

A “New Economy” for Japan ?

New METI’s Mission

Presentation by

Nobuo Tanaka

tanaka-nobuo@rieti.go.jp

Vice President & Senior Fellow

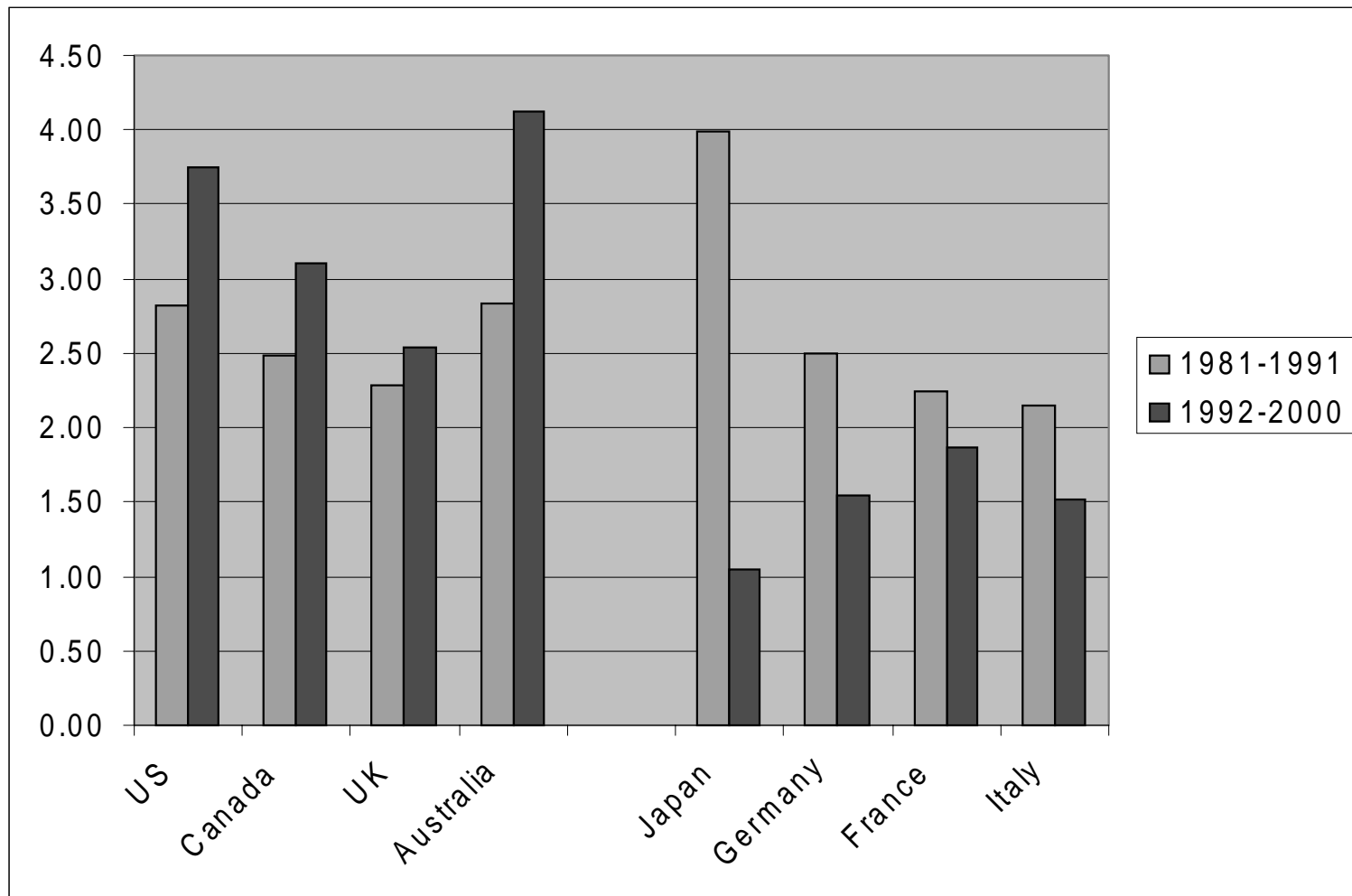
Research Institute of Economy, Trade and Industry

June 13th, 2001



Winners and Losers

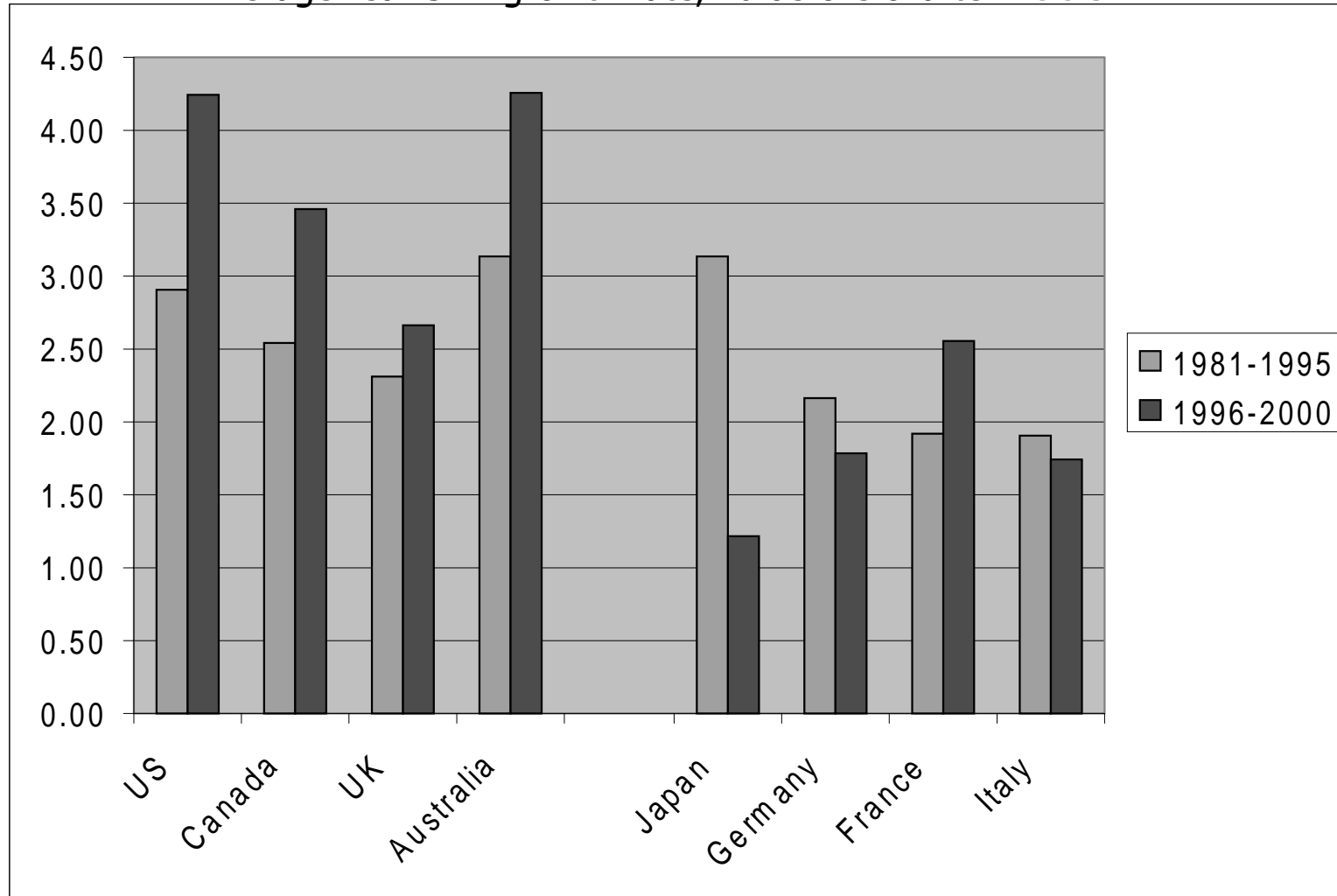
Average real GDP growth rate % before & after 1991



