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*Japan's historical political
power shift and efforts toward
economic revitalization:
the DPJ's New Growth Strategy
and MHRI's proposal for
domestic demand stimulation*

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Summary

1. The year 2009 marked a historical transfer of power in Japan where the Liberal Democratic Party (LDP) had maintained a long-standing position as the majority in parliament. Approximately one year has passed since the new coalition government led by the Democratic Party of Japan (DPJ) came into power with high expectations among the public. Regretfully, the DPJ's track record has been less than satisfactory. Prime Minister Yukio Hatoyama – who initially assumed office – resigned in the face of a plunge in the public's approval ratings and was replaced by Prime Minister Naoto Kan. Immediately thereafter, the leading party suffered a massive loss of seats in the House of Councilors election, resulting in a loss of a majority. The Kan administration was thus faced with greater difficulties in its management of government. Furthermore, a shortage of fiscal resources has left part of the agenda set forth in the *Democratic Party of Japan's Policy Platform for Government* (the “*DPJ Manifesto*”) unaccomplished, resulting in its *de facto* amendment. Faced with difficulties in parliamentary procedures, the passage of bills in Diet plunged to the lowest level in post-WW II history. Given the mired state of the economy and the mountain of unresolved policy issues, the DPJ-led coalition government will be tested for its ability to facilitate consensus formation with the opposition parties in Diet in its second year in power.
2. *The New Growth Strategy: Blueprint for Revitalizing Japan* (the “*New Growth Strategy*”) compiled in June 2010 is a rare bright spot, earning it a certain level of commendation, for the DPJ-led coalition government which has faced difficulties since its assumption of power in the autumn of 2009. Japan fell into a prolonged period of stagnation referred to as the “Lost 20 Years” since the collapse of the bubble economy in the late 1980s and has not been able to recover fully from the economic malaise

subsequent to the global financial crisis and recession in 2008. Under these conditions, fundamental steps to raise growth and revitalize the economy are needed. The *New Growth Strategy* includes approximately 330 items in the following seven areas: (1) the environment, (2) medical treatment and nursing care, (3) Asia, (4) tourism and regional revitalization, (5) science, technology and information & telecommunications (IT), (6) employment & human resources, and (7) finance. However, despite the focus of attention upon measures such as the reduction of corporate tax rates and overseas infrastructure exports, there are also views that there is not enough “selection & focus” amid the tight fiscal constraints. While the *New Growth Strategy* will move on from its planning stage to a stage of actual implementation, concerns regarding its effectiveness may not be dispelled.

3. Simultaneously with the government’s *New Growth Strategy*, MHRI proposed its own plan for Japan’s economic revitalization (the “*MHRI Proposal*”). The *MHRI Proposal* sets forth a package of measures placing emphasis upon measures to stimulate domestic demand that are thought to be effective in view of the current state of the economy which lacks dynamism in terms of domestic demand, the shortcomings of the measures taken in the past, and the shifts in Japan’s socioeconomic environment expected ahead. In compiling the package, attention was paid to the fact that Japan is a mature economy, thus possessing an abundance of potential human, physical and financial resources as well as the necessity to pay due regard to tight budget constraints. Based upon an accurate recognition of Japan’s strengths and weaknesses, the axis of effective domestic demand measures is a policy package which is capable of providing continuous stimulus to both demand and supply of human, physical and financial resources, and a methodology utilizing private sector resources which is the strongpoint of a mature economy. Furthermore, to raise consumer spending which is the main component of domestic demand, the key is how to create employment to generate income and serve as

a foundation to dispel household uncertainties.

4. For the effective stimulation of domestic demand from both the demand and supply sides to generate employment by utilizing Japan's dormant resources, MHRI has proposed the following policy measures in five key areas.

- (1) Utilization of financial assets and residential assets held by the elderly
 - * Reduction of the gift tax to increase asset transfers from parents to children and to support consumer spending by the working generation
 - * Wider usage of reverse mortgages enabling the elderly to obtain living expenses by utilizing residential assets
- (2) Public assistance to promote the purchase of "green" housing and cars
 - * Expansion and development of a system to provide points which are exchangeable with products at the time of construction of new energy-saving houses
 - * Extension of tax cuts and subsidies for the purchase of next-generation cars which reduce green house gas emissions
- (3) Development of a system to stimulate tourism demand through the revitalization of domestic travel and accommodations
 - * Creation of a government-funded Travel Point Program which can alleviate the cost burdens of domestic travel and accommodations
 - * Expansion of national holidays and legislation to promote the acquisition of paid leave
- (4) Realization of potential demand through the development of the markets for housekeeping services, childcare and nursing care services
 - * Conversion of part of the payments to households with children to vouchers for housekeeping and childcare services

- * Secure number of nursing care workers to meet demand by improving the labor conditions of nursing care workers
- (5) Promotion of employment of women
- * Improvement of infrastructure and services for child care such as the increase and upgrading of nurseries and services
 - * Full-fledged introduction of a work-life balance lifestyle including men

If the domestic demand stimulus measures in the five key areas above are realized, it would generate demand equivalent to approximately JPY120 trillion in the coming decade and create approximately 2.5 million jobs. This will lead to an early closing of the GDP gap and enable the Japanese economy's return to an autonomous and stable growth orbit. Even though the cost necessary for these measures is estimated to be approximately JPY50 trillion, additional fiscal burdens will be kept in check since 80 percent or so of the cost will be covered by shifting the budget of existing measures.

5. In addition to the stimulation of domestic demand through measures such as those mentioned above, it will be necessary to capture overseas demand and seek balanced growth resting both upon domestic and overseas demand. Apart from capturing the rising demand in emerging markets such as Asia through the growth of exports including services and agricultural products, it is important to take measures facilitating the repatriation of overseas earnings of Japanese companies engaging in global business. If such steps are taken and are augmented by corporate business endeavors, it will be possible to raise the rate of Japan's potential economic growth from the current level of approximately 1% to a level over 2%. Moreover, Japan's target will be to set forth a "Japan Model" as a mature developed economy possessing vitality through the combination of effective measures. In such context, the *MHRI Proposal* and the government's *New Growth Strategy* are poised fundamentally in the same direction. The *New Growth*

Strategy is nearing the end of the planning stage and will be entering the second stage. The steady implementation of effective measures to boost growth is expected of the DPJ-led coalition government.

Introduction

Given the occurrence of the global financial crisis and recession, the year 2008 is viewed as a historical year among the countries of the increasingly globalized world. The same is also true for Japan. The only difference is that the subsequent years in 2009 and 2010 also look likely to become unforgettable for Japan.

The year 2009 marked the transfer of power from the Liberal Democratic Party (LDP) to the Democratic Party of Japan (DPJ). Indeed, a full-fledged shift of political power through a turnaround of the leading party in the House of Representatives election was a historical event for the Japanese who have had very little experience of this sort.

2010, it appears, will become the year when Japan relinquishes its position held for approximately 40 years as the second largest economic power ranking after the US. Position No. 2 will be taken by rapidly-growing China. This reversal of Japan and China epitomizes both China's exponential growth and the stagnation of the Japanese economy.

The global financial crisis and recession served Japan with a serious economic downturn. The recession weakened support for the LDP-led ruling coalition's economic policy management and served as one of the factors to the political power shift in the following year. Furthermore, there is no doubt that the economic contraction accompanying the recession accelerated the timing of China's reversal of position as the second largest economic power in the place of Japan. In such context, these historical events during the

three years are linked.

Japan's economic slump dates back far before the global financial crisis and recession to the collapse of Japan's asset-inflated bubble at the end of the 1980s. The prolonged ensuing stagnation has been referred to as the "Lost Decade" or the "Lost 20 Years". Such stagnation marks a sharp contrast with China which has grown rapidly since the 1990s. Moreover, the DPJ which is now the leading party is expected to deliver measures to bring Japan out of the prolonged economic malaise.

Approximately a year has passed since the start of the new DPJ-led administration. Thus far, the overall public view is that the new DPJ-led government's accomplishments fall below expectations. Such views led to the leading party's retreat in the House of Councilors election in the summer of 2010. Meanwhile, *The New Growth Strategy: Blueprint for Revitalizing Japan* (the "*New Growth Strategy*") (<http://www.npu.go.jp/en/policy/policy04/index.html>) compiled by the DPJ-led coalition government has gathered widespread attention especially in the business community. The *New Growth Strategy* serves as the basic guideline for Japan's future economic policy management, thus serving as the key to whether Japan can emerge out of its prolonged stagnation. However, given the inclusion of numerous policy measures, the *New Growth Strategy* turned out to lack a perspective of "selection and focus", making it difficult to discern clear priorities among the policy measures. Amid Japan's tight fiscal conditions, such lack of priority is casting doubts regarding the effectiveness of the *New Growth Strategy*.

Mizuho Research Institute (MHRI) has proposed its own set of policy measures (the "*MHRI Proposal*") at the time of the government's release of the *New Growth Strategy*. The *MHRI Proposal* is a package of measures selected by placing emphasis upon measures which are effective in boosting Japan's economic growth, leading to the steady expansion of domestic demand while keeping fiscal costs in check.

In this paper, we shall look back upon the government's policy

management following the creation of the DPJ-led administration. Subsequent to a review and evaluation of the *New Growth Strategy*, we shall provide an explanation of the *MHRI Proposal* centering mainly upon measures to stimulate domestic demand. We shall also show that Japan will be able to regain economic growth if effective measures are implemented. In the following pages, we shall seek the key to Japan's full-fledged economic recovery in this historical year when Japan slid down from its position as the second largest economic power in the world.

1. Looking back at the DPJ-led administration's year in power

The DPJ swept into power in the general election in August 2009 with its campaign pledge to implement measures placing emphasis upon the "household sector" through "political leadership". However, the Hatoyama Administration faced a rocky road ahead. Triggered initially by its difficulties stemming from the the relocation of the US Marine Corps Air Station in Futenma, Okinawa (the "Futenma issue") (note 1), former Prime Minister Yukio Hatoyama stepped down from office in June 2010. Subsequently, the DPJ under Prime Minister Naoto Kan suffered a massive defeat in the House of Councilors election in July 2010. After winning the DPJ presidential election in September 2010 and upon a cabinet reshuffle, Prime Minister Kan still remains in charge of the administration. In this section, we shall look back upon the DPJ's past year in power amid a "twisted Diet" where the majority party differs in the House of Representatives and House of Councilors.

