The Socio-Economic Situation in Japan and Policy Direction

1. An Outline of the Current Situation and Issues

Signs of a recovery can be seen in parts of the Japanese economy, such as certain types of production, but these are largely due to external demand and the economic fundamentals are still weak. Although the outlook for personal consumption appears bright in some sectors, domestic demand lacks overall vitality and the job market remains tight. Moreover, prices continue to fall and overcoming deflation has become a major issue. Against this background, the continuing problem of non-performing loans is stifling the supply of funds, which in turn is paralyzing new technology development and investment in plants and equipment. Another major factor is uncertainty over future issues such as the sustainability of social security systems, which is constraining private sector vitality.

The global economy is showing some signs of recovery. However, low share prices and the low dollar stemming from mistrust of corporate accounting practices in the United States have created a sense of uncertainty surrounding overall economic recovery both within and outside the U.S., and it is difficult to make predictions.

Considering Japan's economy and society from a structural point of view, the declining birthrate and aging population, as well as the developing service-sector economy, are creating a need to re-think the very structure of economic development. At the global level, economic and population growth are creating demands for higher standards of living, which increase both the energy demand and the amount of waste materials. Both at the domestic and the global level, social and economic development cannot be achieved without addressing global warming and other environmental issues. In thinking about Japan's future development, we have to construct strategies that are based on addressing these various issues.

In light of the situation outlined above and amidst severe restrictions on public spending, we need to consider how to make the best use of private sector dynamism. Key policy issues include overcoming deflation, enhancing competitiveness, integrating internal and external economic policy, and enhancing measures to deal with environmental and energy issues. Since these matters are intertwined, an integrated approach is required to address them.

2. Basic Policy Direction

Overcoming Deflation
Solving the deflation problem is the most crucial step in revitalizing the economy, and this issue cannot be solved without sparking demand. As conventional fiscal stimulus policies reach their limits, there are high expectations of the role to be played by financial policy and calls for more radical measures to make maximum use of private sector dynamism. To that end, the first requirement is to put in place measures such as a taxation system that stimulates investment in research and development as well as the demand for information technology. Such a system would aim to end deflation by spurring innovation, which in turn creates demand, bringing about a "virtuous circle" of innovation and demand.

**Enhancing Industrial Competitiveness**

On the supply side, a level of competitiveness appropriate to an advanced industrial economy is essential to achieving sustained economic growth in Japan. To this end, there is a need to make enterprises, individuals, and the business environment in which companies operate more competitive at the global level. The government is actively backing companies’ efforts to overcome the “three surpluses,” push ahead with management reforms, introduce new technology, and strengthen industrial competitiveness. In terms of the business environment, we are not only reducing infrastructure costs, but also creating a more competitive environment through deregulation to strengthen our ability to compete globally. Concerning the private sectors, however, it is expected that they appropriately utilize the systems established by the government side. For example, the JPO receives numerous patent applications compared with other countries and this has caused the delay in examining patent applications.

**Integrated Internal and External Economic Policy**

As outlined above, there is a need to become more globally competitive. On the other side of the coin, individual economic activity is crossing borders and merging at the international level. Economic players are pursuing a single global market and production processes are being divided across borders. To respond to these developments, structures including government policies and tax systems have to be constructed from an integrated viewpoint that considers both internal and external issues. In particular, it is essential to create a unified structure for East Asia. At the same time, it cannot be denied that drastic changes in the international situation are another compelling factor. It is important to develop flexible policies that are adaptable enough to respond appropriately to sudden environmental changes.

**Responding to Environmental and Energy Issues**
A new conceptual framework is emerging in respect of environmental issues such as global warming, waste management, and recycling. A wide variety of economic activities are now being conducted on the assumption that such issues need to be properly addressed. Given the fact that 90 percent of the global warming gases that Japan produces originate from energy sources, we are taking an integrated approach to the issues of energy and global warming and responding to waste management issues through the “3 Rs” (reduce, reuse and recycle). In addition to the environmental issues outlined above, we must take a comprehensive and positive approach to policy development, including issues such as securing stable oil and natural gas supplies and creating a new market environment in the electricity and gas sectors.

3. Pushing Ahead with Administrative Reforms

We are working to achieve higher-quality public services through the introduction of e-government initiatives and reorganization. Furthermore, through the conversion of special public corporations into independent administrative institutions, which may be deliberated by the Diet this autumn, we will undertake concrete reforms after formulating management philosophies embodying the mission of each institution.