Source: OECD

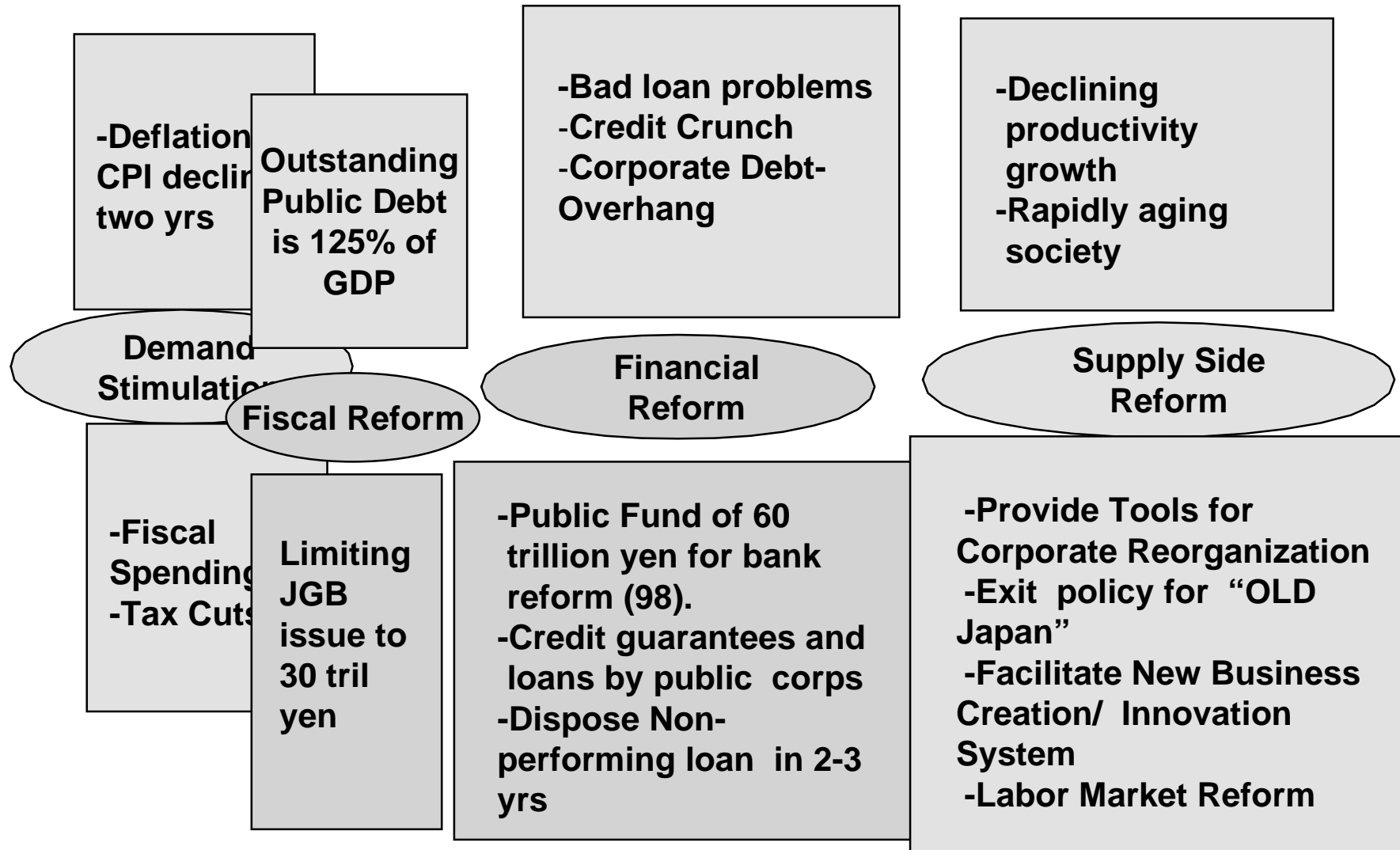
Winners and Losers

Average real GDP growth rate, % before & after 1995

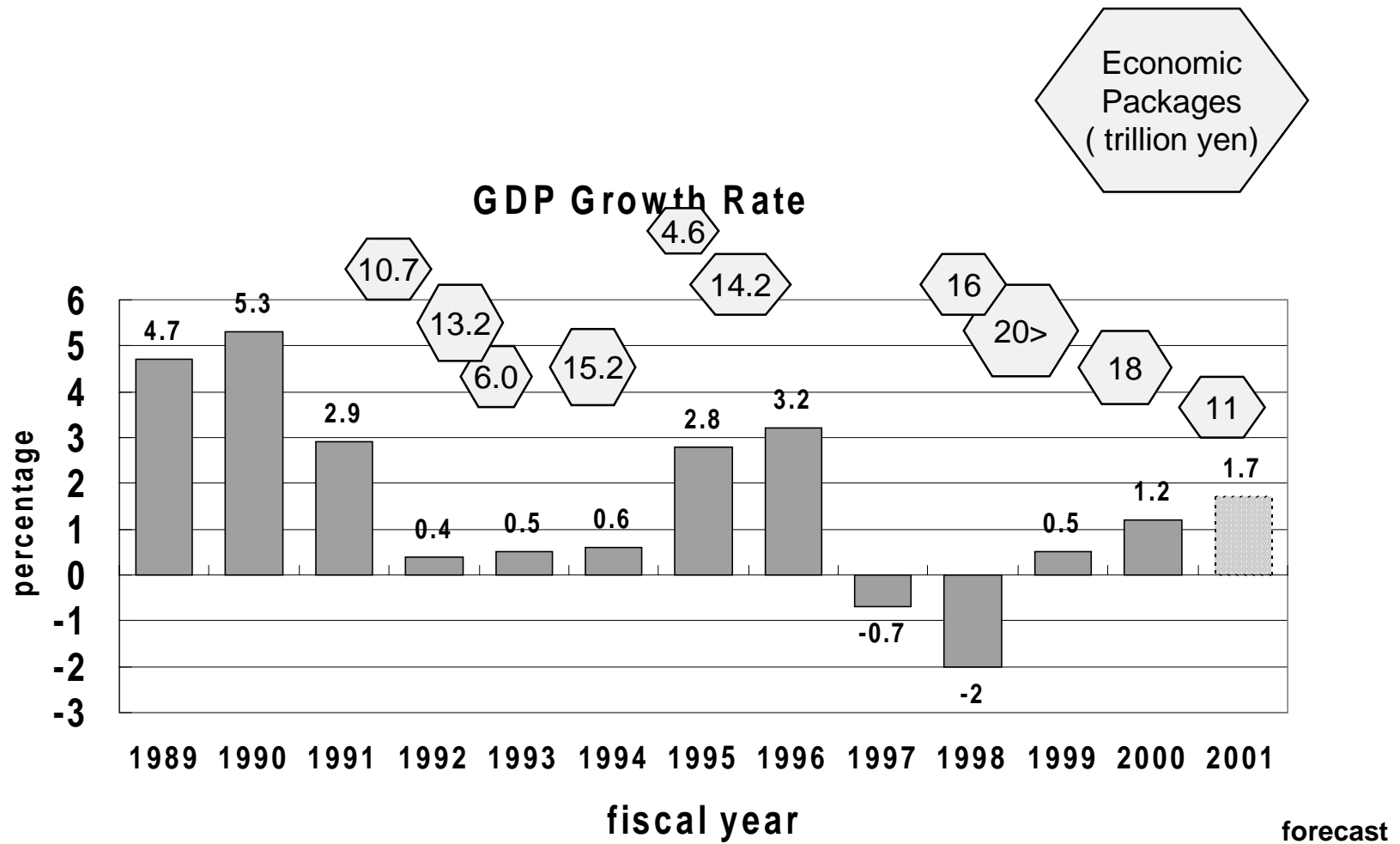


Source: OECD

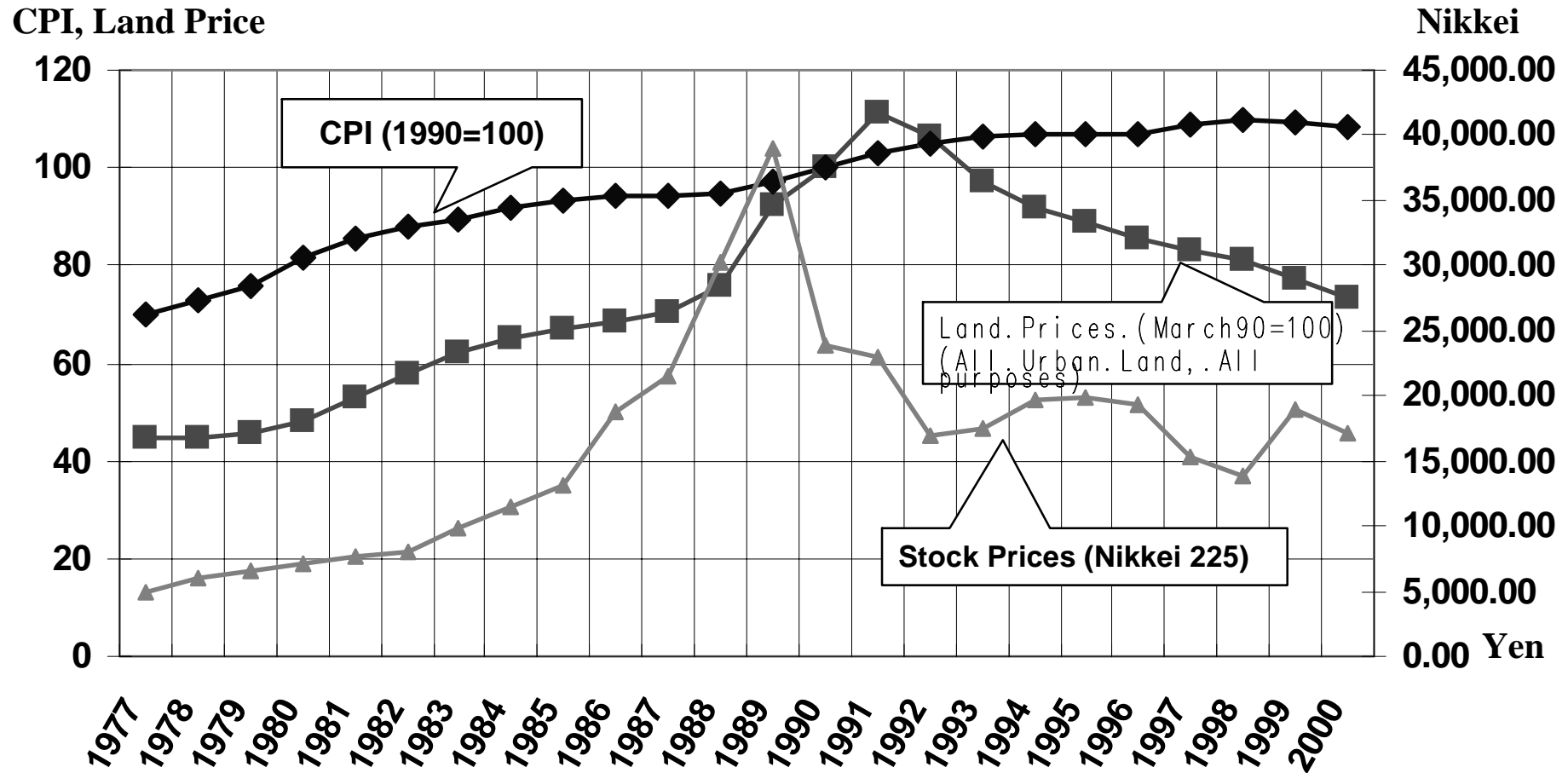