(1) Remarks on consumption tax hike are not the only reasons for the DPJ's defeat

In the House of Councilors election on July 11, 2010 (number of

contested seats: 121), the DPJ won only 44 seats, falling below the number of seats taken by the LDP (51). As a result, the number of seats of the ruling coalition including the People's New Party fell below the majority, leading to the reemergence of a twisted Diet. Unlike the twisted condition of the Diet from 2007 to 2009, the ruling party does not have a two-thirds majority needed for the repassage of bills in the House of Representatives (note 2). Thus, given the need for a certain level of cooperation by the opposition parties for the passage of bills, the governing coalition faces a delicate task in Diet proceedings.

One of the reasons for the DPJ's defeat in the House of Councilors election was Prime Minister Kan's unexpected remarks regarding a consumption tax hike. Furthermore, the shift in comments during the election campaign and criticisms against Prime Minister Kan's consumption tax comments from among fellow DPJ Diet members served to deepen the public's sense of mistrust. Nevertheless, it is necessary to remember that the DPJ's election defeat stems not only from the consumption tax hike remarks but also the DPJ-led government's mishandling of the Futenma issue, the political scandal of a high-ranking DPJ member as well as the DPJ's disappointing track record falling below the public's expectations.

(2) Key measures are left behind due to tight fiscal resources

Following the power shift, the Hatoyama Administration focused upon its task of compiling the FY2010 budget for the implementation of key measures such as the child allowance (note 3), income compensation for farm households (note 4), and elimination of expressway tolls (note 5) set forth in the *Democratic Party of Japan's Policy Platform for Government* (the "*DPJ Manifesto*"). In October, the Hatoyama administration requested the ministries to resubmit their budget requests in the light of the *DPJ Manifesto* and carried out a budget screening process to reduce wasteful spending (note 6) in November. Despite criticisms regarding the lack of transparency in the selection of the members of the screening panel and the short

time limit (one hour) allowed for the review process for each spending item, the process deserves commendation at the very least for bringing discussions on the usage of tax money out into the open. Nevertheless, the spending cut achieved by the screening process only added up to JPY1 trillion or so, and the abolition of the provisional tax rate was shelved in the FY2010 budget (note 7). As a result, some of the key measures have been left behind.

Faced with the difficulty to secure fiscal resources in the course of its first budget compilation process after coming into power, the DPJ made *de facto* amendments to some of the key measures in the *DPJ Manifesto* for the House of Councilors election (**Chart 1**). However, the reasons for the amendment were not made clear. Apart from the evaluation of reviewing measures which are said to be pork-barrel measures, the government should be subject to a certain degree of accountability when altering its pledge to the public.

Chart 1: The DPJ's key measures which have been subject to *de facto* amendments

	<i>DPJ Manifesto for House of Representatives election (2009)</i>	Reflected in FY2010 budget	<i>DPJ Manifesto for House of Councilors election (2010)</i>
Child allowance	Payment of child allowance of JPY26,000/month per child (JPY13,000/child in FY2010)	Realized (however, part of the costs are to be funded by local governments)	Additions to the current JPY13,000, with the additional amount convertible to actual services (<i>de facto</i> relinquishment of full payment)
Income compensation for farm households	Income compensation toward farm households selling agricultural and livestock products from FY2011 (research and model operations in FY2010)	Realized (implementation of model operations for rice)	Gradual expansion to other items and sectors other than agriculture (without specifying the timing)
Abolition of provision tax rates	Abolition of provisional tax rates on gasoline and other taxes in FY2010	Unrealized (maintenance of provisional tax rates on gasoline tax etc.)	Ease burdens regarding the automobile weight tax and the automobile purchase tax (<i>de facto</i> relinquishment of abolishment)
Elimination of expressway tolls	Gradual elimination, leading to a complete phase-out in FY2012	Partially realized (implemented by limiting it to certain sections of expressways)	Gradual phase-out, upon due consideration of the effect of the elimination of expressway tolls (without specifying the timing)

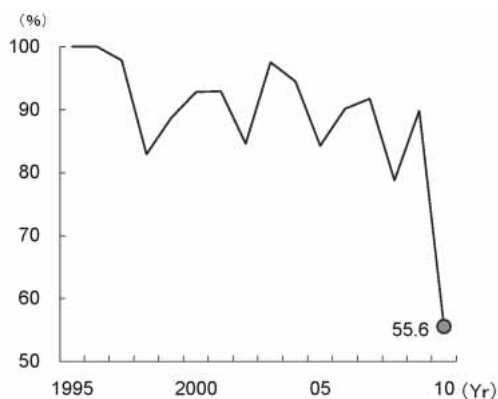
Source: Based upon *DPJ Manifesto* and FY2010 budget.

(3) Passage of bills in the ordinary session of Diet falls to the lowest level in post-WWII history

The lack of careful deliberations in the Diet's legislative process is another quandary of the DPJ-led administration. The ordinary session of Diet convened in January 2010 proceeded more or less smoothly up to the passage of the FY2010 budget during FY2009. However, as exemplified by the hasty passage of the postal reform bill (note 8) in the House of Representatives after a mere six-hour deliberation process due to tight schedule restraints in the run-up to the House of Councilors election, the leading parties' hasty vote without providing adequate time for deliberations led to a hardening of the opposition parties' stance.

Even though the ordinary session of Diet closed on June 16th without an extension, many important bills (such as the bill on measures for global warming (note 9) and the bill on reform of the labor dispatch law (note 10)) were either scrapped or postponed as in the case of the postal reform bill which was scrapped without satisfying deliberations in the House of Representatives. As a result, only 55.6% of the bills submitted to the ordinary Diet session were passed, marking the lowest level in post-WWII history (**Chart 2**).

Chart 2: Rate of passage of government-submitted bills in the ordinary session of Diet



Source: Made by MHRI based upon House of Representatives website.

(4) A long and winding road to the reduction of dependence on bureaucrats and the increase of political leadership

During the general elections last year, the DPJ set forth its target of reforming the conventional bureaucracy-led policy formation process to one led by political leadership. While, the DPJ has carried out various endeavors since its acquisition of power, it is still in a trial-and-error process.

First of all, to break out of the bureaucracy-led policy formation process in each ministry, the three most important posts in each of the ministries – comprised of the Minister, Senior Vice Minister and Parliamentary Secretary – was empowered with the adjustment and decisions regarding policy formation. However, the discretion of the Minister in the conduct of the meeting of the three top posts led to the alienation of bureaucrats in some cases, serving to the detriment of relations between politicians and bureaucrats.

Secondly, views are divided among the administration even with respect to the National Policy Unit (NPU) which was created as a cornerstone to bolster political leadership. The NPU was established under the Cabinet Secretariat to engage in the planning, gestation and general coordination of the Cabinet's basic stance on key policies including economic management. Indeed, the NPU played a central role in the formation of two basic policies decided by the Cabinet in June 2010. One was the Fiscal Management Strategy, which sets forth targets to achieve a surplus in both the national and local governments' primary balance by FY2020, and to keep the amount of new government bond issues in FY2011 from rising above FY2010 (approximately JPY44 trillion). The second was the *New Growth Strategy*, which will be explained in more detail in Section 2.

Even though the NPU is commendable for its achievements thus far, Prime Minister Kan revealed that the NPU would be effectively "downgraded" to an advisory body to the Prime Minister because of the uncertainty of the passage of legislation on upgrading the NPU to a bureau for the clarification of its legal authority. However, faced with criticisms from both the ruling and opposition parties that such move amounts to a "retreat of political leadership", the NPU was

granted the two functions of providing the Prime Minister with proposals and general coordination of policies.

(5) A shaky relation between the government and the ruling party

In the *DPJ Manifesto* in the general election of 2009, the DPJ proclaimed that policy making would be unified in the Cabinet. However, its realization appears to be quite difficult considering the developments during the past year.

In the days when the LDP was in power, the government could not submit a bill to the Diet unless the LDP approved the bill. Given the DPJ's position that such prior approval system of bills by the ruling party serves as a cause for Diet members to act for specific interest groups and for collusion between politicians, bureaucrats and businesses, the DPJ limited political parties' involvement in the policy-making process through – for example – the abolition of political party policy research groups which engage in discussions on policy formation.

However, this led to growing dissatisfaction among DPJ Diet members without positions in government, due to their inability to involve in the policy-formation process. Thus, along with Prime Minister Kan's rise to power, the DPJ restored its policy research group and devised a system where the chief of the policy research group would join the Cabinet and reflect the DPJ's views in government policies. Nevertheless, it is uncertain whether this system will function effectively in the event of a conflict between the government's policy stance and the DPJ's view, given the possibility that the chief of the policy research group might be caught in a dilemma as a Cabinet member.

(6) The consensus-formation ability of the ruling and opposition parties

The public has served a harsh judgment on the DPJ for its sub-standard track record. However a closer look at the election results reveals that while the DPJ fell far below the LDP in terms of

total Diet seats due to its crippling defeat in single-seat regional constituencies, the total number of votes won by the DPJ surpass those of the LDP in both single-seat electorates and proportional representation constituencies. This enables the interpretation that the public flashed a “yellow card” rather than a “red card” toward the DPJ in order to facilitate more careful debate with the opposition parties.

Amid the widespread belief that the “twisted Diet” would prevail for a prolonged and continued period (note 11), the ruling and opposition parties are now tested for its wisdom and action to facilitate smooth consensus formation in Diet. In the extraordinary Diet session convened on October 1, 2010, Prime Minister Kan is showing a more sincere approach in providing explanations and holding deliberations with the opposition parties. The future course of Diet deliberations deserves close attention.

2. The *New Growth Strategy* of the DPJ-led coalition government

As in the previous section, the DPJ is following a wayward path facing numerous difficulties in handling of the government. Indeed, disappointment came early, given the high expectations toward the power shift, leading to the results of the House of Councilors election. The DPJ is also facing a deadlock on the policy front. Amid such circumstances, the *New Growth Strategy* released in June 2010 has gathered attention and received a certain level of acclaim. The *New Growth Strategy* sets forth a comprehensive set of measures for the Japanese economy to emerge out of its prolonged stagnation and raise its growth rate, and will serve as the DPJ-led coalition government’s guideline for future economic policy management.

