

**Japan's Global Strategy:
With the Recovery of Its Economy, What Steps Will Japan Take for the World?**
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1. Japan's Global Strategy and the Japan-U.S. Alliance for Asia and the World
(1) New global challenges

Thank you, Dr. Green.

Distinguished guests, Ladies and Gentlemen:

The purpose of my present visit to the United States is to call on and exchange views with Treasury Secretary Paulson and other high-ranking officials concerning prospects for the global economy and cooperation in the financial area between our two countries. Before coming here today, I discussed a wide range of topics with Secretary Paulson, including the global economy and the further enhancement of Japan-U.S. cooperation, and I can say that it was a fruitful meeting.

Today, I would like to start by discussing some of the major changes in the world in recent years.

First change: the end of the Cold War, which had a significant influence on the security balance and the post-World War economic relationships. The new order has seemingly begun to allow different regions of the world to adopt different behaviors and views.

Second, since September 11, humankind has been engaged in the fight against terrorism. The terrorist attacks have been utterly condemned, and I offer my deep condolences to the victims and their families. In this context, stability in Iraq is crucial.

Third, more recently, challenges have been made against the nuclear non-proliferation system. The announcement of nuclear testing by North Korea on October 9 last year represents a grave threat not only to Japan and the Asian region but to all humankind, and this is totally unacceptable. Iran also restarted uranium enrichment-related activities last summer. I would like to welcome the unanimous adoption of a resolution to impose sanctions against Iran by the U.N. Security Council on December 23. The current non-proliferation system is in danger of being destroyed. We need to maintain this system for the future of the entire world. Japan will make every effort to stop North Korean nuclear development.

Fourth, Asia's economic weight in the global economy has been increasing. In the midst of this Asian growth, China is considered one of the superpowers, thanks to its very rapid economic growth. This seems to have made China feel that it can go its own way. Consequently, more discussion is now needed on how to integrate the Chinese economy into the global economic order. China's continued expansion of its defense spending, which remains opaque, is also noteworthy.

In Asia, India is another country with a large population and with enormous potential for future economic development.

Japan wants to gain economic stimulation from the vitality of these Asian countries while effectively contributing to their economic development.

Fifth, the recent high oil prices' negative impact on the world economy has highlighted the importance of the

energy issue. As natural resources are finite, I believe that science and technology will play an increasingly important role in order to strike a sound balance between economic activity and environmental protection.

Sixth, environmental protection, such as reducing greenhouse gases, has become a critical issue for the sustainable development of the global economy. The Kyoto Protocol covers only about 30% of total current CO2 emissions in the world. This ratio is projected to decline further as emissions from developing countries increase.

With all these changes facing us, I believe that it is time for humankind to change its approach by establishing a new set of principles. This is necessary so that people everywhere can co-exist peacefully and prosper in this new environment. Here are some of my basic ideas.

We should establish a philosophy for co-existing peacefully and living in harmony, irrespective of beliefs, religion, or nationality.

We need to strike a good balance between economic activity and environmental protection in order to ensure the continued existence of humankind. In this context, it is important to go beyond the Kyoto Protocol to create a new, practical and effective framework in which all countries, including the United States, China and India, will participate.

The nuclear non-proliferation system must be firmly maintained. In order to do so, the international community, together with the U.S., needs to take a decisive position to solve the North Korea and Iran nuclear developments.

We must fight terrorism, which is a common challenge for everyone in the world, irrespective of their positions.

(2) Japan-U.S. alliance for Asia and the world

It is critical to solve these global challenges facing us so that we can pass on today's peace and prosperity to future generations. In order to do so, it is necessary for the major nations of the world to come to a fundamental agreement to tackle these challenges together.

The United States is the world's most powerful country, both economically and militarily. The United States and Japan share the common values of freedom, democracy and market economy and these values are shared by all humankind. In order to meet the new challenges, I believe that the United States plays a critical role. Japan would like to encourage this leadership and we are willing to throw our support behind the U.S. Without American leadership, these difficult tasks cannot be accomplished.

For our part, we will never again take the road to becoming a military superpower. The foundation of Japan's national security policy is to maintain our security, with the Japan-U.S. Security Treaty at the heart of our relationship. Rather than have a strong military, Japan wants to remain an "economic superpower" and a "leader in science and technology" in the world. By giving our support to U.S. leadership, we want to contribute in our own way to world peace and prosperity, primarily through economic strength and advanced science and technology.

Japan also considers that the U.S. presence in Asia is critical for economic development and stability throughout the region. We look forward to continued U.S. engagement in the Asia-Pacific region through such bodies as the APEC. The American presence in the Asian region, broadened to include India and

Australia, is to be further encouraged.

In this respect, I would like to applaud the successful launch of the first Strategic Economic Dialogue between the U.S. and China held last December in Beijing.

The Japan-U.S. alliance has already borne fruit for Asia and the world. Let me give you some recent examples.

Japan highly appreciates the decisive stand the United States has taken on the North Korea nuclear issue on various occasions, including the Six Party Talks. We are resolved to make our best efforts on this issue, because of the grave threat it poses to nuclear non-proliferation.

