Japan's Economic and Political Future

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Thank you for that very generous introduction. I'd also like to thank today's sponsors, the Sasakawa Peace Foundation USA where Dan Bob is working with Junko Chano and doing a terrific job helping build that organization, and the Center for Strategic and International Studies where Mike Green has been doing a similarly terrific job for so many years. And Mike is now joined by Matt Goodman who's just recently been appointed the Simon Chair for Political Economy where's he's putting his extensive White House, Treasury and State Department experience to very good use.

With the Japan-U.S. summit just days away, this conference is obviously timely. But the subject matter—Japan's economic and political future—is particularly important since questions over the direction in which Japan is headed are of vital importance to the United States, to the Asia Pacific and really to the entire world.

The upcoming bilateral summit will be the first between Japan and the United States since 2009 when the Liberal Democratic Party held the government, and Prime Minister Aso made his way to Washington as the first foreign leader to meet President Obama. The decision to have our Prime Minister make that trip was a clear symbol of the importance the United States placed on the bilateral relationship, and an early indication of the Obama Administration's intent to rebalance its strategic focus toward the Asia Pacific.

Another early step in that process was Secretary of State Hillary Clinton's decision to buck tradition and make her initial overseas visit to the Asia rather than Europe, with a first stop in Japan. She has since returned to the Asia numerous times as has the President. Such personal diplomacy is vitally important in demonstrating the U.S. commitment to the region, but so too are the tangible actions the United States has taken recently—from signing the Treaty of Amity and Cooperation with ASEAN to joining the East Asia Summit, moving forward on trade liberalization with passage of the KORUS FTA and progress on the Trans-Pacific Partnership, hosting a successful APEC summit in Hawaii, upgrading ties with Vietnam, Singapore, the Philippines, South Korea and Indonesia, and taking early and important steps to engage Myanmar/Burma.

Japan is and will remain central to America's rebalancing efforts in the Asia Pacific as our two countries not only share close military and economic ties, but also have a breadth and depth of people-to-people exchanges and other bonds that make the Japan-U.S. relationship so vibrant and strong.

The incredible work our armed forces did together in responding to the 3-11 earthquake, tsunami and nuclear meltdown with Operation Tomodachi was clear evidence of those bonds. So too was the immediate and considerable assistance that average Americans provided Japan at such a critical time. Indeed, private American donations to Japan after 3-11 constituted the largest U.S. philanthropic outpouring ever for a disaster in a developed nation. The people of Japan will never forget the generosity and kindness of the American people or the dedication and skill of the U.S. government and armed forces in helping us overcome the tragic events of last year.

I think it's clear, 100 years after Japan presented the United States with 3,000 cherry trees, that the bilateral relationship is vigorous, robust and enduring. And by the way, Japan is very much looking forward to receiving 3,000 dogwood saplings from the United States in a reciprocal gesture of our robust relationship.

But as with any relationship, keeping the bonds between our two countries strong requires ongoing care and attention. So I find it troubling that it's been more than three years since the last Japan-U.S. summit, a delay that I'm afraid is mainly the result of mismanagement on our side.

As I observed the United States develop a comprehensive, sensible and strategic policy of rebalancing toward the Asia Pacific, and made real attempts to place Japan at the center of that policy, I could only watch with dismay as the new government led by the Democratic Party of Japan strayed from one confused policy to another. There was talk of forming an East Asian Community without the United States, and plans offered to forge a bilateral relationship with China somehow equivalent to the one we maintain with the United States. Prime Minister Hatoyama badly mishandled the basing issue, first promising during his campaign that he would move the Futenma facilities off Okinawa, and after that proved impossible, famously saying to President Obama, "trust me," to overcome differences—which of course he failed to do.

The DPJ government's poor record managing Japan-U.S. relations is symptomatic of broader problems the party has had in tackling foreign and domestic issues, let alone developing a coherent strategy for Japan's future.

Today, as we think about that future, I believe we should do so based on certain guiding principles and clearly discernible realities.

First, Japan's relationship with the United States must remain vital, close and preeminent as it continues to develop and mature in response to economic, political and diplomatic changes across the Asia Pacific.

Second, the Alliance must remain at the core of Japan's security strategy even as the strategic environment evolves and Japan shoulders greater responsibilities. For our part, I think we must take a hard look at self-imposed constraints on participating in collective self-defense, an inherent right of all nations. Engaging in collective self-defense will allow Japan more robust participation in peacekeeping around the globe at a time when our contributions are more needed than ever. Moreover, I believe any changes Japan makes in this regard, will be understood by our friends in the region, so long as we openly and honestly address the burdens of history.

In fact, this coming Saturday, on the 60th anniversary of Japan's return to sovereignty, the Liberal Democratic Party will propose amendments to the constitution that will permit Japan to engage in collective self-defense and to recognize the Self Defense Force as the true military service it clearly is. Of course, our constitutional amendment process is long and difficult even as we and our allies and friends face a wide range of near-term contingencies. Therefore, I believe Japan should quickly work to pass legislation that would permit collective action for contingencies demanding a multilateral response.