Will the *New Growth Strategy* succeed in reviving the Japanese economy? This section will provide an outline as well as the

evaluation of the *New Growth Strategy* and forecast whether or not the goals can be achieved.

(1) Japan's economic stagnation and external shifts

The *New Growth Strategy* gathered widespread attention not only because it was the first full-fledged set of policy measures by the DPJ-led coalition government. The focus of attention is due to an acute sense of crisis stemming from Japanese economy's predicament and large shifts in the socio-economic environment surrounding Japan.

Since the collapse of Japan's asset-inflated bubble in the second half of the 1980s, the Japanese economy entered a prolonged period of stagnation referred to as the "Lost Decade" or the "Lost 20 Years". During this period, the Japanese economy was unable to grow on a nominal GDP basis. As a result, Japan's per-capita GDP which once ranked among the top countries of world is now hovering among the lowest group of developed countries. From 2008 to 2009, Japan suffered under an unprecedented recession due to the global financial crisis and recession. Even though economic conditions are improving, deflationary concerns are still not dispelled because of a significant shortage of demand equivalent to 4% of GDP.

Meanwhile, the socio-economic environment surrounding Japan is undergoing significant shifts. Domestically, demographic ageing has progressed and its population has started to shrink. Looking overseas, the surge of the emerging countries of Asia such as China is leading to fierce international competition. Moreover, Japan also faces common global issues such as environmental concerns and energy restraints. Policy initiatives are imperative, given the possibility that such domestic and external shifts may serve as further negative impacts upon the Japanese economy. Even so, from a different perspective, endeavors to address these issues may serve as effective steps to generate new growth and the fruits of growth will make it easier for Japan to solve these issues.

(2) The menu for new growth: 21 strategic projects in seven key areas

The fundamental direction of the *New Growth Strategy* decided upon under such sense of crisis reflects Prime Minister Kan's stance. For example, since his assumption of office in spring this year, Prime Minister Kan has advocated the establishment of a "strong economy", "strong public finance" and "strong social security". Of these three targets, the *New Growth Strategy* serves the role of achieving a "strong economy". For a "strong economy", the *New Growth Strategy* seeks a "Third Approach", other than the "First Approach" relying upon public works and the "Second Approach" skewed toward supply-side fortification.

The policy package – organized into seven key areas was formulated to pursue the "Third Approach" – is the framework of the *New Growth Strategy*. The seven key areas are as follows.

- (1) Strategy for becoming an environment-conscious society through "green innovation" (including the purchase of renewables-derived electric power through a feed-in tariff system)
- (2) Medical power strategy through "life innovation" (the creation of new pharmaceuticals and medical appliances, and a wider acceptance of foreign patients)
- (3) "Asian economic strategy" to capture the demand of rapidly growing emerging countries (the reduction of corporate tax burdens and the promotion of infrastructure exports such as railways, water, and nuclear power)
- (4) Promote "tourism-oriented nation and local revitalization" to generate demand in local areas by increasing the number of foreign visitors to Japan (simplification of visa acquisition procedures, establishment of "special zones" recognizing exceptions to regulations and tax systems etc. in certain regions)
- (5) "Science-and-technology and IT-oriented nation" strategy to build the foundation of growth through the utilization of knowledge and human resources (the formation of

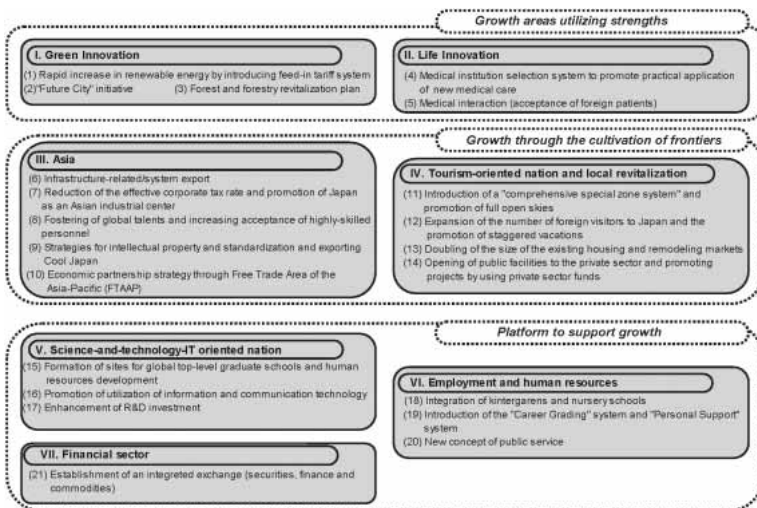
global-level sites for industry-academia partnerships, and the improvement of support systems to promote technological development)

(6) “Employment and human resources” strategies to provide a role to play and a place to belong for all (the enhancement of lifelong opportunities to develop capabilities and skills, and establishment of a system for developing and evaluating occupational skills)

(7) “Financial sector” strategy (establishment of an integrated exchange which is capable of handling securities, financial products and commodities)

A total of 21 national strategic projects are provided in the foregoing seven key areas (**Chart 2-1**). Furthermore, various policy measures of up to 330 items are provided in the national strategic projects. The *New Growth Strategy* sets forth time schedules for each of the measures as well as the market size and numerical targets regarding job creation in major areas.

Chart 2-1: The 21 National Strategic Projects in the *New Growth Strategy*



Source: Made by MHRI based upon *The New Growth Strategy: Blueprint for Revitalizing Japan* (Cabinet Decision of June 18, 2010)

(3) Commendations and the necessity for selection and focus

As shown above, the *New Growth Strategy* was compiled in the form of a comprehensive policy package. How has it been evaluated? Given the strong sense of urgency for measures to raise Japan's growth amid its severe economic conditions, the *New Growth Strategy* has been more or less well-received by the public such as the business community. Indeed, the package deserves commendation for its wide perspective, its approach from both demand and supply, the presentation of a time schedule and numerical targets. Furthermore, in terms of each of the measures contained in the package, the inclusion of infrastructure exports to emerging countries such as Asia for the first time and the step forward in reducing the corporate tax rate deserve attention.

Having said so, we must still raise questions regarding the *New Growth Strategy*. The key point is Japan's current dire state of public finance, making it questionable whether it is possible to implement effectively such a wide array of measures under tight fiscal resources. A perusal of the time schedule from such a perspective reveals several items in the area of regional and medical treatment strategies which may not necessarily raise the growth rate. While the inclusion of a wide range of measures most likely stems from expectations toward multilateral effects, there are views that a single policy measure should be taken to achieve a single policy target (Timbergen's rule), posing questions regarding the consistency of the means with the top priority target of raising economic growth.

The most serious concern is that such a wide array of measures in the name of growth will hamper the focus of resources upon measures which are most effective for the fundamental target. For example, by earmarking so much of the fiscal resources to so many measures, the corporate tax rate cut might turn out to be smaller than necessary. Given the importance of "focus" under limited fiscal resources, clear priorities must be established.

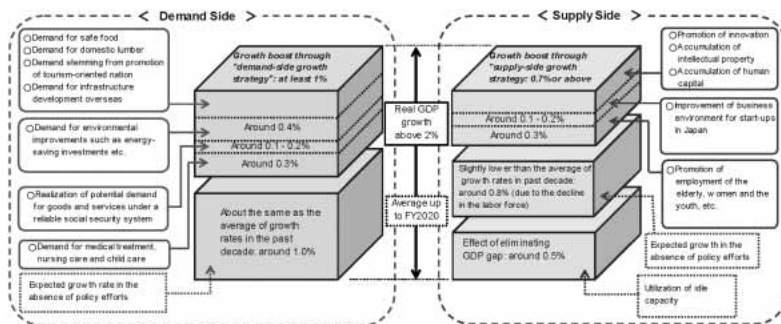
In view of Japan's tight public finances, the prior provision of fiscal resources is necessary for policy measures which pose a large burden upon fiscal costs. There is virtually no mention of fiscal costs

and fiscal resources in the *New Growth Strategy*, providing concerns regarding the effectiveness of the measures.

(4) The growth target and the difficulties for its achievement

In the past, guidelines for Japan’s long-term economic growth have tended to provide outlooks on the industrial sector. While it is not always appropriate for the government to point out the industries possessing growth potential, note that the *New Growth Strategy* sets out a range of industrial sectors considered promising in terms of growth potential. These industries are those related to the environment, medical treatment, nursing care, tourism and infrastructure. This is also evident from the growth targets in the *New Growth Strategy*. According to the growth target set forth by the Cabinet Office, the generation of “demand for improvement of the environment such as energy-saving investment” and demand for “medical treatment, nursing care and child care” are said to boost real GDP growth by approximately 0.4% and 0.3% respectively (Chart 2-2).

Chart 2-2: Breakdown of real GDP growth targeted under the *New Growth Strategy*



Note: The breakdown of growth necessary to achieve real GDP growth above 2%, in terms of demand-side and supply-side measures. The chart illustrates the growth boost by the measures in the *New Growth Strategy* on top of the rate of growth which would be achieved in the absence of policy efforts.

Source: Made by MHRI based upon Cabinet Office, “*New Growth Strategy*” Reference (June 18, 2010).

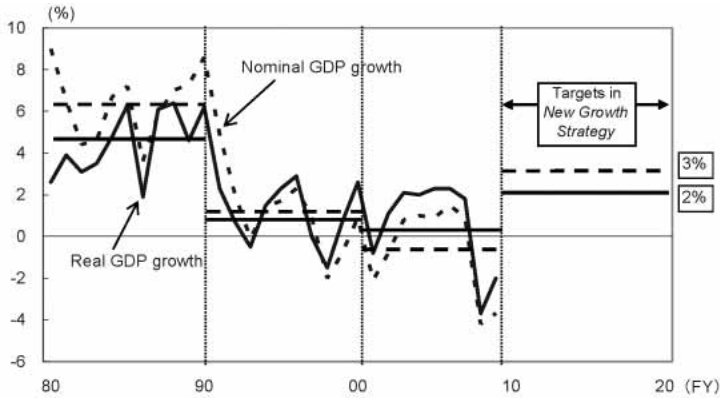
Even so, growth will not be attained only through demand-side measures. Even though the unemployment rate is not declining at present due to grim labor market conditions, the labor force is predicted to shrink along with the decline of the population in the future. Thus, it will be necessary to develop an environment conducive for women and the elderly to gain jobs. At the same time, the combination of the promotion of innovation and the improvement of the environment for business startups would lift Japan's growth potential. Given these conditions, actual growth may be achieved through the creation of demand.

