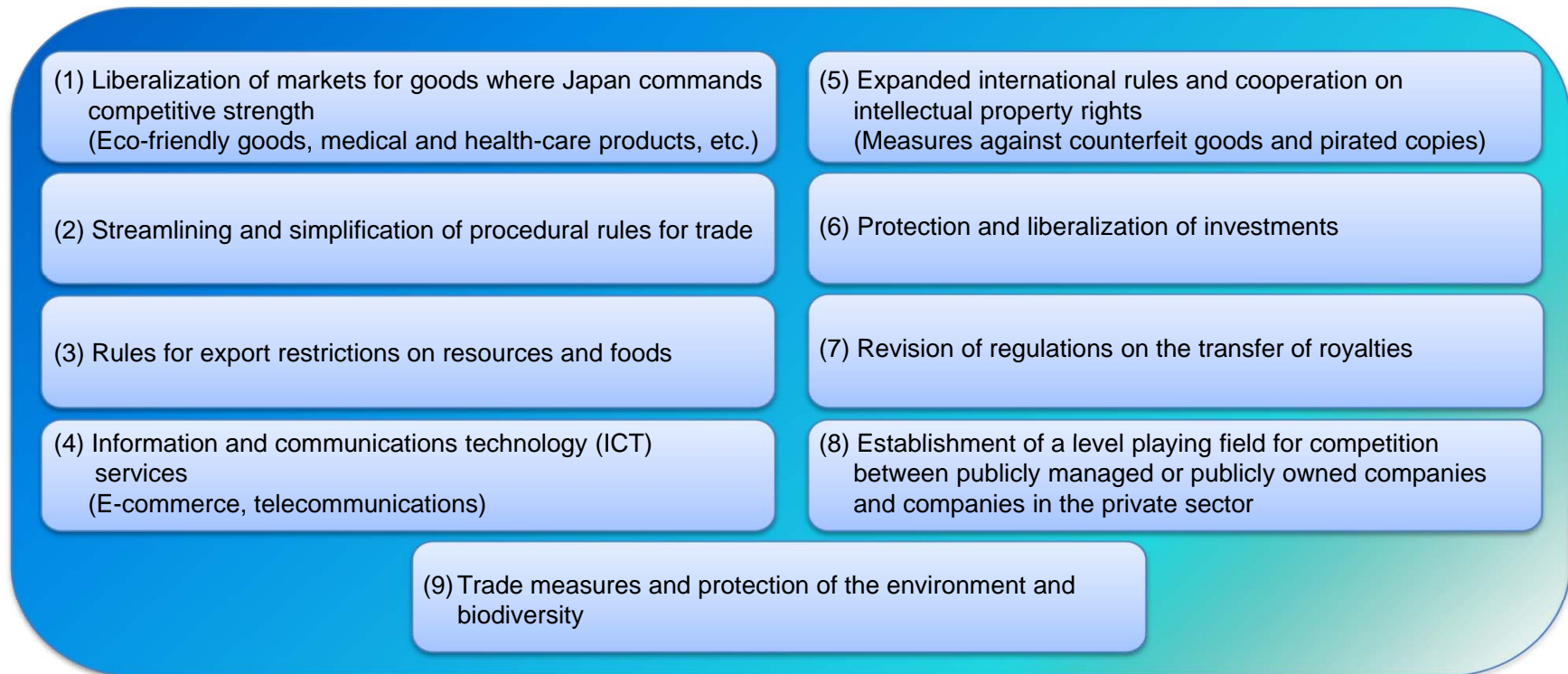


Source: Ministry of Finance.

d. Seeking Early Conclusion of the TPP and Other Economic Partnership Agreements Contributing to the National Interest

Current Status and Issues	Specific Policy Actions Required
<ul style="list-style-type: none"> • The battle for the lead in establishing new global rules through regional free trade agreements (FTAs) has been intensifying. • Delays in the conclusion of new FTAs have interfered with the smooth formation of global supply chains and value chains. 	<ul style="list-style-type: none"> • formulate desirable trade and investment rules for the nation as "a unified axis" and negotiate to reach an international consensus on these rules. • Expand negotiations on Trans-Pacific Partnership (TPP) to realize Japan's national interest. • Conclude a Japan-EU economic partnership agreement (EPA) at an early date. • Pursue a regional comprehensive economic partnership (RCEP) and a Japan-China-South Korea FTA, which lead to the creation of a Free Trade Area of the Asia-Pacific (FTAAP).