The Four Pillars of Japan's Economic Policy



Japan's Economic Growth and Stimulus Packages

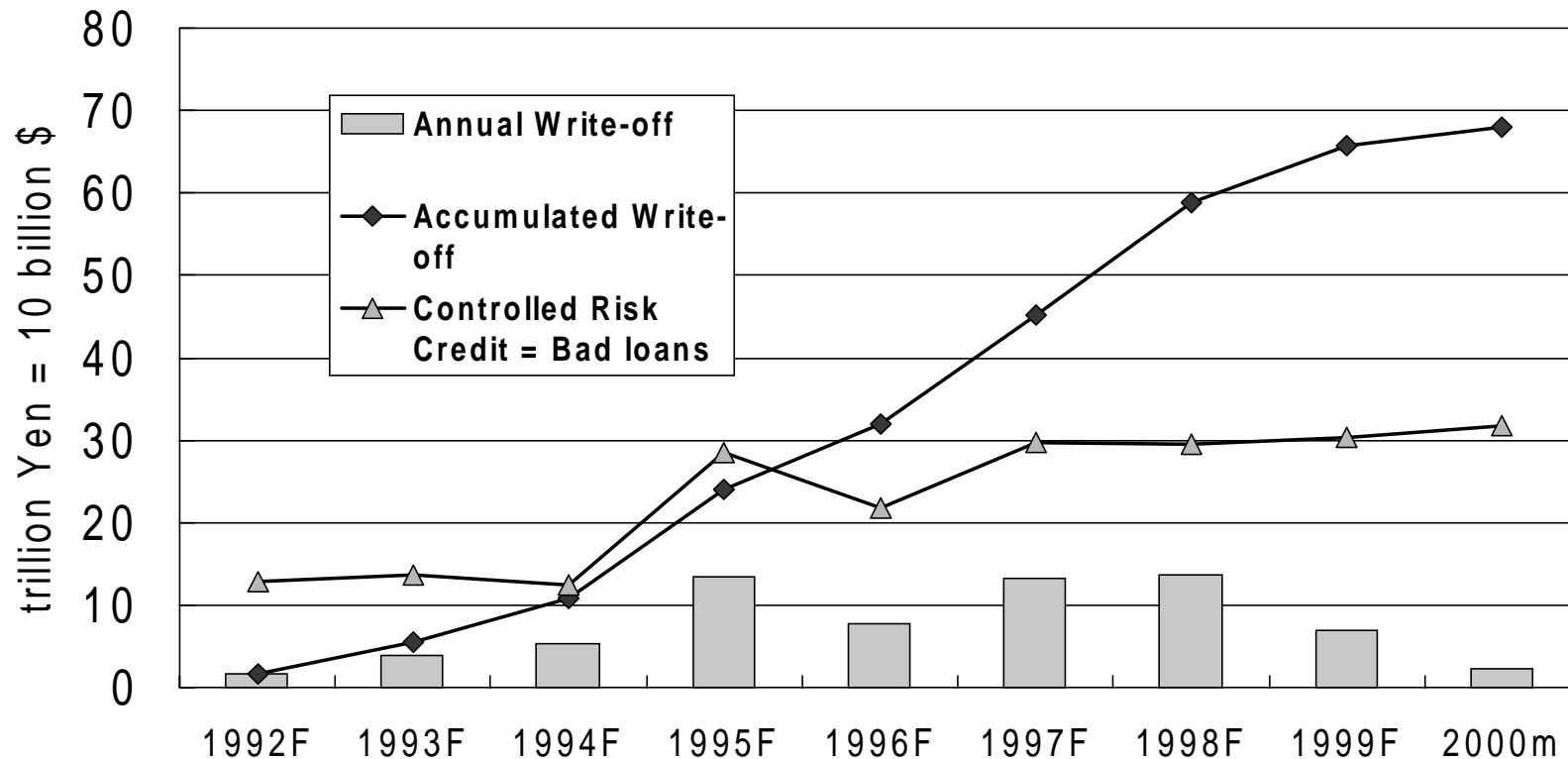


Japan's Stock and Land Prices



Bad Bank Loan Issue Is Over ?