The *New Growth Strategy* targets a rate of over 2% in real terms and over 3% in nominal terms (the average rate up to FY2020) by taking these demand and supply-side measures. Are these targets feasible?

Looking back at the trends in economic growth from the 1980s onward, the rate of average growth in both real and nominal terms fell sharply in the 1990s following the collapse of the bubble economy (**Chart 2-3**). Average growth fell further in the 2000s, dipping below 1% in real terms and falling into negative territory in nominal terms. Even though the global financial crisis and recession during the past two years is indeed serving as a major downside factor, it should be noted that the Japanese economy has not grown in nominal terms over the medium term.

Judging from these conditions since the 1990s, it would be necessary for government to take measures whose effectiveness clearly surpasses the various measures taken during the past 20 years, along with corporate business initiatives, to bring the average rate of growth during the coming decade to the level targeted in the *New Growth Strategy*. In such context, the achievement of the targets in the *New Growth Strategy* is no easy matter.

Chart 2-3: Trends in real and nominal GDP growth and the targets in the *New Growth Strategy*



Note: The horizontal lines indicate the average rate of growth during each of the relevant period (the bold line represents growth in real terms and the broken line represents growth in nominal terms).
 Source: Made by MHRI based upon Cabinet Office, *Annual Report on National Accounts*.

3. The *MHRI Proposal* on effective measures to stimulate domestic demand

Even though the DPJ-led coalition government has revealed its *New Growth Strategy*, note the absence of explanations on fiscal resources necessary to carry out many of the measures. Furthermore, given the lack of clear priorities among the measures, it is dubious whether Japan will be able to boost its growth potential through these strategies. In view of Japan’s current economic conditions, it would be necessary for the time being to focus upon measures which are deemed highly effective. Prior to the government’s release of the *New Growth Strategy*, MHRI proposed its own package of policy measures in areas which are effective for the stimulation of domestic demand. The following sections elaborate on these domestic demand stimulus measures.

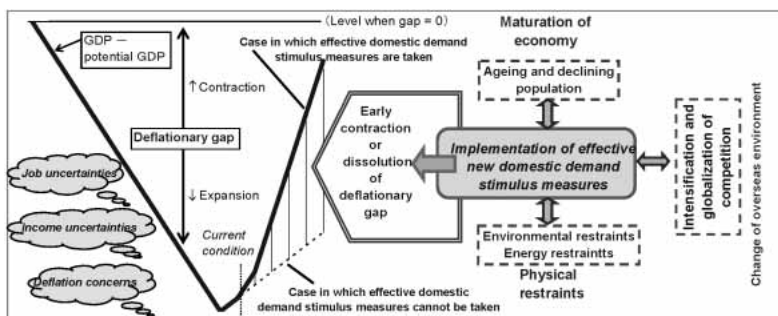
(1) The need for effective domestic demand stimulus measures

Even though the darkest moments of the global financial crises are behind us, Japanese economic conditions remain extremely severe, with economic revitalization still an urgent task. Time and again, economic stimulus measures have been discussed and implemented. However, a look at the current state of the economy shows that few have succeeded in achieving their goals. Thus, it is necessary to hammer out effective stimulus measures which take into consideration the reality and future environment of the Japanese economy as well as the policy measures taken in the past. Here, we shall discuss what are the core axis, criteria and fields which are the most appropriate in the selection of such a policy menu.

The existence of a huge deflationary gap (or GDP gap) provides the most vivid portrayal of Japan's economic malaise. The deflationary gap, representing a condition where demand falls far below potential output, grew rapidly amid the global financial crisis. Even though the gap is narrowing after Japan's economic conditions bottomed out, there is still a gap of approximately JPY25 trillion (approximately 5% of GDP) at the moment. While the gap stems partially from the contraction of overseas demand due to the global financial crisis, the atrophied state of domestic demand – which should normally compensate for the loss of overseas demand – is aggravating the conditions.

The stagnation of domestic demand had plagued the Japanese economy from before the global financial crisis. Never before is the need so strong to compile an effective package of measures to stimulate domestic demand and narrow the deflationary gap through the expansion of demand, comprised mainly of consumer spending (**Chart 3-1**). Thus, the prescriptions set forth below are necessary to stimulate new demand.

Chart 3-1: Domestic demand stimulus measures to reduce the deflationary gap



Source: Made by MHRl

(2) Effective measures in five key areas – from the perspective of stock and employment

The following are the necessary perspectives in compiling a domestic demand stimulus packaged in order to buoy the Japanese economy.

Firstly, the shortcomings of the past stimulus packages provide some clues. The packages compiled in the 1980s and 1990s relied heavily upon public demand whereas the packages in the 2000s were skewed toward supply-side measures. The shortcomings of these packages indicate the importance of a package of measures to stimulate both demand and supply of human, physical and financial resources. Secondly, it is necessary to reflect upon the past policy measures predicated upon high economic growth despite Japan’s shift in to a mature economy, thus continuing to serve as a considerable burden upon fiscal conditions. A more viable policy option would be to create demand through the utilization of dormant resources which is the strongpoint of a mature economy. In addition, to stimulate consumer spending which is the main pillar of domestic demand, the key is how to create employment which provides the base to generate income and dispel uncertainties.

In selecting effective measures from the perspective of both

supply and demand which utilize dormant resources and generate employment, the five following areas are deemed effective in present-day Japan.

The first key area is the utilization of assets held by the elderly. Japan has financial assets totaling more than JPY1400 trillion, of which the major part is held by the elderly generation. The demand-boosting process may be triggered by upgrading the liquidity of such stock through means such as shifting the financial resources to the working-age generation.

The second key area is the promotion of environment-friendly (“green”) housing and cars. If durable goods needed by the working-age generation such as housing and cars may be renewed to create a “greener” environment, this would result in connecting the financial resources with physical resources.

The third area is the reinvigoration of domestic tourism and accommodations. By generating demand by seeking out and utilizing tourism resources, this would lead to the expansion of markets and jobs in many of Japan’s localities. In just the way that the “green-ification” of durable goods can serve to spark the growth of the manufacturing sector, this would serve to spark the growth of the services sector.

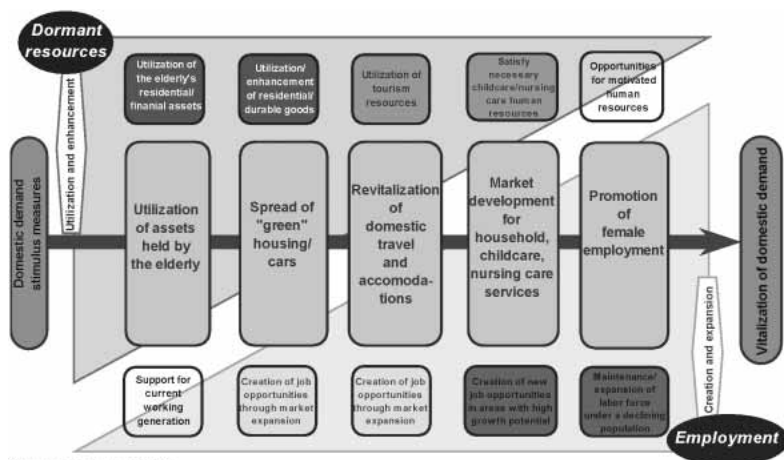
As the fourth key area, we add the development of the market for housekeeping, childcare and nursing care services. This area has enormous market potential, judging from the shifts in Japan’s society. By connecting this with human resources, this would have a significant economic impact leading from demand to employment and income.

The fifth key area is the promotion of female employment. The supply of new labor to the expanding market and job opportunities created through the measures in the first four key areas would create domestic demand from both the sides of supply and demand. If female human resources can be tapped amid Japan’s declining population, this would spark and trigger the income growth process.

Chart 3-2 sets forth these five key areas from the perspective of dormant resources and employment.

In the selection of specific measures in the five areas, apart from their effectiveness in raising domestic demand, it is important to select highly cost-effective measures which cut down on additional fiscal costs as much as possible in consideration of Japan's fiscal conditions. One such means is the utilization of dormant resources mentioned above, in other words, the mobilization of potential resources in the private sector through incentives such as tax cuts and subsidies. Furthermore, the shift of existing measures to more effective options would enable the minimization of additional costs. In Section 4, we will elaborate on the specific measures in the key five areas selected under these premises.

Chart 3-2: The 5 key domestic demand stimulus measures from the perspective of dormant resources and employment



Source: Made by MHIRI

(3) The flow from domestic demand stimulus measures to self-sustained growth

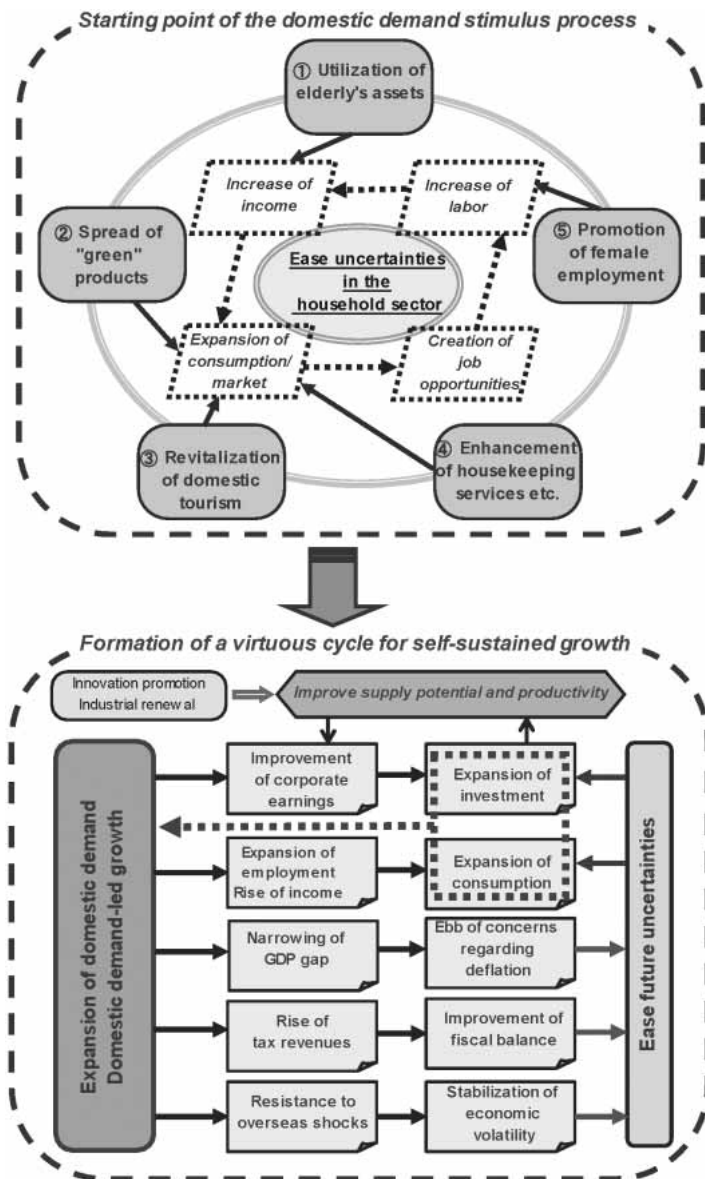
At the end of this section, this paper will set forth the roadmap from which the measures in the five key areas will create demand and lead to the self-sustained growth of the Japanese economy.