For the United States, I believe a healthy alliance requires a realistic look at basing issues in the context of America's regional strategy as well as bilateral necessity and local reality. In this respect, I think the agreement to delink progress on the Futenma replacement facility from the movement of marines to Guam, and the land returned to Okinawa as a result, is a step in the right direction.

In my meetings with Senators Webb and Levin this week, both mentioned their concerns over lack of consultation on the issue. As a legislator, I fully understand the need for such

dialogue and discussion. Both Senators are strong supporters of the Alliance, and so I hope the Administration will take steps to alleviate their concerns.

In addition, I know that Mike Green and CSIS are now working on an independent assessment of the U.S. strategic posture in the Asia Pacific, including basing issues, as mandated by Congress in the FY2012 National Defense Authorization Act —and I look forward to their recommendations.

As the process continues to play out, and as local politics on Okinawa and Guam continue to dominate the headlines, I sincerely hope we not lose sight of the goals we have so long sought to achieve—strengthening the Alliance and enhancing the SDF's capabilities. And that is why I believe the recent moves, primarily initiated by Japan, to develop joint Japan-U.S. training capabilities on Tinian are so welcome. Such training will allow our forces to operate together even more effectively than they do now.

A third issue central to thinking about Japan's future is a recognition that our economic interaction with China and the rest of the Asia Pacific will—and should—continue to grow. After all, the world's economic center of gravity will continue to shift ever more toward the region. China became Japan's largest trading partner three years ago, and economic opportunity abounds not only in that country and in India, but also Vietnam, Indonesia and the Philippines – what I call the "VIP" countries – as well as the rest of the Asia Pacific.

Fourth, Japan's overall population is decreasing and our working age population is declining even faster. We must adapt to that development by making social, economic and structural changes. Moreover, we must deal forthrightly with our public debt burden, which is reaching unsustainable levels, while recognizing that in instituting appropriate measures, timing is critical to achieving success.

Fifth, political leadership has been sorely lacking in recent years in Japan, at a moment when knowledgeable and mature leadership is more important than ever in both formulating and instituting the policies necessary to ensure that Japan's future remains bright. One important step in that direction is for Japan to spend more time choosing party leaders. Currently that process lasts only two weeks, not giving us sufficient time to fully debate the issues in ways that the parties and people can best choose the right policies and best leaders.

I don't think I'm being too partisan in saying that the Democratic Party of Japan has failed to deliver adequate leadership. The poster child for that failure, I submit, is Tanaka Naoki—not the accomplished economist and close advisor to former Prime Minister Koizumi whom we have with us at today's conference—but Defense Minister Tanaka Naoki who has demonstrated time and again his utter lack of preparation for his position and a thorough inability to carry out his solemn responsibility to safeguard Japan. And let's not forget that Prime Minister Noda appointed him to that post as a replacement for Ichikawa Yasuo. In a bold display of honesty after his own appointment as Defense Minister, Ichikawa confessed that he was an "amateur" on security matters—a characterization he immediately proved accurate.

In any case, given the realities described and the principles enumerated, how can we best shape Japan's future?

To begin with, I believe we must get beyond the bilateral squabble over Futenma. Japan-U.S. ties are far too important to founder for so many years over this issue. As I mentioned, I

view delinkage as a positive development. In addition, delinkage effectively means that the key decisions on Futenma are now mainly in Japan's hands.

On the economic front, Japan faces a number of critical challenges, from our aging population and increasing levels of public debt to the underperformance of our economy, rebuilding efforts in the aftermath of 3-11 and the requirement that we maintain stable energy supplies despite soon losing most or possibly all of our nuclear energy production.

But in addressing these challenges, we must also recognize that Japan retains numerous inherent strengths, and that our economic problems, while real, have often been exaggerated. For example, in the aftermath of LDP-instituted structural reforms, and with the benefit of an appropriately-valued yen, from 2002 to 2008, Japan realized its longest unbroken expansion in post-war history.

Indeed, during that period, Japan recorded the highest annual GDP growth per worker and the highest annual Total Factor Productivity (TFP) increase of any major economy. TFP, of course, refers to growth in national output not attributable to increases in labor or capital—and thus due instead to technological and process improvements.

In my view, Japan should focus on three key areas to overcome our economic challenges.

First, we must break the cycle of deflation. To do that, we need a more aggressive monetary policy. As a party, the LDP decided two years ago that Japan should adopt an inflation target, and during the last Upper House election my party pledged to pursue a 1.5 (+/-1) percent range to push Japan's consumer price index into positive territory.

Since then, both the Federal Reserve Bank and the European Central Bank adopted inflation targets of two percent, while the Bank of Japan announced only an inflation "goal' of one percent. A major problem with this "goal," is BOJ's consistent refusal to state that it represents a policy change. Moreover, one percent is simply too low. Unless the BOJ has decided to accept an over-valued yen, Japan's inflation target must match those of the Fed and the European Central Bank. Tomorrow, the BOJ's policy board holds its next meeting, and my hope is that they will announce a true inflation target of two percent.