Non - Performing Loan Reduction by Japanese Banks
(all bank basis)

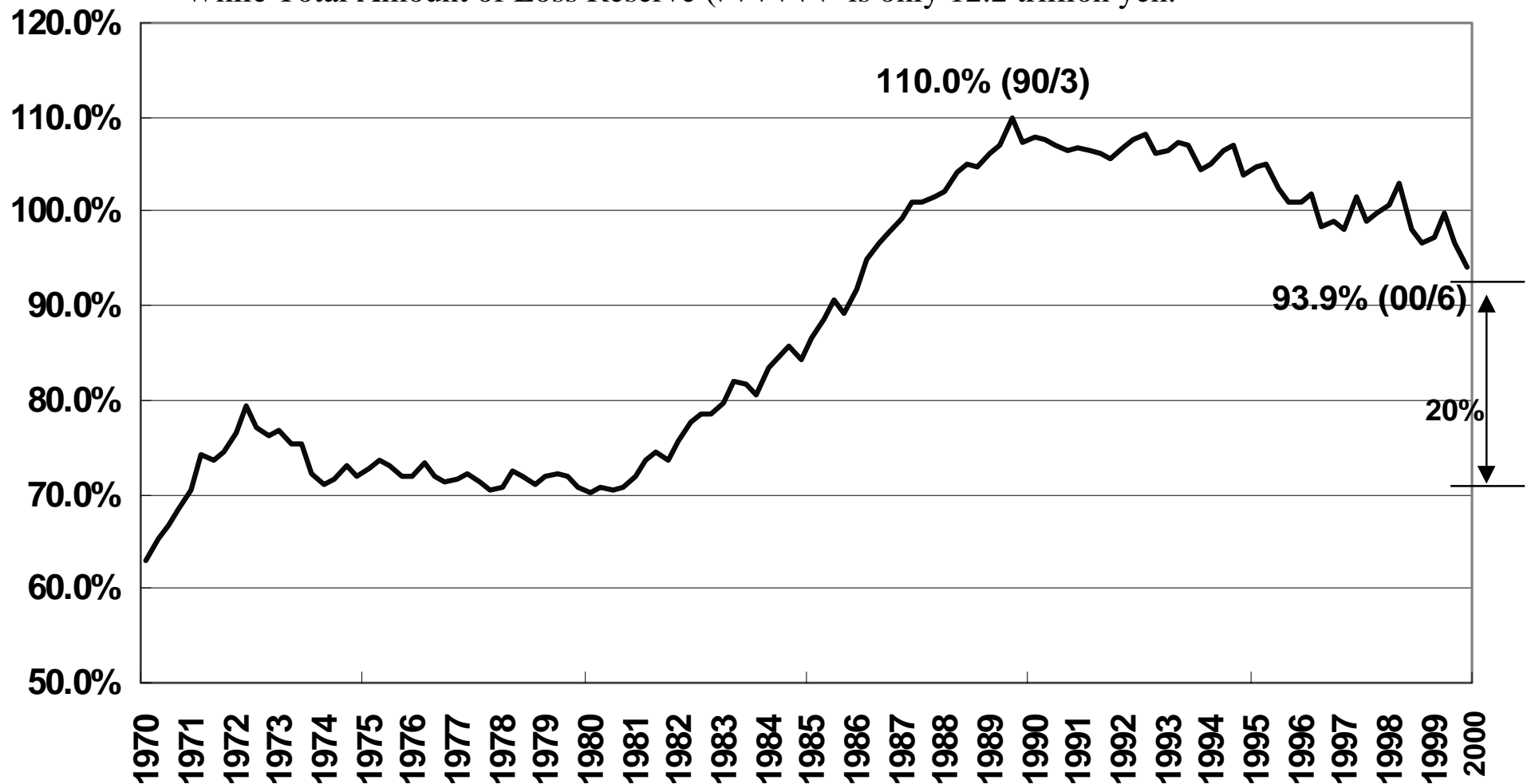


Controlled Risk Credits are defaulted loans, favored repayment loans, and delayed repayment loans. All banks are city, long-term-credit, trust, regional, 2nd regional banks)

Potential Impact of Non Performing Loans

Total Amount of Outstanding Loans as a Percentage of GDP By Domestic Banks (including Trust Accounts)

20% of GDP is about 100 trillion yen. NPL can be More than 100 trillion yen,
While Total Amount of Loss Reserve (.) is only 12.2 trillion yen.

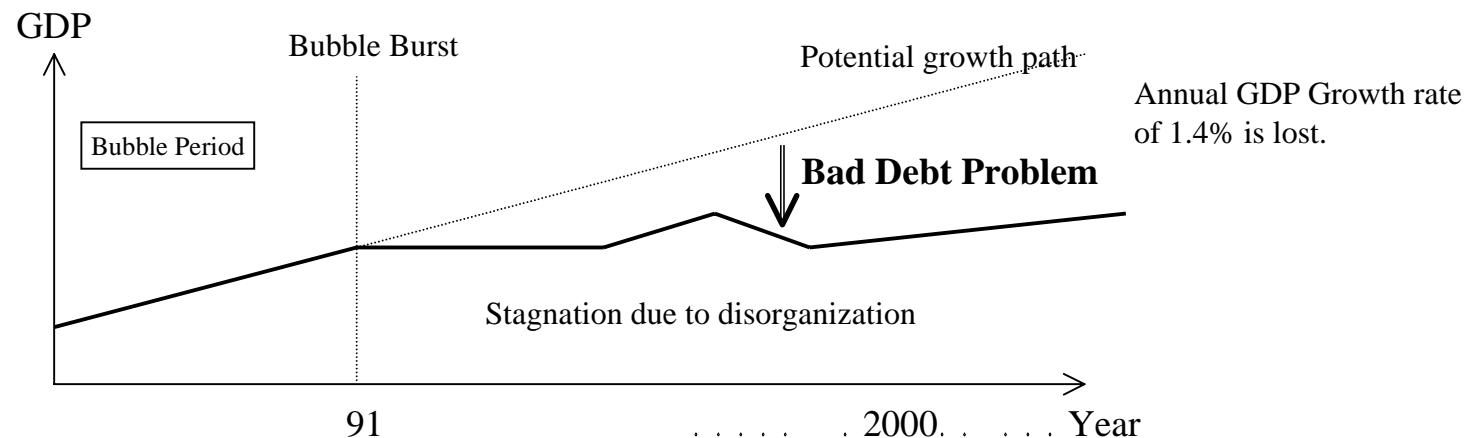


Why Is Balance Sheet Restructuring of Both Banks and Corporate Sector Necessary.

Debt Disorganization (by Keiichiro KOBAYASHI)

Decline of economic growth due to disorganization of supply chain networks.

- . Increase in number of firms carrying bad debts and banks carrying bad loans.
- .. ➡ Coordination failure in division of labor and formation of supply chains, triggered by suspicion and distrust among banks and companies.
- .. ➡ Disorganization of supply chain
- .. ➡ Decline of productivity and shrinkage of business activities
- .. ➡ Decline of potential growth and asset prices