At present, the Japanese economy has dormant resources as a

mature economy, represented by financial assets surpassing JPY1,400 trillion. Under these conditions, consumer spending is not growing due to the sluggish income growth among the working generation and various uncertainties enveloping the household sector, resulting in the stagnation of domestic demand. The key is to create a cycle by mobilizing Japan's dormant resources to stimulate income to spending, leading to the expansion of the market and employment opportunities. By encouraging women to join the work force under such an environment, the employment opportunities thus created would lead to actual employment. If the flow starts to gain momentum, uncertainties surrounding households such as income and job concerns should start to ease. This is the first phase of the process, which is depicted in **Chart 3-3 (upper chart)**.

If the five key policy measures succeed in jump-starting the stimulation of domestic demand, this would lead to the self-sustained growth of the economy. The expansion of demand would lead to the improvement of corporate earnings and generate new investment. The rise of investment – combined with innovation and industrial reinvigoration – would raise output capacity and productivity and lead to a further improvement of corporate earnings. Next, the contraction of the output gap as a result of the increase of domestic demand will lead to the alleviation of concerns regarding deflation and keep consumers from putting off consumption. Meanwhile, the improvement of income and corporate profit will lead to the improvement of the fiscal balance and enhance the sustainability of public finances. Furthermore, domestic demand-led growth will result in a shift of Japan's export-led growth pattern, making it more resistant to shocks from overseas and stabilize economic fluctuations. The formation of such a virtuous cycle generating these multifaceted effects would lead to the establishment of a self-sustained growth path (**Chart 3-3, lower chart**).

Chart 3-3: Flow from domestic demand stimulus measures to autonomous and sustainable economic growth



Source: Made by MHRI

4. Key measures to stimulate domestic demand and their effectiveness

Of the measures deemed necessary for the vitalization of domestic demand, this section will focus upon proposals targeting the five following key areas selected in the previous section and provide estimations of their economic effect: (1) utilization of assets held by the elderly, (2) promotion of environment-friendly (“green”) housing and cars, (3) revitalization of domestic tourism, (4) development of the housekeeping, childcare and nursing care markets, and (5) promotion of female employment.

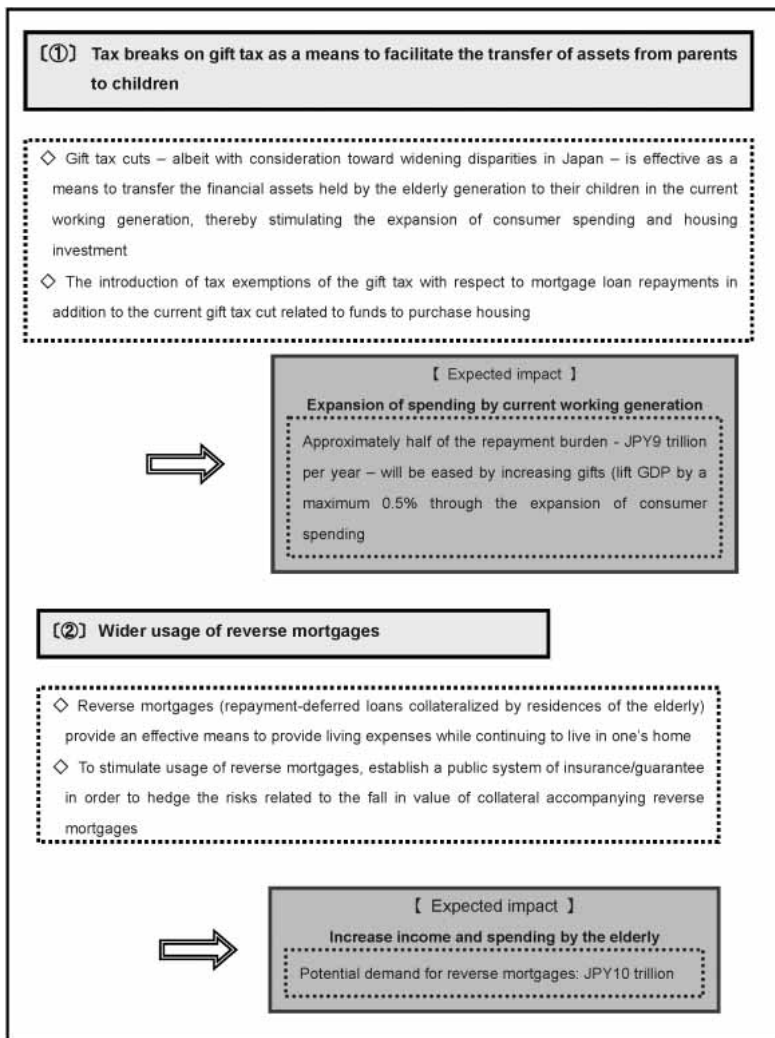
(1) Utilization of assets held by the elderly generation

Currently, assets held by individuals in Japan amount to approximately JPY1,400 trillion in financial assets and approximately JPY1,000 trillion in real assets . If the lush savings in the household sector can be channeled toward spending, it could serve to narrow the deflationary gap. By the same token, the real assets may also be utilized as resources for the stimulation of domestic demand.

In a bid to stimulate domestic demand, we propose the reduction of gift taxes to facilitate the transfer of assets from parents to child(ren) as a means to utilize financial assets and measures to promote reverse mortgages as a means for the elderly to utilize their real assets to acquire living expenses (**Chart 4-1**).

The gift tax cut is expected to push up GDP by a maximum of approximately 0.5% per year by boosting spending in the working-age generation. Moreover, the widespread usage of reverse mortgages is projected to generate potential demand equivalent to JPY10 trillion, of which the bulk is predicted to be channeled to consumption expenditures.

Chart 4-1: Key measures and impacts of the utilization of assets held by the elderly



Source: Made by MHRl

(2) The promotion of “green” housing and cars

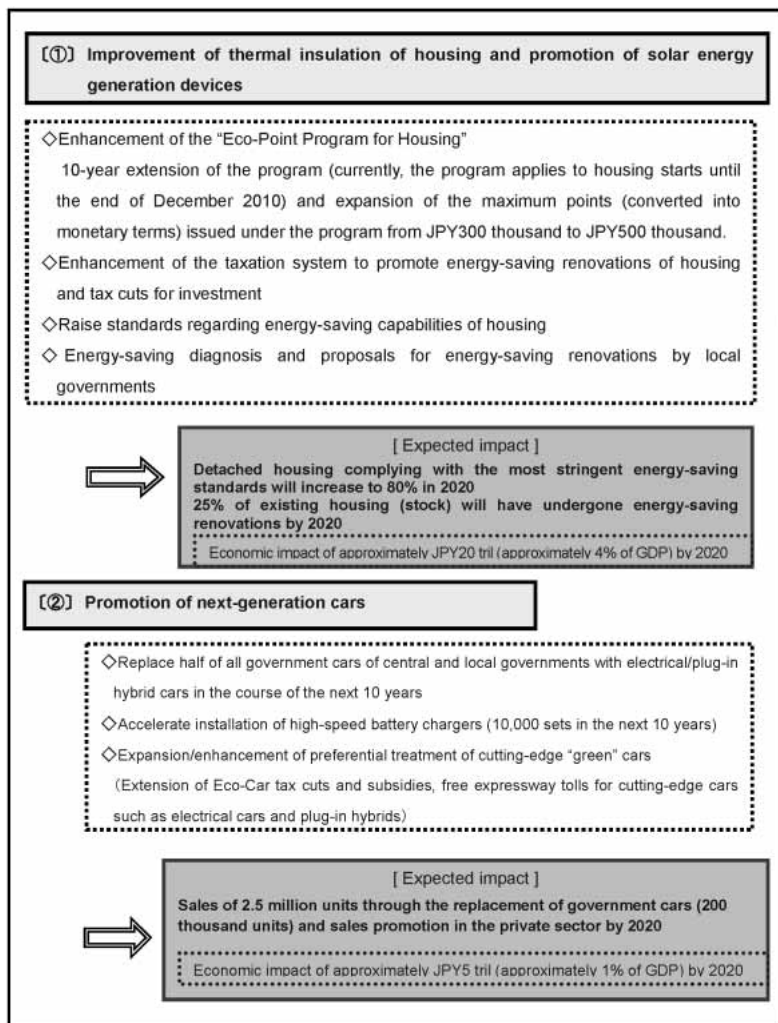
To facilitate the expansion of domestic demand in the area of environmental protection and conservation, the key will be to devise policy measures which succeed in achieving both the reduction of greenhouse gas emissions and the generation of new demand and jobs. Japan should focus upon energy-efficient civilian buildings (residential and office buildings) and the promotion of energy-efficient appliances and next-generation cars, given their effectiveness in curbing global warming and strong economic ripple effect in terms of domestic demand stimulation and industrial development.