The second key area Japan needs to focus on in fostering economic growth is a shift from gross domestic product to gross national income (GNI) as the key measure of economic success. GNI is equal to GDP plus the net receipt of interest and dividend payments from overseas. I believe we should seek to maximize GNI through the promotion of economic activities carried out by Japanese people and companies throughout the world.

I recently issued a report detailing my views on GNI, which should have been made available to all of you in the audience today. The key point, though, is that in maximizing GNI, Japan should look beyond domestic markets and production to opportunities abroad. This is particularly important for the vast number of small and medium-sized Japanese companies possessing cutting-edge technology that too often sell their products exclusively in the domestic market—in many cases to a single large company with which they are affiliated through keiretsu relationships.

For big multinational manufacturers and corporations, GNI maximization will entail maintaining the bulk of research and development, design and what we call the "mother factory" within Japan, while moving lower value added processes and final assembly closer to markets

overseas. Research has shown that the most globalized Japanese companies enjoy a higher TFP, and in many cases, have actually increased domestic employment over the medium term and beyond.

In embracing opportunities overseas, Japan must simultaneously adopt tax policies, investment arrangements with other countries, protection of intellectual property and other measures to encourage the return of overseas profits to Japan. Finally, Japan should take steps to liberate our service sector, which by international standards, remains relatively inefficient. Ultimately, a more productive service sector will create more jobs.

The third key element in improving Japan's economic future encompasses creating demand stimulus by the public sector spending focused on preparations to mitigate the consequences of the next major natural disaster. By doing so, we will not only reduce the costs of rebuilding after such a disaster occurs, but also stimulate the economy in the near term.

According to Tokyo University, there is a 70 percent chance that the Tokyo metropolitan area will be hit directly by an earthquake of magnitude 7 or greater within four years. Meanwhile, the Government of Japan estimates the probability a magnitude 7.3 quake centered in the north of Tokyo Bay at 70 percent over the next three decades, with projections of 11,000 casualties and 850,000 buildings destroyed. Regardless of which prediction is correct, unfortunately but inevitably, Japan will be hit at some point by another major natural disaster. But if we act now, we can minimize the cost in terms of lives lost and property destroyed.

Now, let me address one final issue—Japan joining the Trans-Pacific Partnership. The LDP issued a policy paper recently, based on discussions I chaired, listing a number of conditions we believe should be met before Japan joins the TPP negotiations.

Beyond those conditions, I have a major concern over what might seem to some merely a technical issue. Having worked in the 1990s for a senior Member of the U.S. Senate Finance Committee, the late Sen. Bill Roth, who went on to serve as chairman of that committee, I'm acutely aware that the U.S. Administration is pursuing TPP without the benefit of trade promotion authority—what we used to call fast track trade negotiating authority. I have to say that the United States has entered rather uncharted territory in this respect. I'm afraid I do not understand how an agreement can be reached, let alone implementing legislation passed by Congress, in the absence of TPA.

In addition, as a politician, I am fully aware of the considerations one must take into account when facing an election. And this year's U.S. contest, promises to be particularly hard-fought as the House, Senate and the presidency all could end up in the hands of either party. So I'm unclear how much progress can be made on TPP until after the November polls.

Having said all that, there is one important aspect of TPP that thus far has gone relatively unnoticed in Japan. Any country with a free trade agreement with the United States covering the energy sector—which most FTAs do—can enjoy access to America's growing shale gas production without having to gain export licenses for each and every contract.

In the midst of a major potential energy shortfall in Japan in coming months and years as a result of the closure of our nuclear power plants, we are urgently looking for new sources of energy. Gas offers one of the best alternatives. It is abundant, relatively cheap, and produces far fewer greenhouse gas emissions than other fossil fuels**.** And as my friend, Sen. Lisa Murkowski, mentioned to me this week, most all the gas Japan imports from the United States comes from

Alaska. Yet, most shale gas deposits are found in the continental U.S. So I think as U.S. gas production continues to expand, while Japan's demand for new sources of energy increases, there is ample room for mutual benefit.

And in the end, finding areas of mutual benefit for our two countries, in addition to maintaining our deep and abiding ties, form the basis of a healthy bilateral relationship.

Two decades ago, Dan and I helped Sen. Bill Roth create the Mike Mansfield Fellowship program by passing legislation to place mid-career American government officials into the offices of Japan's government ministries and Diet for a full year, after a full year of Japanese language training. Twenty years later, that program has more than 100 alumni who have since returned to the United States to put their expertise on Japan and the web of personal ties they developed across the Pacific to very good use.

Just as the cherry trees we sent here 100 years ago form an enduring symbol of the close friendship of our two countries, the Mansfield Fellowship program, I firmly believe, has furthered and deepened that relationship at the vital people-to-people and the government-to-government levels. It is in that spirit that I will continue to work on enhancing the Japan-U.S. relationship to make sure the coming decades are as fruitful and productive as ever. In the end that relationship is crucial to the United States and is an absolutely essential element in ensuring a bright and successful future for Japan.

Thank you.