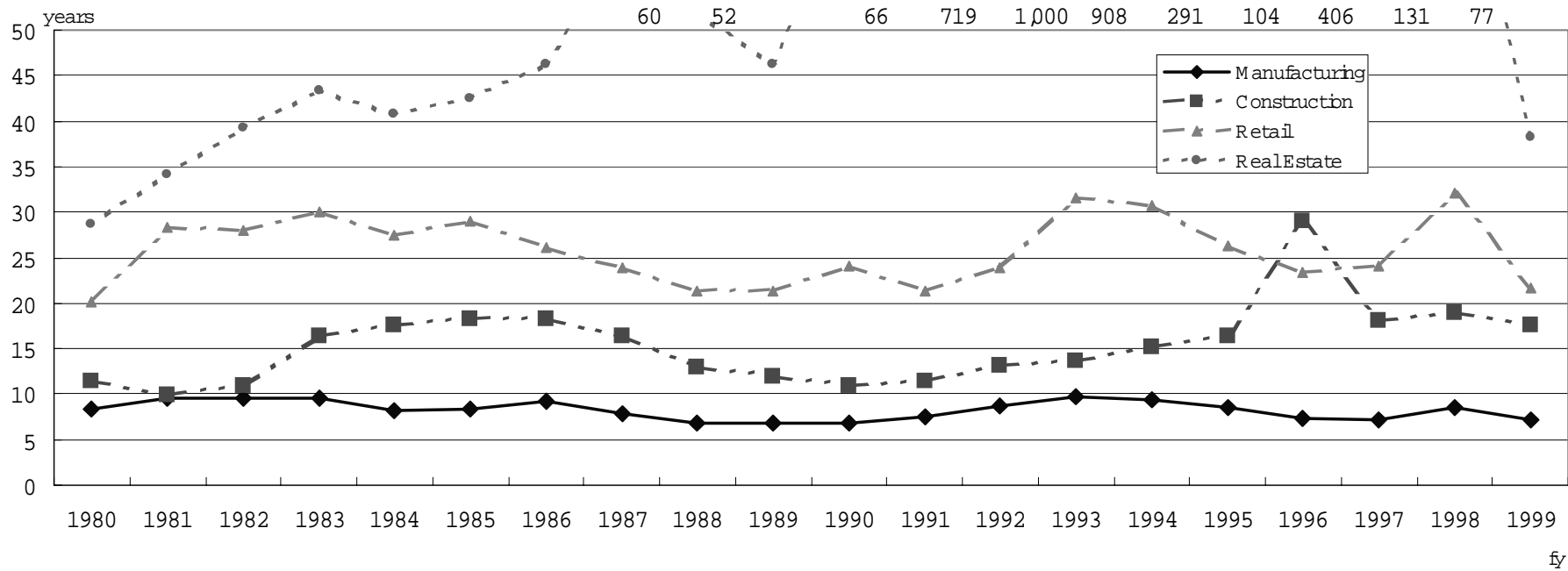


Debt Overhang in Some Industries

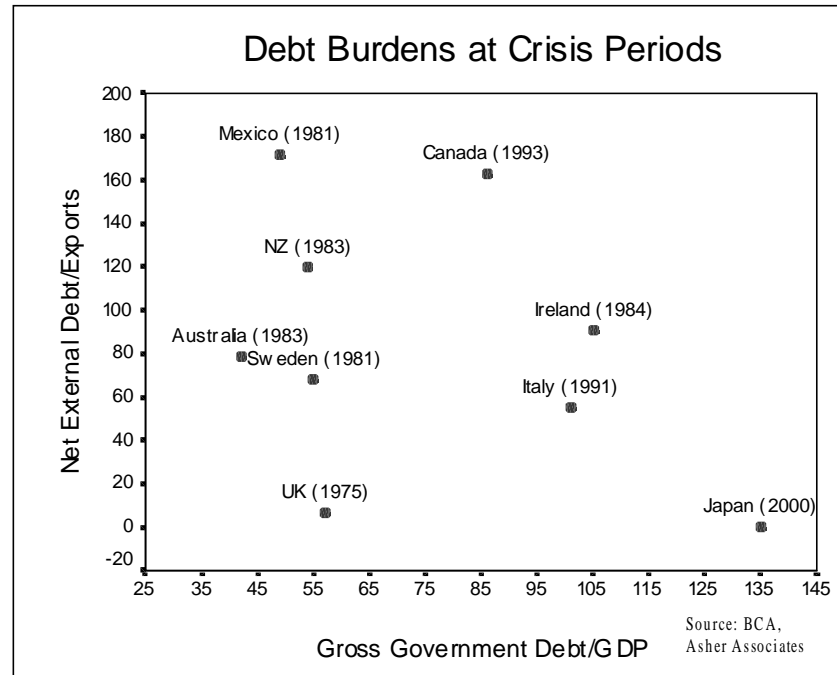
(Manufacturing, Construction, Retail, Real Estate)

Years to Repay Current Debt = Interest Bearing Debt / Cash Flow

Cash Flow = Internal Reserve + Depreciation Charge + Accelerated Depreciation - Extraordinary Items



“World Records Were Made to be Broken”



The Government Debt Olympics: World Record Holders

	Debt/ Tax Revenue	Financing/ Tax Revenue	Debt Interest/ Tax Revenue
#1: Japan 2000	1548.45%	120.83%	65.16%
#2 Great Britain 1947	707.50%	15.71%	13.85%
#3 Italy 1991	290.05%	31.94%	29.02%
#4 Mexico 1981	204.82%	46.80%	20.11%
#5 Canada 1993	438.17%	36.22%	32.75%
#6 Ireland 1984	273.47%	29.67%	27.74%
# 7 New Zealand 1983	209.44%	30.65%	19.25%
#8 Sweden 1981	115.57%	27.93%	12.88%
#9 Great Britain 1975	162.81%	23.81%	10.60%
# 10 Australia 1983	90.53%	11.05%	8.25%
Ref: Germany 1921	216.00%	57.00%	10.00%

David Asher
of AEI

Structural Challenges To Japan

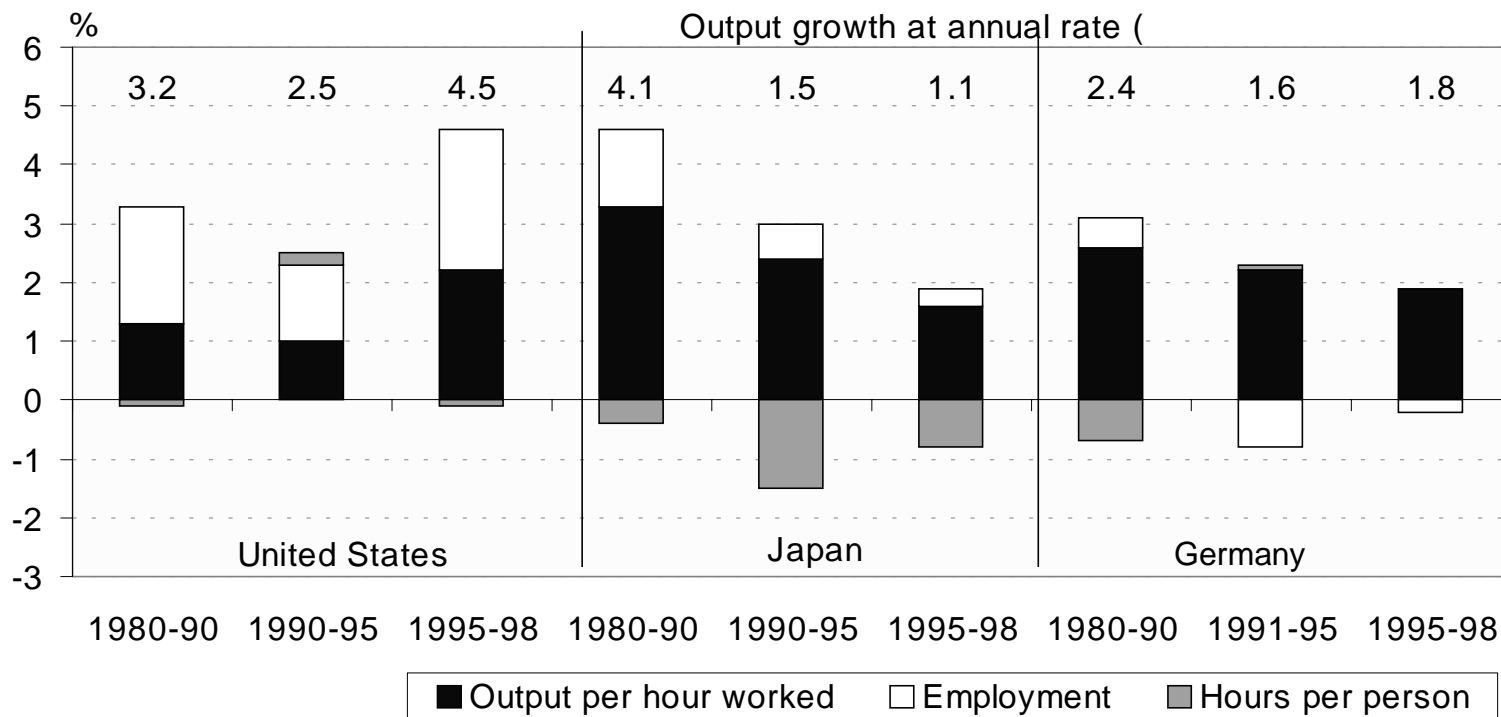
Is a “New Economy” possible?