Chart 4-2 sets forth the impact stemming from the promotion of “green” housing and cars. If 80% of all newly-built housing can satisfy the most stringent energy-efficiency standards by 2020 and 25% of existing housing (stock) are upgraded to energy-efficient housing through the improvement of thermal insulation properties and installation of solar power generation devices, the total economic impact would be equivalent to approximately JPY20 trillion.

Furthermore, if the sales of next-generation cars can grow to 200 thousand units in the government sector and 2.5 million units in the private sector by 2020, the economic impact would be approximately JPY5 trillion.

To finance these measures, it is worthwhile to consider the adoption of a global warming tax which levies taxes upon fossil fuel in accordance to their carbon content.

Chart 4-2: Key measures and impacts of the promotion of “green” housing and cars



Note: A public program providing points which are exchangeable for various goods toward new constructions and renovations with high energy and environmental design and properties.

Source: Made by MHRl

(3) The revitalization of domestic travel and accommodations

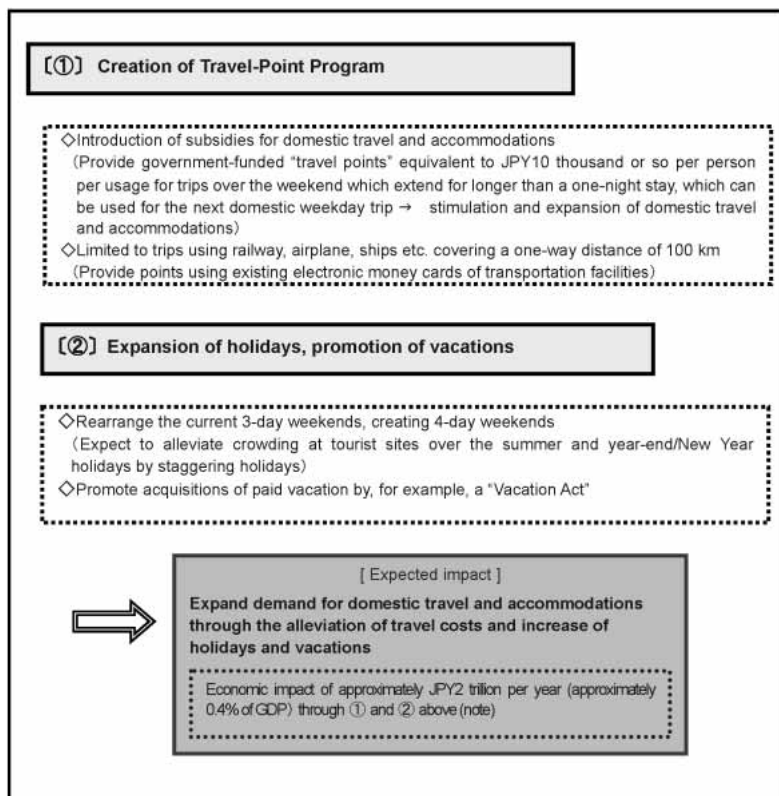
Despite the stagnant growth of spending on travel, various economic effects can be expected if Japan can succeed in stimulating the potential needs of the tourism and leisure industries.

The development of tourism and leisure industries utilizing dormant local tourism resources of various local areas of Japan would lead to the creation of high value-added industries in those localities. Considering the popularity of jobs in the tourism and leisure industries among the young generation, the increase of employment in the tourism and leisure industries would serve as a trump card to halt the outflow of the young population which is the major factor behind the population decline in Japan's localities.

Here, we propose the creation of a "Travel-Point Program" (Chart 4-3) to provide public support toward long-distance domestic travel and accommodations using public transport such as railroad, airlines and ships which are higher in average cost than travel by cars, by diverting part of the fiscal resources for making expressway tolls free which is proposed by the Democratic Party of Japan (DPJ). The main purpose of this program is to urge employed workers who seldom travel for private purposes during weekdays to go on trips during weekdays as much as possible. The fiscal resources necessary for making expressway tolls free is approximately JPY600 billion, and the fiscal resources necessary for the Travel-Point Program would be approximately JPY400 billion. While a simple comparison is not entirely appropriate, the Travel-Point Program would be less costly than the elimination of expressway tolls. The economic impact is estimated to be approximately JPY2 trillion per year, making it a more cost effective measure than making expressway tolls free.

It would also be necessary to arrange the current 3-day long public holidays into 4-day consecutive public holidays and to promote the use of paid leave by workers under a "Vacation Act" which encourages two 1-week vacations every year (Japan has a low rate of vacation utilization of 47% and one 1-week vacation per year is the norm).

Chart 4-3: Key measures and impacts of the revitalization of domestic travel and accommodations



Note: The impact of the Travel-Point Program should emerge in combination with the expansion of holidays and promotion of vacations. In this paper, we calculated the number of people who would go on trips (approximately 40 million) using Travel Points by multiplying the number of weekend travelers using public transportation (a total of approximately 76 million per year) by the rate of additional travel demand (74%) and the rate of travel actualization (70%) and calculated the economic impact of the measure by multiplying the number of Travel-Point users by the average amount of travel expenses (JPY50 thousand).

Source: Made by MHRI

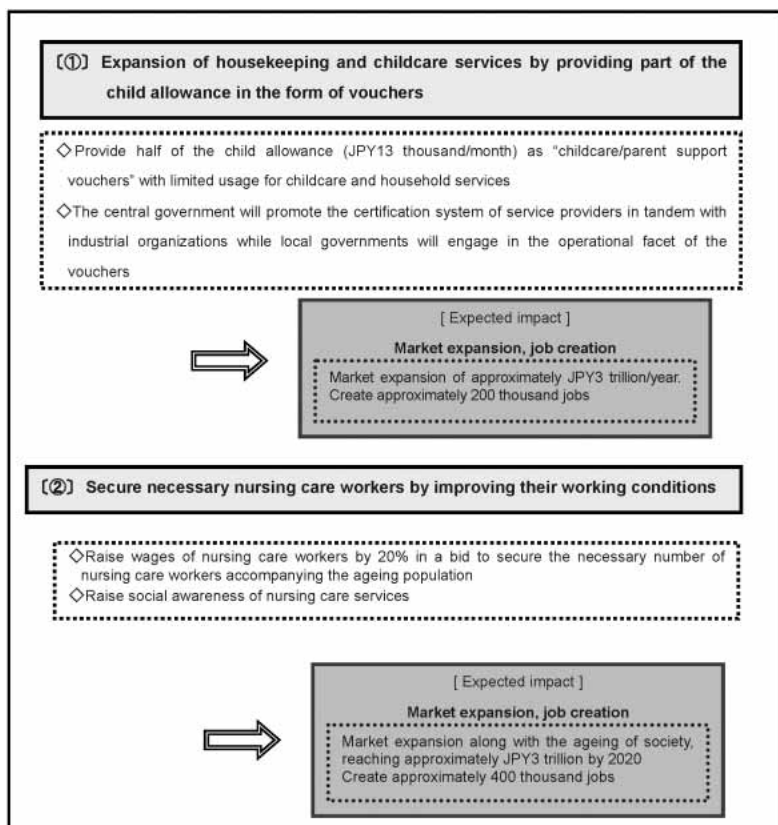
(4) The development of housekeeping, childcare and nursing care services markets

Given the rise of dual-earner households and the ageing population, housekeeping chores, childcare and nursing care which were traditionally taken care of within families, are being outsourced and thus possess potential demand. Furthermore, in view of forecasts that dual-earner households will continue to increase and that the graying of the population will progress further, the implementation of measures to promote the development of the housekeeping, childcare and nursing care services markets and to facilitate the use such services, will lead to the market expansion in these fields.

The keys to the stimulation of potential demand for housekeeping and childcare support services are (1) the improvement of housekeeping and childcare support services, (2) mitigation of the shortage of information regarding the quality of services, (3) reduction of costs for use of services, and (4) the improvement of public perceptions on the use of housekeeping and childcare support services. Furthermore, as a possible measure to spur market expansion, the child allowance (refer to Note 3 at the end of this paper) could be provided in the form of a “childcare/parent support voucher” which can be used for various childcare support and parent support services. In this case, we expect a JPY3 trillion market expansion per year and the creation of 200 thousand jobs (**Chart 4-4**).

Meanwhile, a significant increase in the number of nursing care workers is essential to cope with the rising demand for nursing care. Currently, many nursing care businesses face shortages of nursing care workers. By raising job satisfaction among nursing care workers by, for example, raising wage levels, the size of the market would expand by approximately JPY3 trillion and create approximately 400 thousand new jobs by the year 2020.

Chart 4-4: Key measures and impacts of the development of the housekeeping, childcare and nursing care services markets



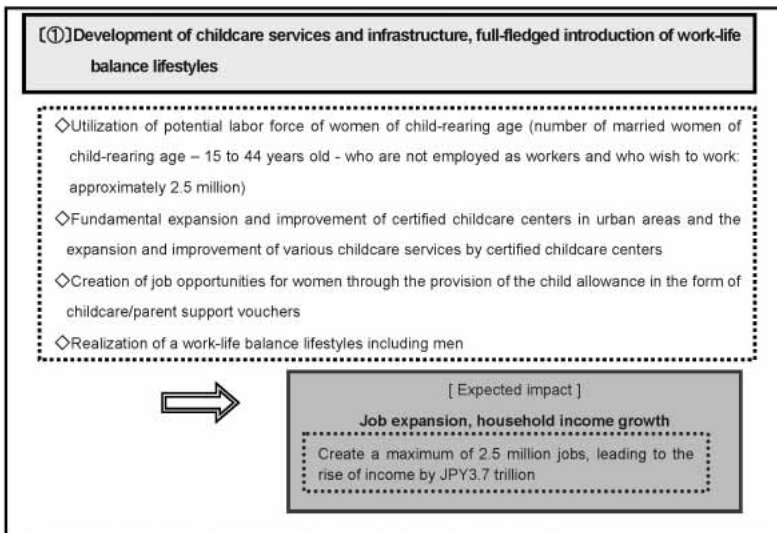
Source: Made by MHRI.

(5) The promotion of female employment

An effective measure for the stabilization and expansion of household income is the promotion of labor market entry of people who wish to work but are currently unemployed. According to a survey by the Ministry of Internal Affairs and Communications of Japan, the total number of people who are not employed as workers and who wish to work (including those who are looking for work and

those who are not actively engaged in job-searching activities) amount to 7.5 million as of 2007. The largest segment of this group is comprised of married women who are currently raising children (2.8 million). Of these people, 2.5 million wish to work as employed workers and not as self-employed workers. If these people were able to work in their desired form of employment, it would have the effect of boosting household income by JPY3.7 trillion per year (Chart 4-5).