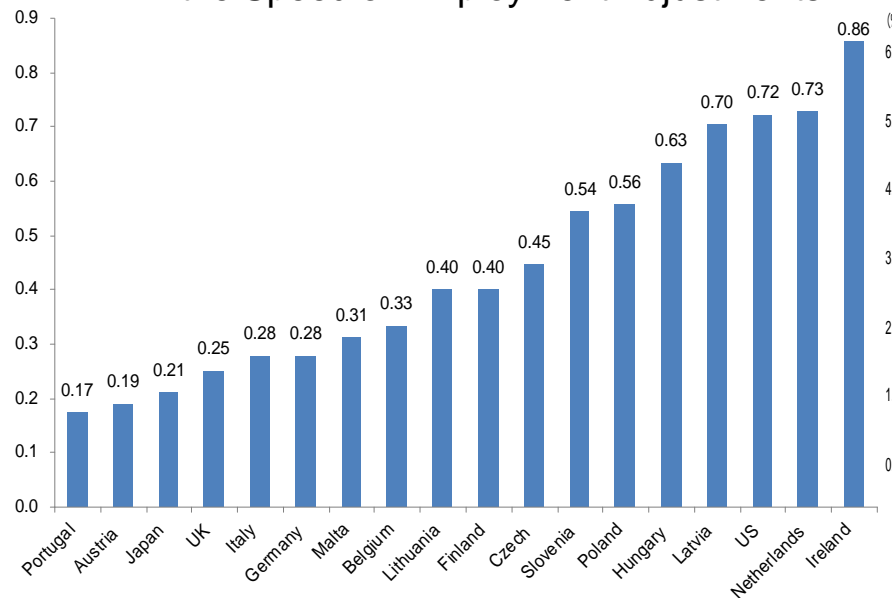
Field-Specific Components of a Unified Axis (Example)



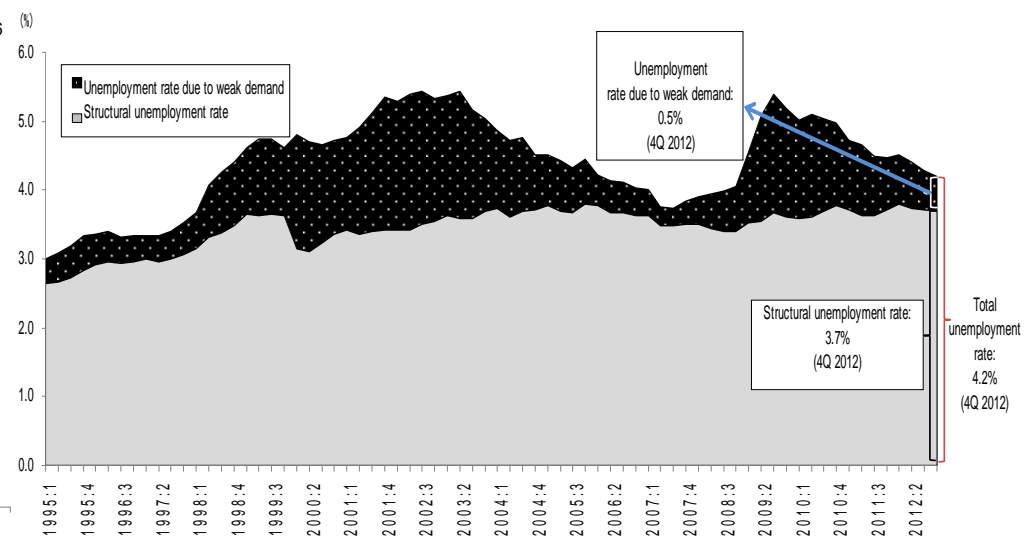
e. Making the Flexible Labor Market

Current Status and Issues	Specific Policy Actions Required
<ul style="list-style-type: none"> Although the unemployment rate in Japan has been kept low compared to other countries as a result of corporate measures to maintain levels of employment, this has been cited as a factor behind prolonging deflation and delaying structural reform. It is urgent to create a more-flexible labor market that facilitates a shift of workforce to growth industries with zero unemployment. Harnessing diversified talent will be increasingly important to the goal of speeding up innovation. 	<ul style="list-style-type: none"> Implement sweeping revisions to worker dispatch system. Reform systems of working hours (including revisions to the discretionary working system for management-related work). Improve the transparency of employer accountability to workers on open-ended contracts that impose limitations on workplace or job category. Promote the acceptance of highly qualified foreign talent.

International Comparison of the Speed of Employment Adjustments



Trends in the Structural Unemployment Rate



Notes:

1. Estimation formula: Number of employees = $\alpha + \beta \times$ number of employees (in previous term) + $\gamma \times$ real GDP + $\delta \times$ real employee compensation + $\zeta \times$ time trend
2. The speed of adjustments to employment is defined as $(1 - \beta)$. Within a range of $0 \leq 1 - \beta \leq 1$, the closer the value moves toward 1, the higher the speed of adjustment, and the closer it moves toward 0, the slower the speed of adjustment, whether expanding employment as needed for increased production or reducing employment in response to business slowdowns.
3. The 1st quarter of 1997 to the 3rd quarter of 2012 was the period on which these estimates were based.

Source: Prepared by Keidanren Secretariat using data from the Cabinet Office "Quarterly Estimates of GDP," Ministry of Internal Affairs and Communications "Labor Force Survey," US Bureau of Labor Statistics, US Bureau of Economic Analysis, and Eurostat.