Productivity Gap

- **New Business Creation**
- **Information Technology Gap**
- **Aging Society & Shortage of Labor Force**
- **High Cost Structure**
- **Innovation System**

GDP and Productivity Growth in the Business Sector

Percentage changes at annual rates

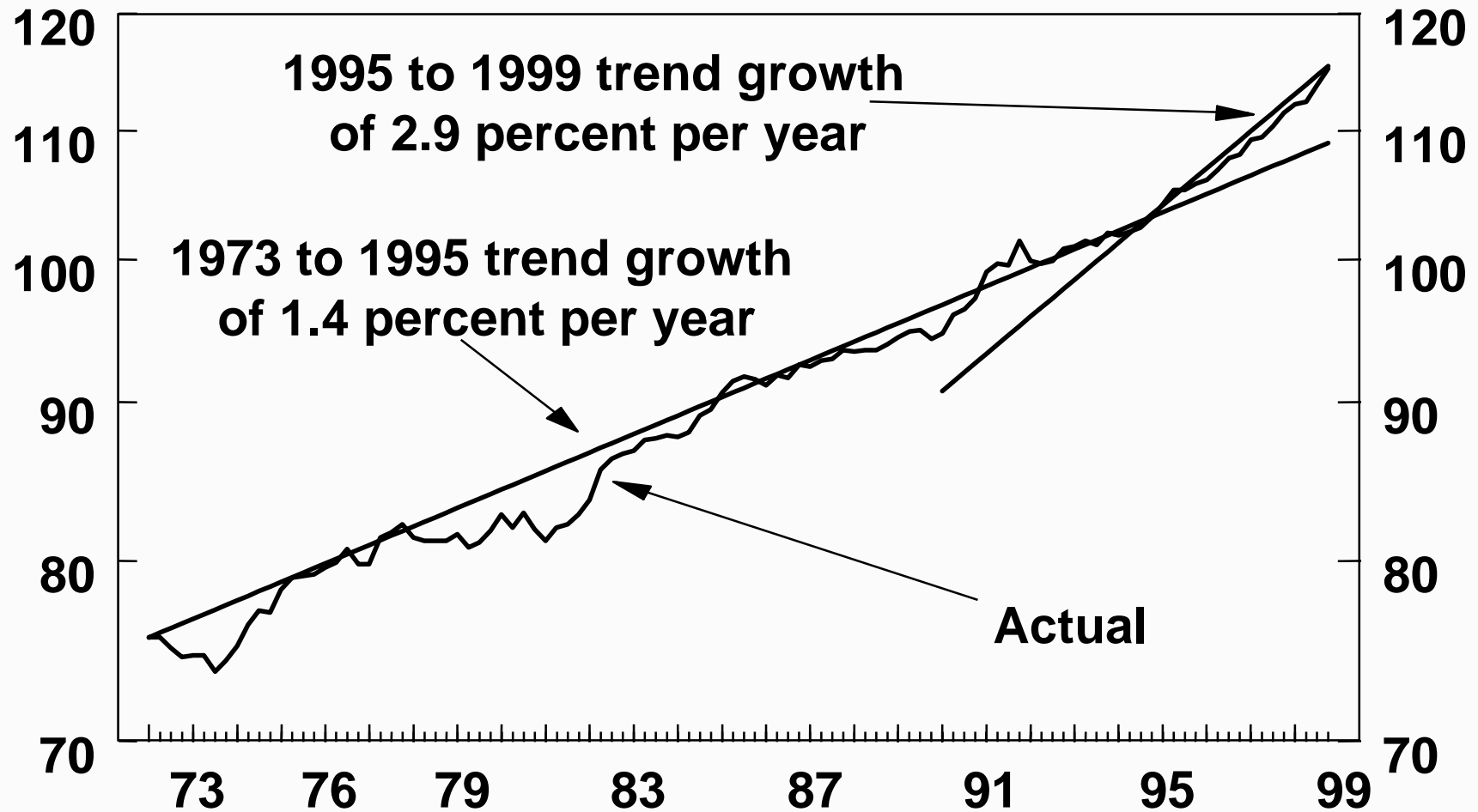


Source: Economic Outlook 66, Scarpetta et al. (2000)