Chart 4-5: Key measures and impacts of the promotion of female employment



Source: Made by MHRI

However, in the background to such a large number of married women wishing to work but unable to do so, are factors such as (1) the declining percentage of families residing with the parent generation due to the increasing number of nuclear families, (2) the long work-hours of male workers, and (3) the shortage of childcare services as shown by the large number of children on the waiting

lists of childcare facilities in large metropolitan areas. Of these bottlenecks, the situation may be improved by policy efforts to spread work–life balance lifestyles which enable couples to share household chores and childcare, and expand the public infrastructure to support childcare.

(6) The economic impact of the five key areas

a. Economic impact generating domestic demand worth JPY120 trillion in ten years

If policy measures are implemented in the five key areas as follows, it would have a significant impact as a means to raise domestic demand in the coming decade: (1) utilization of assets held by the elderly, (2) promotion of “green” housing and cars, (3) revitalization of domestic tourism, (4) development of the housekeeping, childcare and nursing care markets, and (5) promotion of female employment.

First of all, the creation of demand through the measures from (1) to (4) above would have a direct impact of approximately JPY120 trillion in the decade up to 2020. On an annual basis, it would raise the level of GDP by approximately 2%, leading to the expansion of related markets and creation of new jobs. If the expansion of job opportunities, combined with the promotion of female employment in (5), result in actual employment from the perspective of both supply and demand, it would generate new income and form a virtuous growth cycle of the Japanese economy driven by consumer spending.

Given the inevitable rise of fiscal costs for the realization of the measures, the key is to minimize additional burdens amid tight budget conditions. In this respect, the recombination of existing policy measures would be effective. For example, we have devised measures to avoid additional fiscal burdens through the following endeavors. With respect to (2), we propose the replacement of the conventional car–related taxes with an environmental tax to generate new revenues. Moreover, we propose the diversion of the spending to eliminate expressway tolls in (3), and the provision of part of the

child allowance will the form of vouchers in (4). Furthermore in (1), we stress the importance of using the gift tax, which is small in terms of tax revenue, to move a large sum of private-sector funds.

As a result of the foregoing, total fiscal costs will be kept in check around JPY50 trillion. Note also that the net increase of fiscal burdens, excluding expenditures and diversion of taxes, will only be around JPY10 trillion. If this can generate demand worth JPY120 trillion, the cost effectiveness of such measures would be extremely high.

b. The deflationary gap would be closed five years earlier than expected

If the foregoing domestic demand-boosting effect may be realized, Japan's JPY25 trillion deflationary gap can be narrowed in a short period of time. The rise of demand as a result of the stimulus measures – along with successful supply-side measures such as the promotion of female employment – would serve to eliminate deflationary risks and any budding signs of a bubble and create a stable growth path. According to an estimation taking into consideration the proposals set forth in this paper, the stimulus package would close the output gap by the mid-2010s, approximately five years earlier than initially expected. From then onward, the Japanese economy should shift into a sustainable growth path.

(7) Other measures to enhance the effectiveness of the five key measures and other industries possessing high market growth potential

To enhance the effectiveness of the measures in the key areas and to stimulate further domestic demand, measures in the following areas in addition to those in key areas are essential: (1) measures for the livelihood and stabilization of the working generation, (2) measures to vitalize corporate activity, (3) measures to vitalize regional economies, and (4) construction of a sustainable social security system.

As other industries and markets possessing high growth potential, we cite (1) health and medical treatment industries, (2) educational services targeting adults, (3) information & communications technology, and (4) robot and nanotechnology industries among high value-added manufacturing industries (Chart 4-6).

Chart 4-6: Other industries and markets which possess growth potential and their stimulus measures

<p>Medical and healthcare industries</p> <ul style="list-style-type: none">○ A plan to increase the number of medical treatment workers is essential to cope with the increase in number of patients receiving treatment at medical institutions○ Promote disease prevention, nursing care prevention and spread of medical treatment industries in order to curb the rise of medical treatment and nursing care costs <p>Educational services targeting adults</p> <ul style="list-style-type: none">○ Support cultivation of adult-oriented human resources training services to serve the needs for self-development of workers and human resources training of corporate enterprises <p>Information & communications technology (ICT) industry</p> <ul style="list-style-type: none">○ The government-led promotion of ICT investment and cultivation of new Japanese digital industries are necessary <p>Robot industry</p> <ul style="list-style-type: none">○ Government-led efforts to upgrade market research & analysis, and promotion of open innovation are necessary <p>Nanotechnology industry</p> <ul style="list-style-type: none">○ Efforts to reinforce basic research and address human resource shortage are necessary
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Source: Made by MHRI

5. Overseas demand and Japan's future outlook

Up to the previous section, we proposed a menu of measures to utilize potential resources deemed highly effective for the generation of new jobs along with their expected economic impacts. If these proposals are realized, they would open the path for Japan's construction of a stable economy which is resistant to overseas shocks. However, note that the focus of attention toward the stimulation of domestic demand is not synonymous with a disregard

for “external demand” (in this case, referring to “overseas demand”). In the growth of the economy, domestic demand and external demand are “two wheels of one cart”, and a balanced growth trajectory is desirable.

While we have focused upon domestic demand in view of the malaise stemming from the global financial crisis, we shall widen our perspective to overseas demand in the future. In this section, we shall select several key points in order to capture such demand and set forth the desirable medium- to long-term direction of Japan’s economy which is targeted by these policy measures.

(1) The necessity to capture overseas demand

Despite the importance of food and resource self-sufficiency due to Japan’s overseas dependence for such necessities, there are limits because of its geographical restraints. Looking forward, Japan must attain, by means of exports, the funds for the stable procurement of food and resources. Note also that Japan’s population will gradually decline. While we believe that it is possible to raise domestic demand through various stimulus measures as proposed in this paper, Japan’s demographic decline will continue to serve as drag. The capture of overseas demand would be necessary in order to compensate for such demographic restraints.

Together with the indispensable nature of overseas demand, there are great expectations toward exports in terms of future potential. The surge of emerging countries such as China and India should continue for some time. Japan, given its geographic proximity to the emerging countries of Asia, should have great opportunities from the expanding markets of Asia.

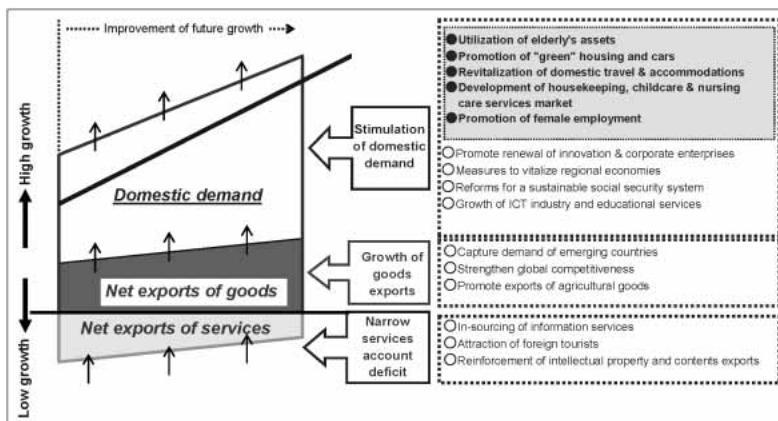
The opportunities and areas which deserve attention are not limited only to exports of industrial products which usually come to mind in discussions on external demand in Japan.

The promotion of export growth of agricultural and marine products in the category of physical resources as in the case of industrial products, (the “in-sourcing” of) information services, the attraction of foreign tourists, and the expansion of exports of services

such as intellectual property, will serve as effective steps to capture overseas demand. Furthermore, the repatriation of overseas profits of Japanese companies operating on a global level will also serve to capture external demand in the wide sense of the term.

Stated succinctly, Japan must tap into the wealth of the expanding global market through various channels, in a bid to feed its own growth. **Chart 5-1** depicts the way in which economic growth is boosted through the key measures to stimulate domestic demand and steps to capture overseas demand explained in the foregoing section. This represents the ideal way to raise Japan's growth.

Chart 5-1: Balanced growth driven by both domestic and external demand



Source: Made by MHRI

(2) The domestic demand stimulus measures and the future vision

The *MHRI Proposal* started out with the question of how to close the deflationary gap which widened due to the global financial crisis and recession. This, we believe, is possible by implementing the stimulus measures in the five key areas which are estimated to generate demand worth approximately JPY120 trillion during a time

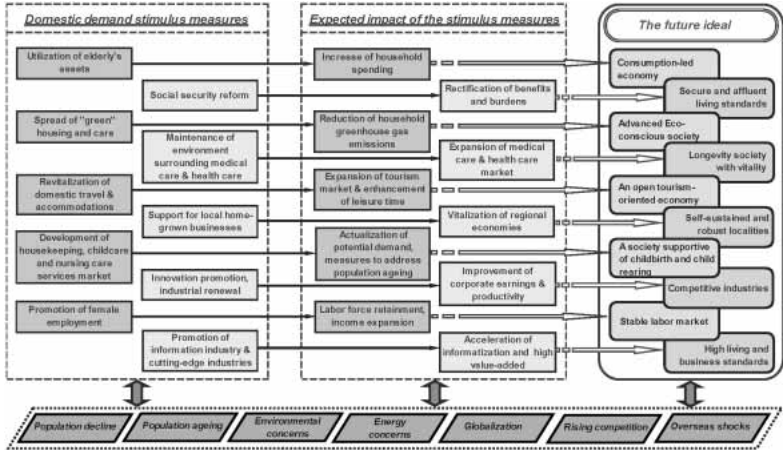
span of ten years.

However, in the process of drafting the *MHRI Proposal*, we focused upon measures which aim not only to close the deflationary gap but also to respond quickly to socio-economic shifts and address the various challenges shared by the developed countries of the world. Thus, the *MHRI Proposal* covers areas such as the ageing population and the environment and also addresses issues such as industrial promotion, regional vitalization. These proposals which cover a wide span of measures provide a new model for a developed and mature economy. In the event such a model is realized, the result should lead to the rise of economic growth.