In the area of measures against money laundering and terrorist and illicit financing, Japan also appreciates U.S. efforts to combat counterfeiting of banknotes and abuses of the international financial system by terrorists. Japan continues its efforts in this field in close cooperation with other countries under the international frameworks set up for this purpose.

Moving forward, we need to continue to discuss the global challenges and the roles to be played by the U.S. and Japan. In my position as Minister of Finance, I intend to maintain close contact and to promote cooperation between Japan and the U.S. in a variety of areas, not merely those linked to economic issues.

2. Japanese Economy and Future Policy Direction

(1) Recovering Japanese economy

Five years ago, the Japanese economy faced problems with non-performing loans, and three excesses in the corporate sector: excess debt, capacity and staffing.

However, since the start of the Koizumi Cabinet in 2001, a policy of structural reforms has been vigorously carried out. The basic principle of the reforms is to leave in the hands of the private sector what it can do best, and to delegate administrative operations as much as possible to local governments.

Thanks to these efforts, the Japanese economy is now on a recovery track, led primarily by investment and exports. The recovery is not supported by public expenditure as advocated by Keynesian economic theory but is being achieved through structural reforms from the supply side. Non-performing loans have been cleaned up and the financial system has been stabilized. The corporate sector has been restructured by eliminating the three excesses.

The Abe Cabinet will continue to dynamically promote structural reforms. Under the basic idea of “no fiscal consolidation without growth,” a policy of structural reforms, not public expenditures, continues to be rigorously pursued to make the economy even stronger.

As for the future outlook, buoyancy in the corporate sector in Japan is projected to continue. Corporate earnings have risen steadily, from 226 billion dollars in FY2001 to 457 billion dollars in FY2005. And estimates are that for FY2006, corporate earnings will record historical highs. The real GDP of the Japanese economy is forecast to grow 2% in the next fiscal year, primarily owing to domestic private demand.

At this juncture, increases in wages and regular employment continue to be modest. But the favorable conditions in the corporate sector will ripple through to the household sector and wages, as the total unemployment rate and the job offers-to-applicants ratio have steadily improved. With this, the income environment will brighten and the recovery track supported by domestic private demand will strengthen. This virtuous circle will put the Japanese economy further along on the sustainable expansion path. I expect that

the recovery path will manifest itself even more strongly by around the time of the House of Councillors election this summer, assuming the global economy continues to do well.

To make sure that the current economic recovery trend is sustainable, it is important to ensure cooperation between the government and the Bank of Japan. The government expects that the Bank of Japan will continue to support the economy from the monetary side.

(2) “No fiscal consolidation without growth”

On the other hand, with regard to Japan’s fiscal situation, Japan’s debt outstanding to GDP ratio for central and local governments combined is 148%. This ratio is the highest among the industrialized countries. Meanwhile, the ratio of tax and social security contributions to national income is 38%. This is practically the lowest among industrialized countries. In other words, Japan offers a medium level of government services for a low burden ratio.

Fiscal consolidation is a challenge of the greatest importance and the Abe Cabinet has the clear intention of resolving this issue. It is also important not to merely pass the burden on for future generations to deal with. By pursuing the goals of restoring fiscal soundness and revitalizing the economy at the same time, the government has pledged to achieve a primary surplus over the course of the next five years to stably reduce outstanding debt in GDP terms by the mid 2010s. I feel at this juncture that we could achieve this goal earlier, if we succeed in our efforts for fiscal consolidation through the integrated reform of expenditures and revenues.

The government budget for FY2007 set at the end of December last year has been further prioritized under the basic idea of “no fiscal consolidation without growth.” By firmly advancing fiscal consolidation efforts, the largest reduction of new bond issuances in history was achieved. Thorough review and reduction of expenditures were also implemented.

While cutting expenditures comes first, the government will also need to secure stable revenue sources to cover the incremental costs associated with the increase in social security benefit payments and measures to address the falling birthrate. These costs cannot be offset by expenditure cuts. To that end, the government is committed to promoting fundamental and integrated tax reform, including the consumption tax, after autumn this year, to avoid shifting the burden onto future generations.

(3) Globalization and economic policy

Economic activity is globalized today and corporations choose which countries they will base their business in. In the face of globalization, the basic policy of the Abe Cabinet is to make Japan an attractive place for business, by securing equal footing competitive conditions between Japan and other countries, including the tax system.

From this viewpoint, corporate tax system reforms for FY2007 will include changes to depreciation schemes. One example is to abolish the current ceiling of 95% for depreciation, to enable companies to depreciate up to 100% like in other countries. Another example is shortening the statutory useful life of equipment for producing semiconductors to levels comparable to those of other countries. We will continue to make reforms so as to introduce global standards in the field of taxation.

Even under such stringent fiscal conditions, investment in R&D is being promoted as a means to invigorate the economy. Budget allocations for R&D have increased in the FY 2007 budget. This is important from the perspective of raising productivity and the long-term potential of the Japanese economy.