Notes:

1. Estimation formula: $\ln U = \alpha + \beta \times \ln V + \gamma \times M + \delta \times N$ (UV curve)
 U: Unemployment rate (= totally unemployed persons ÷ (totally unemployed persons + employees) × 100)
 V: Vacancy rate (= (active job openings – placements) ÷ ((active job openings – placements) + employees) × 100)
 M: Margin of employed persons interested in job changes who are actually pursuing other employment
 N: Ratio of employed persons in tertiary industries
2. The structural unemployment rate (U^*) is defined as the value when U and V are equal.
3. Derived from the estimation formula, $U^* = (\ln U - \beta \times \ln V) \div (1 - \beta)$.
4. The number of structurally unemployed persons (X) was derived from the structural unemployment rate. If the number of employed persons is Z, then the structural unemployment rate (U^*) is obtained as follows: $X \div (X + Z)$.

Source: Prepared by Keidanren Secretariat using data from the Ministry of Internal Affairs and Communications "Labor Force Survey" and Ministry of Health, Labour and Welfare "Employment Referrals for General Workers."

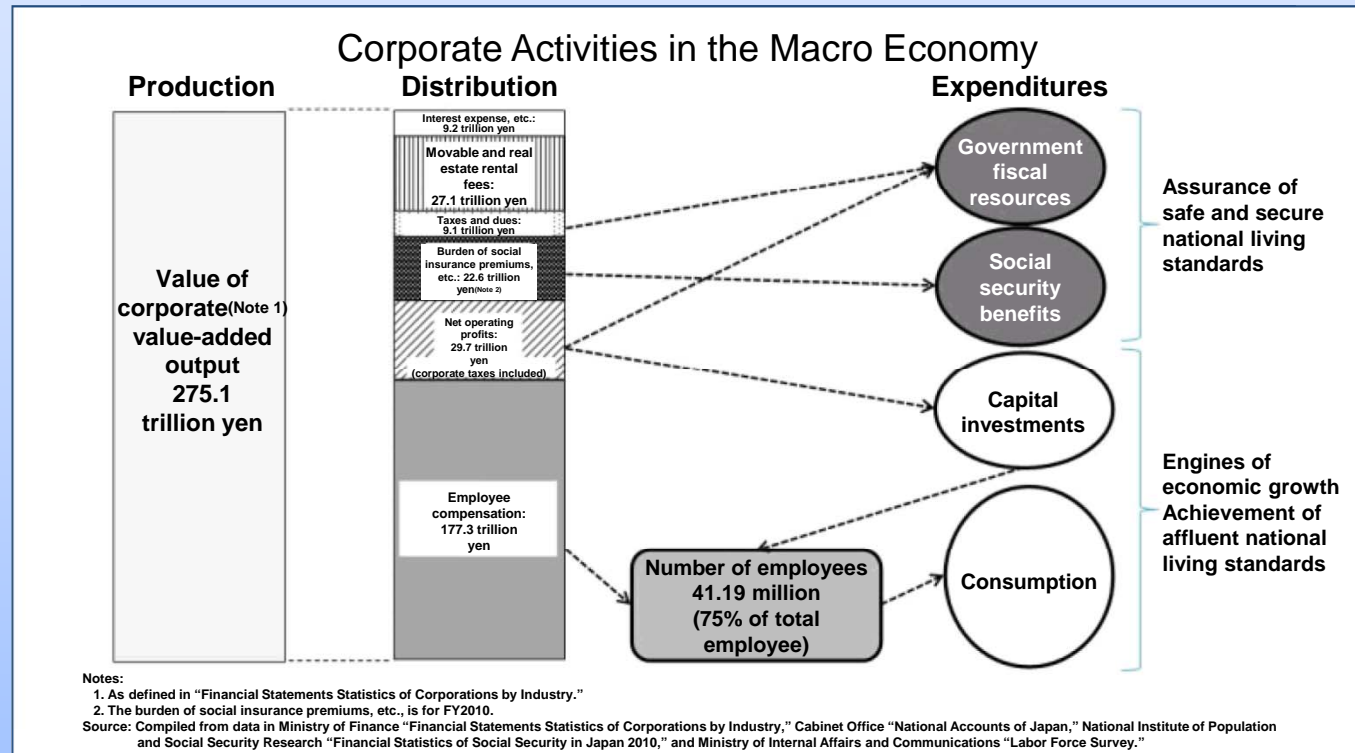
4. Issues That Companies Should Address

(1) The Importance of Corporate Endeavor

- The added value generated by corporate activities contributes to the formation of the economic and social base.
- Companies need to evolve and achieve higher levels of competitiveness and productivity through their own initiative and increase the value of their value-added output.

(2) Strengthening of Innovation

- Companies also need to redouble their efforts in the area of innovation and open up new horizons for business endeavor. Accordingly, in addition to the process innovations where we have demonstrated strength in the past, we should also pursue innovations on a variety of other fronts including product innovations, business model innovations, and reverse innovations.



5. Conclusion

- This is our last chance to rebuild Japan's economy.
- Implementing a growth strategy will also be essential to the solution of the many problems Japan now faces, including the reconstruction of areas damaged by the Great East Japan Earthquake and adapting to our declining birthrate.
- For its part, the business community has taken the government's "Three Arrows" to heart and is determined to contribute to powerful new economic growth led by the initiative of the private sector.