The measures presented in these proposals envisage desirable images of the economy and society through each of their projected impacts. They are not limited only to the stimulation of domestic demand in the short run, but serve as a base to select consistent measures to achieve the long-term goal of constructing a society and economy suitable for a mature developed country.

For example, the promotion of “green” housing and cars provides a step toward building an advanced eco-conscious society through the reduction of green-house gas emissions. As for the development of the market for household, childcare and nursing care services, the measures strive for a society which encourages childbirth and child rearing. The measures in areas other than the five key areas also have the same motive. Social security reform increases the possibility of realizing secure and affluent living standards by improving the level of benefits and burdens. The promotion of the information and cutting-edge industries should serve as a means to achieve high-level living standards and businesses. **Chart 5-2** portrays this vision.

Chart 5-2: Shifts in Japan’s socio-economic environment and the future ideal envisaged by the domestic demand stimulus measures



Source: Made by MHRl

(3) Outlook on medium- to long-term economic growth

To achieve economic growth based upon the stimulation of domestic demand, we have set forth a strategy for growth from the perspective of both supply and demand. Lastly, we shall provide a vision of Japan’s growth over the medium- to long-term in the event the policies in this package are realized.

Firstly, in order to minimize the impact of the shrinking labor force accompanying the decline and ageing of the population, the policy package will promote female employment by alleviating childcare burdens and contain the labor mismatch through functional improvements of the labor market. In particular, the labor force population is expected to increase by approximately 2 million workers as a result of the alleviation of childcare burdens for women wishing to work. This would offset half of the natural attrition of the labor force accompanying Japan’s population decline.

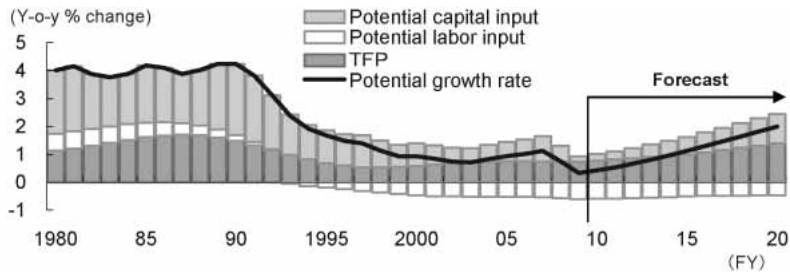
Secondly, the policy package will promote cutting-edge industries such as robots and nanotechnology in a bid to accelerate

the rise of productivity which holds the key to fortifying growth, and will also upgrade productivity in the nonmanufacturing sector. Japan's total factor productivity (TFP) is expected to rise dramatically by improving the conditions for innovation, the renewal of industries and deregulation in the services sector. Furthermore, the capital stock and qualitative improvement of the labor force resulting from the promotion of ICT investment and educational & training services toward adults should also lead to the rise of TFP.

Thirdly, the rise of Japan's growth expectations reflecting the expansion of domestic demand and the improvement of corporate earnings power through the cultivation of high value-added industries and creation of new industries should serve to reinvigorate capital investment. The drive to build up capital stock should emerge out of the doldrums after the collapse of the bubble economy in the first half of the 1990s and regain momentum.

Given the steady improvement of each of the growth factors as described above, Japan's potential growth rate is predicted to rise gradually from +0.3% in FY2009 to +2.0% in FY2020 (Chart 5-3).

Chart 5-3: Outlook on Japan's potential growth rate



If the stimulation of domestic demand through the measures in the five key areas and the reinforcement of long-term growth may be promoted at the same time, the deflationary gap can be closed in a relatively short period of time. Moreover, the absorption of the

fruits of global growth will serve as tailwinds to these developments. From the mid-2010s, the state of the Japanese economy burdened with excessive supply will be resolved and start to follow a self-sustained recovery. As a result, the rate of Japan's real GDP growth should gradually climb along with the rise of its potential growth rate and recover to the 2%-level by the end of the 2010s. Furthermore, as Japan emerges out of deflation and prices start to rise at a stable place, the rate of nominal growth should rise to the 3%-level, above the rate of growth in real terms.

Japan – given its damage stemming from the global financial crisis – is faced with the following tasks in order to achieve economic growth to provide its people with a tangible sense of affluence: (1) the expansion of domestic demand in the form of a virtuous cycle where the rise of income leads to the growth of consumer spending, and (2) the fortification of long-term growth to support the foregoing. The *MHRI Proposal* sets forth measures to achieve economic growth through the stimulation of domestic demand from both the perspectives of supply and demand. If the Japanese economy succeeds in reviving itself by carrying out these measures, it will be able to overcome its restraints such as its ageing and dwindling population and achieve a new growth model – that is the stable expansion of domestic demand and the incorporation of the fruits of overseas economic growth – as a mature developed economy ahead of other countries of the world.

Conclusion

We have looked back upon the DPJ's policy management over the past year in power and have provided an overview of its *New Growth Strategy* as well as the fundamental philosophy, actual measures and respective impacts of the *MHRI Proposal* centering around domestic demand.

The Japanese economy is in dire conditions, facing numerous issues which need to be addressed. Having said so, the government's *New Growth Strategy* and the *MHRI Proposal* coincide in their views that it would be possible to raise Japan's growth rate again if effective measures are taken in a timely and accurate manner.

Looking forward, the key will be how to carry out the necessary measures. Despite the compilation of medium to long-term road maps for economic policy management from time to time in the past, they have not been successful in turning around the economy during the past 20 years. Even though this stems partially from changes in the socio-economic environment, the failure to carry out the plans may not be underestimated. It is necessary to reflect upon these past mistakes and to engage in the revitalization of the economy with a sense of urgency and crisis.

Approximately one year has passed since the historical shift of political power. Given the decision on the *New Growth Strategy*, the stage of the government's economic policy management has progressed from the planning to the implementation stage. Furthermore, its mere implementation is not enough. It is necessary for the measures to take effect and lead to the rise of economic growth. Amid the changes in socio-economic environment and fierce global competition, there is no time left to waste to boost economic growth. Growth accompanied by the increase of tax revenues is also imperative to restore the state of Japan's debilitated public finance. Looking forward, the steady implementation of measures deemed effective upon a clear prioritization among the wide range of measures in the *New Growth Strategy* will be necessary.

As mentioned at the beginning of this paper, the year 2008 was a historical year for the global economy. While the countries of the world staved off the crisis for the time being by taking emergency measures, risks still remain in a different form in both the US and Europe. Moreover, note that the countries are still seeking ways to regain economic stability. Such endeavors may indicate a sense of crisis among the countries of the US and Europe, given the state of

their economies which resemble Japan's stagnation during the past 20 years.

It would be extremely meaningful if Japan can step beyond a mere bad example and present a "solution" for economic revival. Therefore, the implementation of the *New Growth Strategy* which is about to be started, deserves attention in the context of both overcoming the crisis and serving as a role model for the leading mature economies of the world.

While it looks likely that the year 2010 will become a symbolic year when China surpasses Japan in terms of economic size, if Japan can take a strategic move to put an end to the prolonged stagnation of its economy, it will become a symbolic year on a more fundamental level. The DPJ-led coalition government must engage in the steady implementation of measures which are deemed effective to raise the rate of economic growth.

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Notes:

- 1 The issue involving the relocation of the US Marine Corps Air Station Futenma (Ginowan City, Okinawa Prefecture) due to its current location in a densely-populated residential area which is said to pose safety concerns. In 2006, the governments of Japan and the US agreed upon the relocation of the Air Station to Henoko, Nago City. Although Prime Minister Hatoyama – who came into power in 2009 – searched for ways to relocate the Air Station outside of Okinawa Prefecture, differences within the DPJ and Prime Minister Hatoyama's backtracking of remarks led to prolonged confusion, ultimately resulting in the announcement of a joint Japan-US statement on the relocation of the Air Station to Henoko.
- 2 In the "twisted Diet", the House of Representatives and the House of Councilors tend to vote differently on matters. In case the House of Councilors vote down a bill passed by the House of Representatives, a two-thirds majority vote of the House of Representatives is necessary for a repassage of the bill.
- 3 The "child allowance" is an allowance paid to parents before the child completes junior high school (Grade 9) education for the alleviation of economic burdens for raising children. There is no income test for eligibility.
- 4 The income compensation program for farm households is a program providing compensation for the difference between the sales price and production cost for farm households engaged in the sale of agricultural and animal products, for the revival of agriculture and improvement of food self-sufficiency.

- 5 The “elimination of expressway tolls” refers to the staged phase-out of expressway tolls for the reduction of distribution costs, alleviation of traffic jams in ordinary roads, and the revitalization of regional economies.
- 6 In the “budget screening process to reduce wasteful spending”, the pros and cons of projects on a project-by-project basis are discussed in the public, taking into consideration views from outside. The budget screening process is conducted by the Government Revitalization Unit which was established under the Cabinet Office after inauguration of the DPJ administration, for the purpose of the overall renovation of the government’s budget, systems and overall public administration process.
- 7 The “abolition of provisional tax rates” refers to tax cuts through the abolition of provisional tax rates added to the statutory tax rate with respect to the gasoline tax, automobile weight tax and the automobile acquisition tax.
- 8 The “postal reform bill” sets forth the merger of the current Japan Post Group (currently comprised of five companies) into a parent company comprised of three companies (the holding company, postal company and post office) and two companies (savings and insurance companies) as subsidiaries, as well as the direct and indirect holding of a certain percentage of the shares by the government.
- 9 The “global warming bill” sets forth, among other matters, (1) explicit mid- to long-term goal to reduce greenhouse gas emissions by 25% from the level in 1990, (2) the introduction of a domestic emissions trading system and global warming tax as basic measures to achieve the goal, (3) the purchase of renewables-derived electric power through a feed-in tariff system, and (4) the promotion of innovative technology development.
- 10 The “bill on reform of the labor dispatch law” prohibits, as a general rule, the dispatch of workers on a registry system, the dispatch of workers to manufacturers, the dispatch of day labor, and measures for the protection and improvement of labor conditions of dispatch workers.
- 11 Since half the members of the House of Councilors are elected every three years, it is said that it is difficult for a single party to secure a majority of all the seats. In fact, from 1989 to the present, the ruling party has never secured a majority of the seats on its own in the House of Councilors.



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