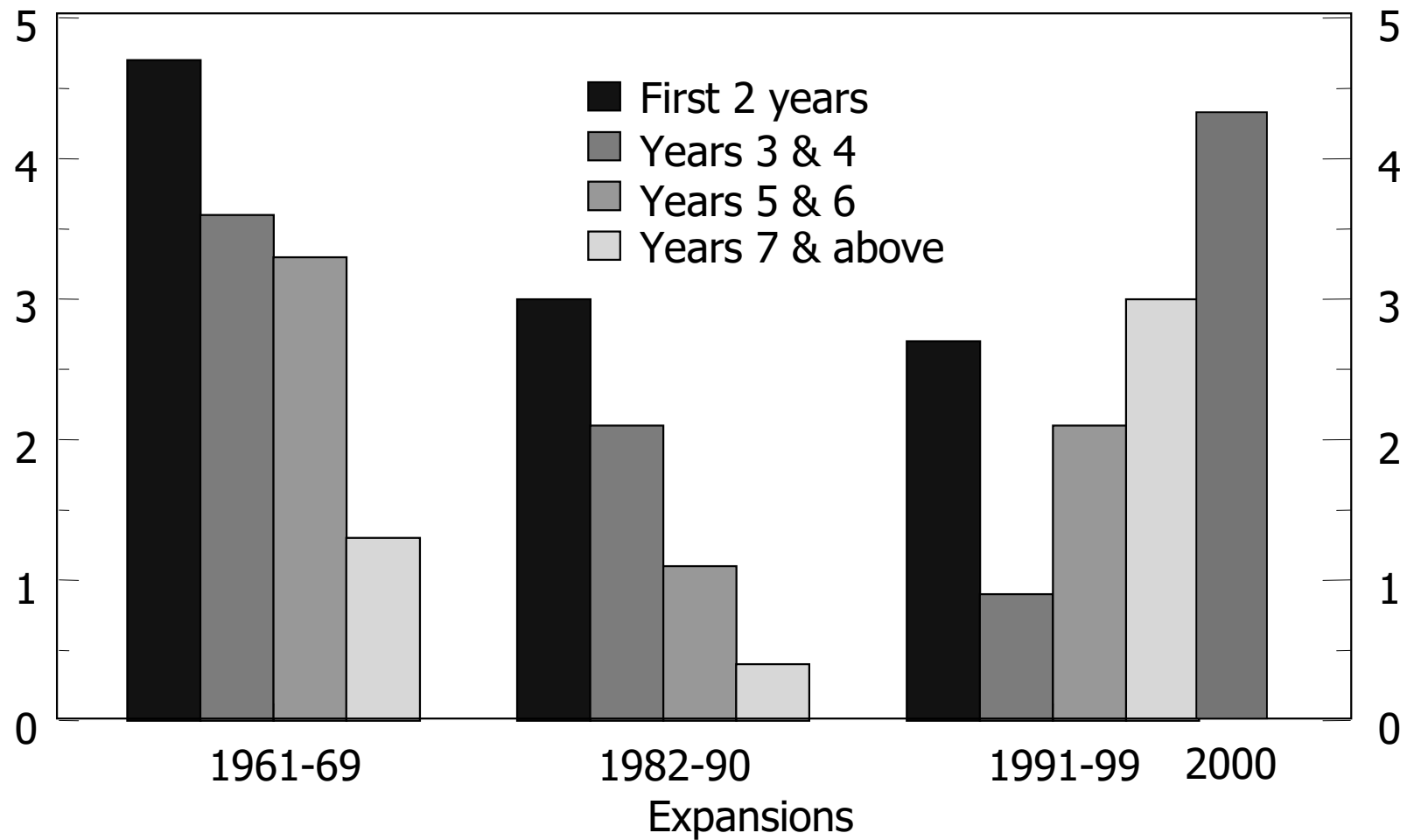
OECD

U.S. Productivity in Nonfarm Business Sector

Index 1992 = 100



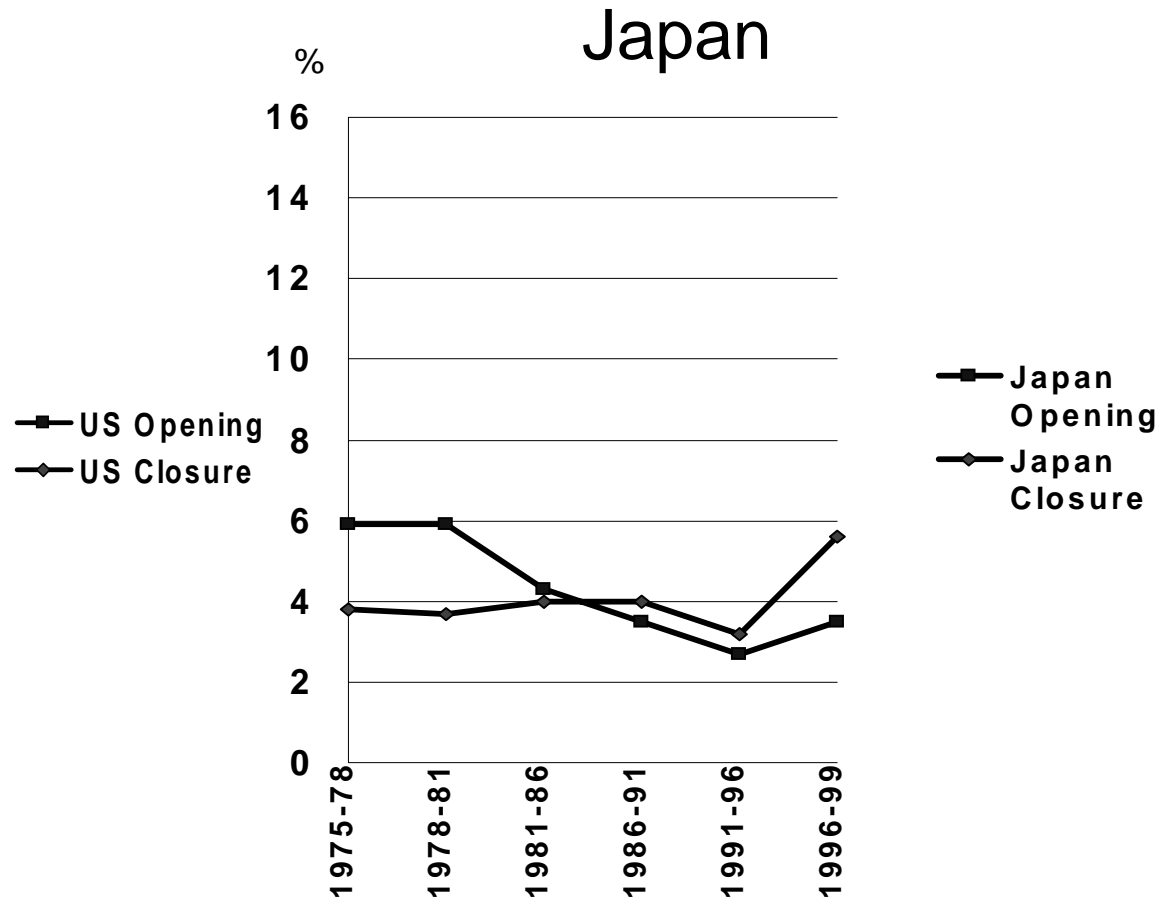
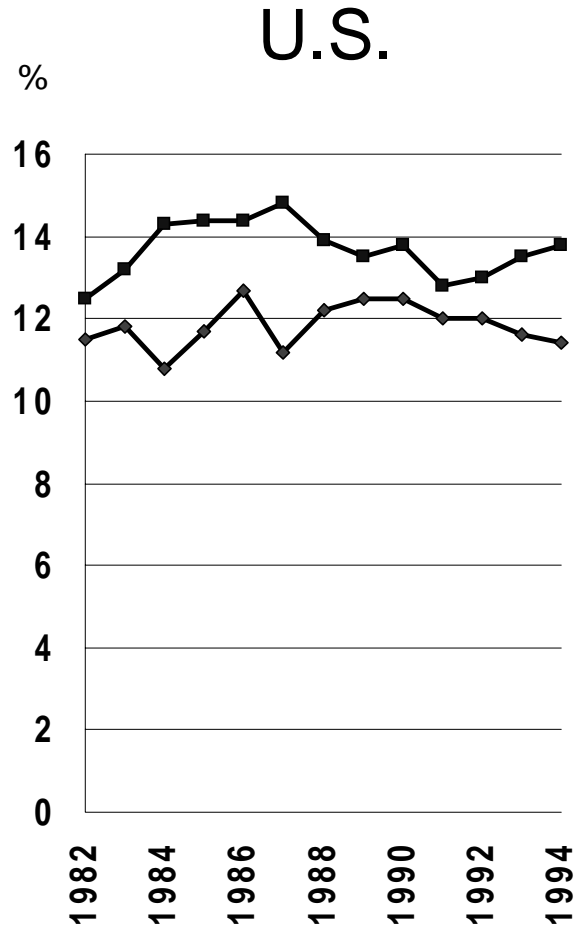
US productivity growth during expansions



Source: USDOC

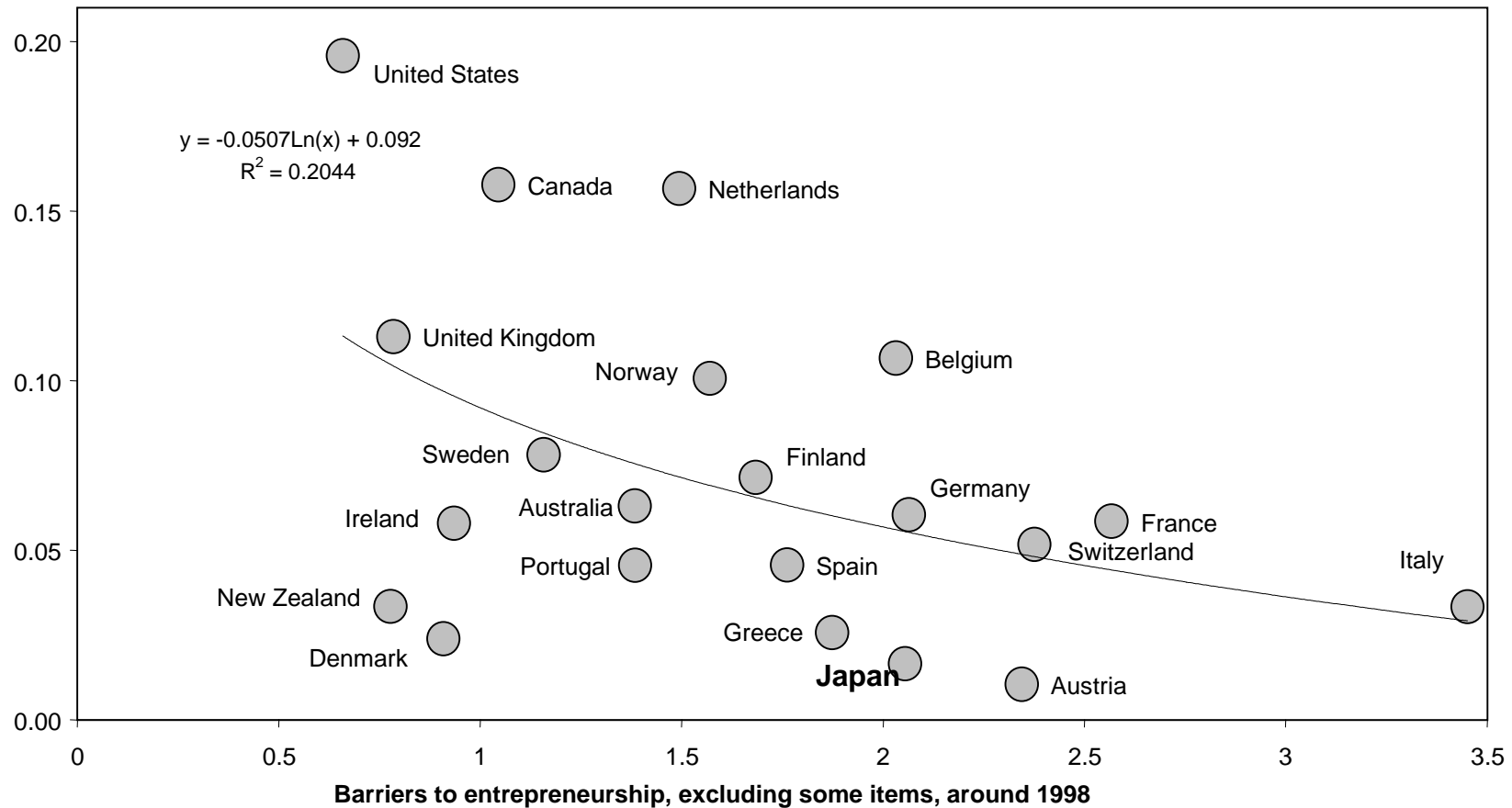
Business Start-ups and Closures in Japan and the U.S.

