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A Country in Transition: Reforming Japan's Economy

Speech by

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Thank you, I'm delighted to be here this afternoon. This is the second time I have spoken at CSIS since my recent arrival in Washington. And since I have only given one other regular speech thus far, my speeches to CSIS currently make up two-thirds of my total. Tomorrow, however, I take off for Denver to give a speech. And then CSIS will be down to 50% of my total.

An ambassador, like a butterfly, goes through different stages . . . from egg to caterpillar to finally getting his wings. In my case, the rumor first went around last January that I would be appointed as ambassador to the United States. In May, the Government made an informal, internal decision on the appointment, which was quietly leaked. I didn't do it. In September, the Government made a formal decision on the appointment. Fortunately, no Senate confirmation was needed. In October, I arrived in Washington. Until I presented my credentials to the president I was, according to State Department rule, an appointed ambassador. And then two days ago I presented my letter of credentials to President Clinton, and I became an Ambassador Extraordinary and Plenipotentiary. What an extraordinary life! Until last week, I was a caterpillar! Now I have my wings. So I flew to Seattle to be greeted by demonstrators.

I thought I would begin today by commenting on the current situation of the Japanese economy, and then I'd be happy to take any questions you might have. After five consecutive quarters of negative growth, the Japanese economy registered positive growth in the first two quarters of 1999. This is largely thanks to the stimulus measures taken by the Government--in particular, the policy package implemented since November 1998. As you know, that package consisted of a variety of measures, including improvement of economic and social infrastructure, as well as reduction in individual income and corporate taxes. The total scale of the package was more than 190 billion dollars.

Now, although the Japanese economy is recovering, this is largely due to the effects of various government policies. Private sector demand remains weak. Last month the Government therefore adopted a new policy package called "The Policy Measures for Economic Rebirth," which is designed to achieve a smooth transition from public-sector-led growth to private-sector-led growth. We hope it will put the Japanese economy back on the path of full-fledged recovery. The new package amounts to approximately 170 billion dollars. It promotes small and medium companies and venture firms, job creation and employment stability. It further upgrades

infrastructure with more focus on information technologies. It also continues to encourage deregulation. In a year's time, we expect the expansionary effects of these measures to be about 1.6 percent in terms of real GDP growth.

Meanwhile, the reform of Japan's financial system continues. In light of the rapidly changing global economy, the administration of former Prime Minister Hashimoto in 1996 embarked upon major financial reforms under the principle of "free, fair and global". The measures included the removal of barriers between life insurance and non-life insurance businesses and removal of restrictions on use of foreign currencies in Japan and on foreign exchange transactions. The commissions on stock trading were also completely liberalized as of October 1, 1999.

The burst of the bubble economy drove a number of Japanese companies into serious economic trouble. Sanyo Securities went bankrupt. Yamaichi Securities had to cease operations. Hokkaido Takushoku Bank also went bankrupt. Since the fall of 1997, emergency laws were passed to inject public funds into sound banks, promote mergers and temporarily nationalize failed banks. Moreover, the government established the Financial Reconstruction Commission to cope with the difficult financial situation. According to Minister Ochi who chairs the Commission, the condition of the Japanese financial markets has become much more stable in 1999, compared to 1997 and 1998. Japan's Top 15 banks have largely disposed of their non-performing loans.

We're also seeing business alliances in both the banking and insurance fields, which are aimed at strengthening competitiveness domestically and internationally. For example, Dai-ichi Kangyo Bank, Fuji Bank and the Industrial Bank of Japan announced a plan to integrate their operations by forming a joint holding company with assets of about 1.3 trillion dollars. Sumitomo Bank and Sakura Bank announced a merger plan.

Japan even has a new word "risutora," which is the Japanese version of restructure. Nissan Motor Co. is not only eliminating 21,000 jobs but also considering to sell its shares in 1,400 suppliers and related companies. Nippon Telegraph and Telephone is cutting 20,000 jobs. Mitsubishi Motors is cutting 10,000 jobs. Sony 17,000. NEC nearly 15,000. I take no pride in saying that Japan's unemployment rate is now higher than that of the United States. It is, however, an indication of a transition that is underway in my country. The restructuring, of course, deals with more than jobs. Lost jobs are the outward and visible sign of the deeper economic change that is occurring. The keiretsu system is unraveling. The convoy system is de-coupling. These represent both economic and social changes.

The reforms taking place are occurring not because of foreign pressure or gaiatsu, not because the Government of Japan wants the changes, but because Japanese themselves want them. I find the rapidity with which foreign firms are influencing the Japanese business environment quite remarkable and positive. The wave of acquisitions, mergers and joint ventures will have far-reaching consequences. GE Capital bought Japan Leasing. Merrill Lynch acquired the entire retail branch of Yamaichi Securities. Renault has bought a big chunk of Nissan. Foreign investment in Japan is running at the pace some three times last year's.

I believe the influence of these foreign companies will reshape Japan's economic landscape. Mr. Kaoru Yosano, former Minister of International Trade and Industry, is reported to have made the interesting point that there isn't any backlash or economic nationalism surrounding these acquisitions, which indicates to me how ready Japanese are for change. When British Cable and Wireless was going to acquire Japan's overseas phone carrier, International Digital Communications, the British government approached me to convey its concern over whether the Japanese public would be opposed to the sale and whether the Japanese government might try to prevent it. The sale went through with no negative reaction from either the Japanese people or their government. Just as in the 1970s and '80s when American companies were learning from Japanese business practices, I think the foreign investment that is taking place in Japan right now will bring new ideas and energy to Japanese business practices.