The population of Japan began to decline in 2005. According to the experts, in 50 years' time the population may have fallen to under 90 million, assuming that the current trend continues. Against this backdrop, it is quite important to take bold policy actions to maintain current population levels.

The Abe Cabinet also intends to channel new vitality to the Japanese economy through the power of innovation and openness.

With regard to overseas investment into Japan, we aim to double that level to 5% of GDP by 2010. We are engaged in implementing a number of measures to promote inward direct investment.

Japan-U.S. economic relations are closely meshed in this regard. As of the end of 2005, Japanese direct investment in the U.S. stood at approximately 150 billion dollars, and Japan was ranked the No. 2 investor country in the United States. U.S. investment in Japan stood at approximately 44 billion dollars, and the U.S. was ranked the No. 1 investor country in Japan. The fruits of those investments stood at around 10 billion dollars and 5 billion dollars, respectively, in 2005.

To promote active investment relations between Japan and the U.S., a new tax convention was put into effect in March 2004, which considerably reduced the burden of taxes withheld at the source on investment income.

3. Environment and Nuclear Energy

In order to ensure sustainable world economic growth, we must address concerns about the environment as well as the stability of energy supplies. When we look at these issues, I believe that we should think 100 years ahead. Oil and other energy sources may have dried up by then. Technological breakthroughs may lead to alternative energy sources such as wind, solar and bio-energy, but it is unlikely that those sources can play a major role.

Ultimately, I believe that nuclear energy provides a realistic and effective answer to the issues of ensuring a stable energy supply and of addressing climate change. This is why Japan has been promoting the peaceful use of nuclear energy. Premised on stringent measures for safety and non-proliferation, a growing number of countries appear to be developing a more favorable stance toward adopting and utilizing nuclear energy for peaceful purposes. I hope that more countries and more people among the general public will come to deepen their understanding of the case for utilizing nuclear energy.

4. Science and Technology and International Interaction

As a member of the Diet, I have been involved in the formulation of science and technology policies for many years. From April 2001, I served as Minister of State for Science and Technology Policy in the first Koizumi Cabinet. During my tenure, I came to realize, more than ever, the great importance which science and technology has for the future of humankind. And I began to feel the need to create a new international platform to discuss the lights and shadows of science and technology issues from the perspective of the long future of humankind.

Progress in science and technology has brought prosperity and has enriched the quality of life for much of humankind. But along with the lights have come shadows, such as climate change, ICT-related privacy issues, and ethical problems in biotechnology. We must control the negative factors on the one hand, and promote the positive aspects of science and technology on the other.

The problems we face today are becoming increasingly complex against the backdrop of globalization and international competition. They are beyond the control of any single country. This is because many of the problems will be resolved through changes in social systems, international collaboration, global networks, and the building of common rules.

People from different backgrounds should get together to deal with the lights and shadows of science and technology. Not only professional scientists, but also policymakers, business leaders and media leaders from all over the world need to gather to deal with the science and technology issues from the standpoint of humankind's future.

Based on this fundamental concept, the Science and Technology in Society Forum, known as the STS Forum, was created under my leadership. The inaugural meeting of the STS Forum was held in November 2004 in Kyoto, Japan. At this meeting, the Council decided to meet annually in this city thereafter. As the founder and chairman, I have made great effort so that these meetings are to be successful.

At the third meeting, in mid-September in Kyoto last year, approximately 600 people from 70 countries, regions and international organizations participated. Among the participants were several Nobel laureates in science, more than 20 presidents from top-flight universities, and over 20 ministers of science and technology affairs from all over the world.

From the U.S., about 100 people attended the STS Forum, including Dr. John Marburger, Director of the Office of Science and Technology Policy, Dr. Henry McKinnell, Chairman of Pfizer Inc., Dr. Ralph Cicerone, President of National Academy of Science, and Dr. Elias Zerhouni, Director of the National Institutes of Health. From Japan, Mr. Junichiro Koizumi and Mr. Shinzo Abe, our former and current Prime Ministers, also took part in the past meetings.

The fourth meeting of the Forum is scheduled to take place in Kyoto from October 7 to 9 this year. I strongly hope that people here today will participate in the Forum. This meeting is not a mere conference but a kind of movement of humankind to solve common problems related to science and technology from the long-term perspective. At the fourth annual meeting, we are planning to center the discussions around two topics, "Harmony with nature", and "Innovation".

5. Conclusion

In Japan, the House of Councillors election will take place this summer. Half of its members will be up for re-election after serving their term of six years. The ruling coalition of the Liberal Democratic Party and New Komeito must make every effort to win the upcoming election in July. We are not pessimistic about the result. With the election nearing, Japan will enter a political season. I hope that the American people understand that this election is a critical political juncture for Japan.

As I have made clear in my remarks today, the ruling coalition is working to gain the trust of the people of Japan by continuing structural reforms and supporting innovation and openness, and by promoting fiscal consolidation and economic growth at the same time. A stable majority after the election this summer will enable us to implement these policies in an even more dynamic way.

In conclusion, Japan considers cooperation with the U.S. very important and looks to the United States to assume leadership in the face of the new challenges for the world. Japan pledges its support.

Thank you.