One final change that I want to mention is this. In spite of the collapse of Japan's economic bubble, Japanese consumers are actually doing better than before the bubble burst. Prices are lower. Selection is greater. More options are available than ever before. American products and American customer service are educating Japanese consumers. And that is true for retail products, financial products, technological services and so forth. Japanese consumers expect more than they once did. And I believe this is healthy for our economic future.

In closing, ladies and gentlemen, I want to say that I realize Japan has much to do in order to restructure itself for the 21st Century. We still have difficult choices to make. I am absolutely convinced, however, that the basic changes are already underway. I believe we are right now in the midst of a major and historic transition. I welcome it and my country welcomes it.

Question & Answer Session

Q. You stressed the need to move from public spending as a force of economic recovery, but you have two things going against that. One is the layoffs and economic uncertainty and the second is the aging society where people are worried about saving for their retirement and spending money after retirement. How can policies deal with the issues?

A. First of all, we are trying to revitalize the economy by spending a lot of public funds and also by reducing the tax burden. We welcome investments from abroad to liberalize our economy. We used to have the longstanding Keiretsu tradition, which restricted business opportunities for Japanese companies as well. But this system is unraveling. We hope that liberalization will increase business opportunities for foreign companies in Japan.

As to the aging problem, I think that is one of the problems all the advanced economies are facing now. Perhaps the pace of aging in Japan is the fastest, and to be frank, I have no answer to that. In the long run, we have to really restructure our economy so that we can sustain it with smaller population. I understand that CSIS is developing a project on aging. As you know, this aging problem is one of the most important agenda items for the G-8 summit. Former Prime Minister Hashimoto took the initiative to work together with CSIS to find a solution and I understand there will be a big conference in Washington in January next year.

Q. Where do you see our two nations' relationship headed? In the early 1990s we talked about global partnership. It's one of the words like restructuring that really has no Japanese counterpart, and indeed the concept really never seemed to take off. America's relationship with China is still very shaky and uncertain despite the WTO deal. The situation in the Korean Peninsula still has a great danger. How do you see the relations between our two nations as collaborators in international affairs as opposed to competitors?

A. Although I did not mention specifically our bilateral relations I think the theme of my speech covers bilateral relations, especially in the field of economy. There are increasing investments from the United States to Japan. When I was in San Francisco ten years ago, the current was in a different direction. Many Japanese people came to the United States during the bubble economy to buy many things, including real estate. I was often asked about the trend and the standard question in those days was whether Japanese were trying to buy out America. Of course, that was impossible. The funniest question was about a Japanese company, which was about to purchase Rockefeller Center. A TV commentator asked the question whether there would be a huge bonsai tree at Rockefeller Center at Christmas time. But as you know, a bonsai tree is a miniature tree, so that was very funny. So, I look forward to going to New York to see if there is no bonsai tree now.

I think our relations are excellent now, including our relationship in trade and investment except for a few issues such as steel products, for which anti-dumping procedures have been taken. But, generally speaking, we enjoy excellent relations in the field of trade and investment. It is largely thanks to a very good American economy, which I hope will continue as long as possible. It is our hope that the Japanese economy can catch up and can be on the recovery to growth process while U.S. economy is still in a good shape.

As to other aspects of our relations, we also enjoy a very good cooperative security relationship. One of the most difficult security issues is North Korea. We have been enjoying very close cooperation and coordination in this field. We appreciate very much the efforts made by former Secretary Perry as special coordinator on policies toward North Korea. Of course, the progress in our respective negotiations with North Korea is very slow, but we enjoy very good cooperation with the United States and the Republic of Korea.

There are many other international issues, on which Japan and the United States are cooperating very closely, such as East Timor, Kosovo, and Bosnia. I think this is a new trend that in addition to cooperation in purely bilateral relations, we cooperate in international and regional conflicts. There are many worthwhile projects on which both U.S. and Japan are cooperating in such fields as the environment, the fight against diseases, the protection of natural resources, and efforts to stabilize countries in Central and Latin America, Africa, and the Middle East.

Q. We represent a coalition of some 60 companies, some Japanese. We are interested in seeing the U.S.-Japan Tax Treaty renegotiated. It is a 30-year-old treaty and has extremely high withholding rates on interest, dividends, and royalties. Do you have any insights into that?

A. I was very much involved in the conclusion of the tax treaty in the past. I know that the Tax Convention is one of the old issues. We have received some requests from both American and Japanese companies about reviewing of the Tax Convention. We are now discussing within the government whether and how to deal with the question. We are now analyzing which parts of the existing Tax Convention require a fresh look. We have not reached any conclusion about the policy towards this question. But, we are actively reviewing the question together with the Ministry of Finance. So in due course, I will be able to give a more specific answer to that.

Q. Your predecessor did such a good job that he left you very few difficult trade issues, but he did leave one. That is the U.S.-Japan Flat Glass Agreement. The 1995 agreement will expire at the end of this month and is a high priority for U.S. industry. My question is, may we be optimistic that the agreement will be renewed essentially as is?

A. My predecessors left a few trade issues, but he left big shoes for me to fill. About flat glass, we just had a round of consultations in Tokyo. Our position is that under the existing agreement, the situation has largely improved. In our view, it is not really a problem for the entire industry of the United States, just a few companies. We have examined all statistics in this field. We don't think that we should continue or renew that kind of agreement. We are very much in favor of liberalization and our policy is to discontinue such a sector-by-sector agreement. But we are ready to hear the views of the U.S. government and industry also.