% of total establishments



Barriers to entrepreneurship and venture capital activity 1995-98

Venture capital investment in early stages and expansion as a percentage of GDP, 1995-98

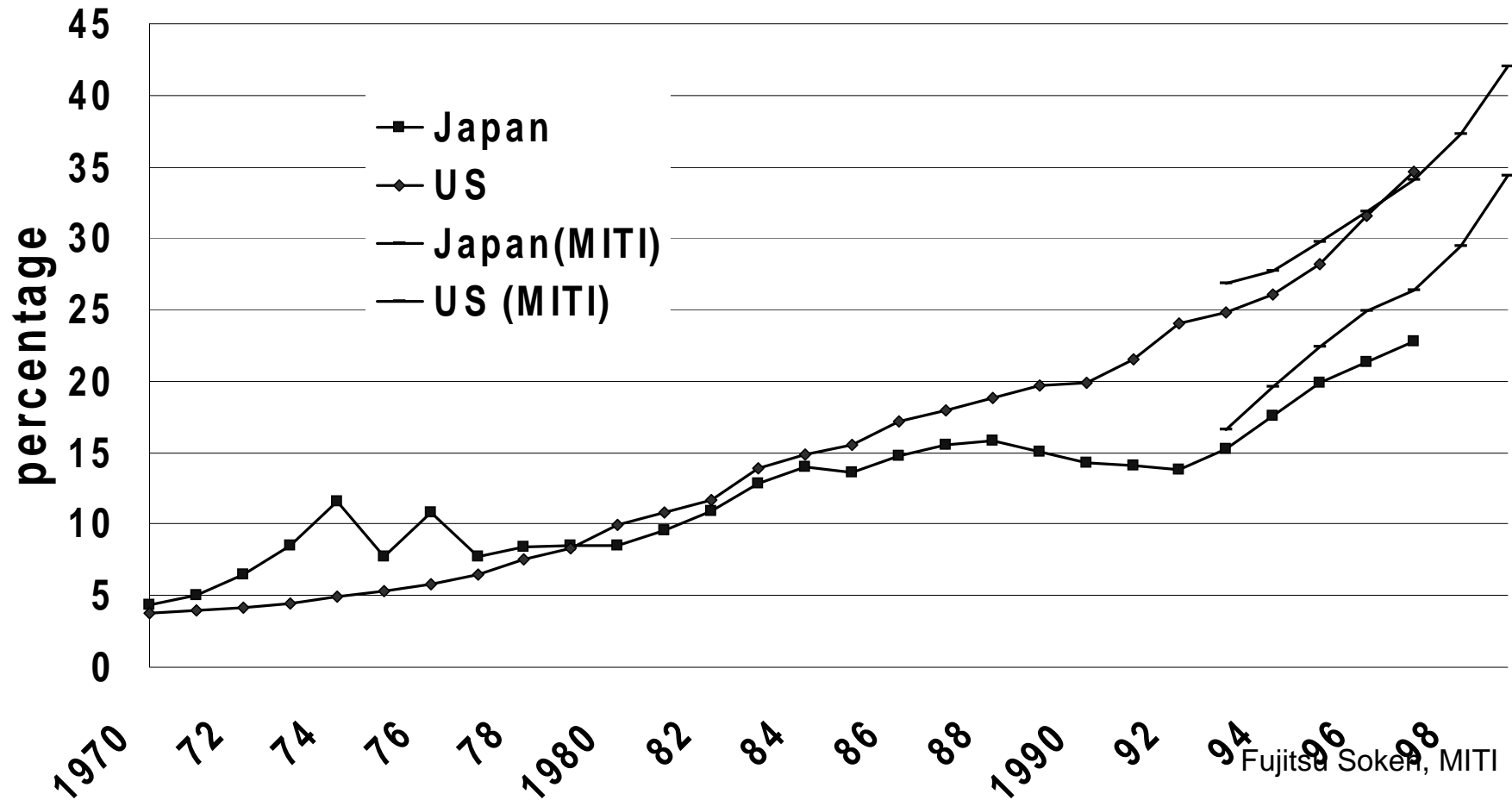


Notes: Excluding "license and permit systems", "sector specific administrative burdens" (for road freight and retail distribution), and "antitrust exemptions" (for public enterprises).

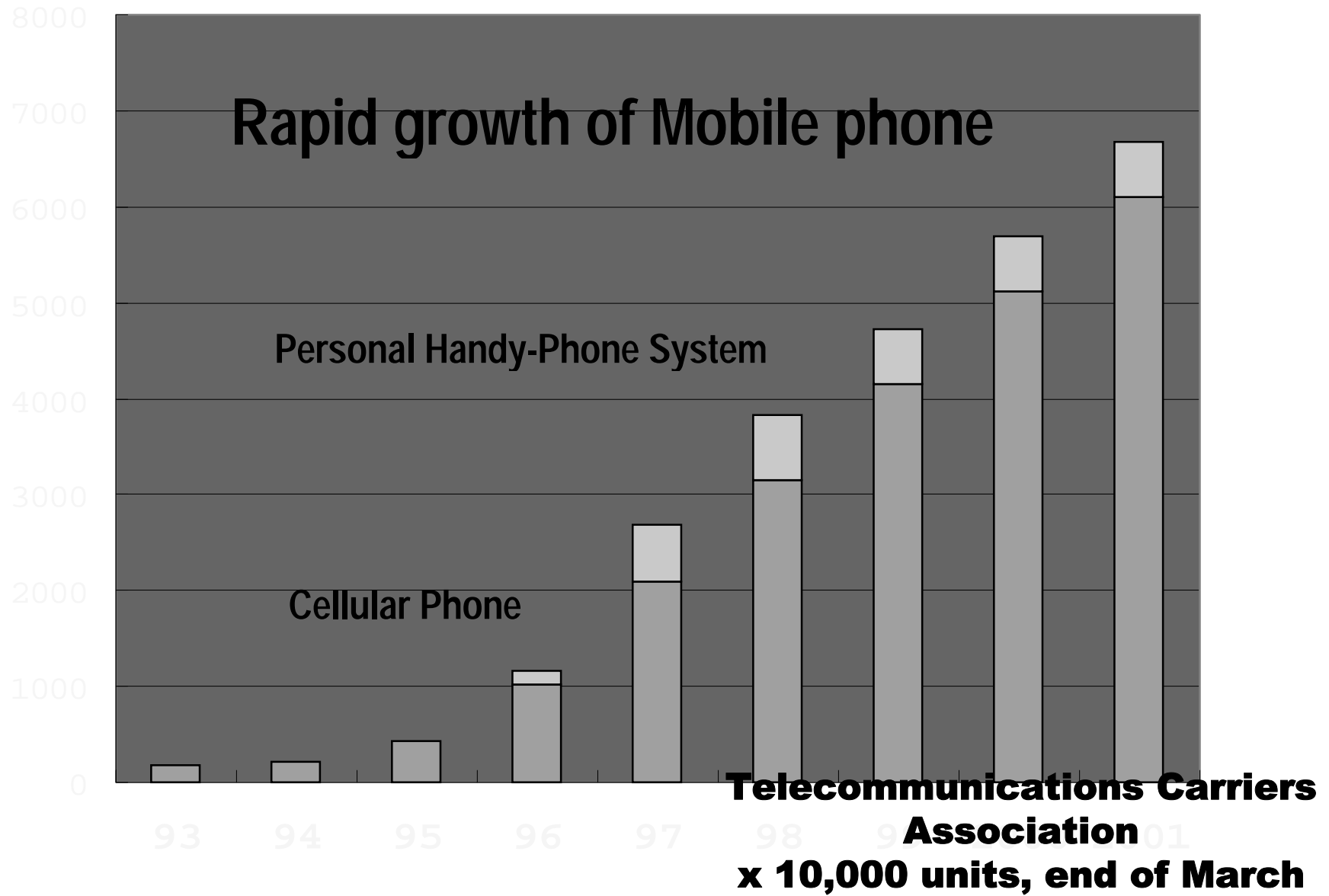
Source: OECD

IT Gap is still there, but narrowing

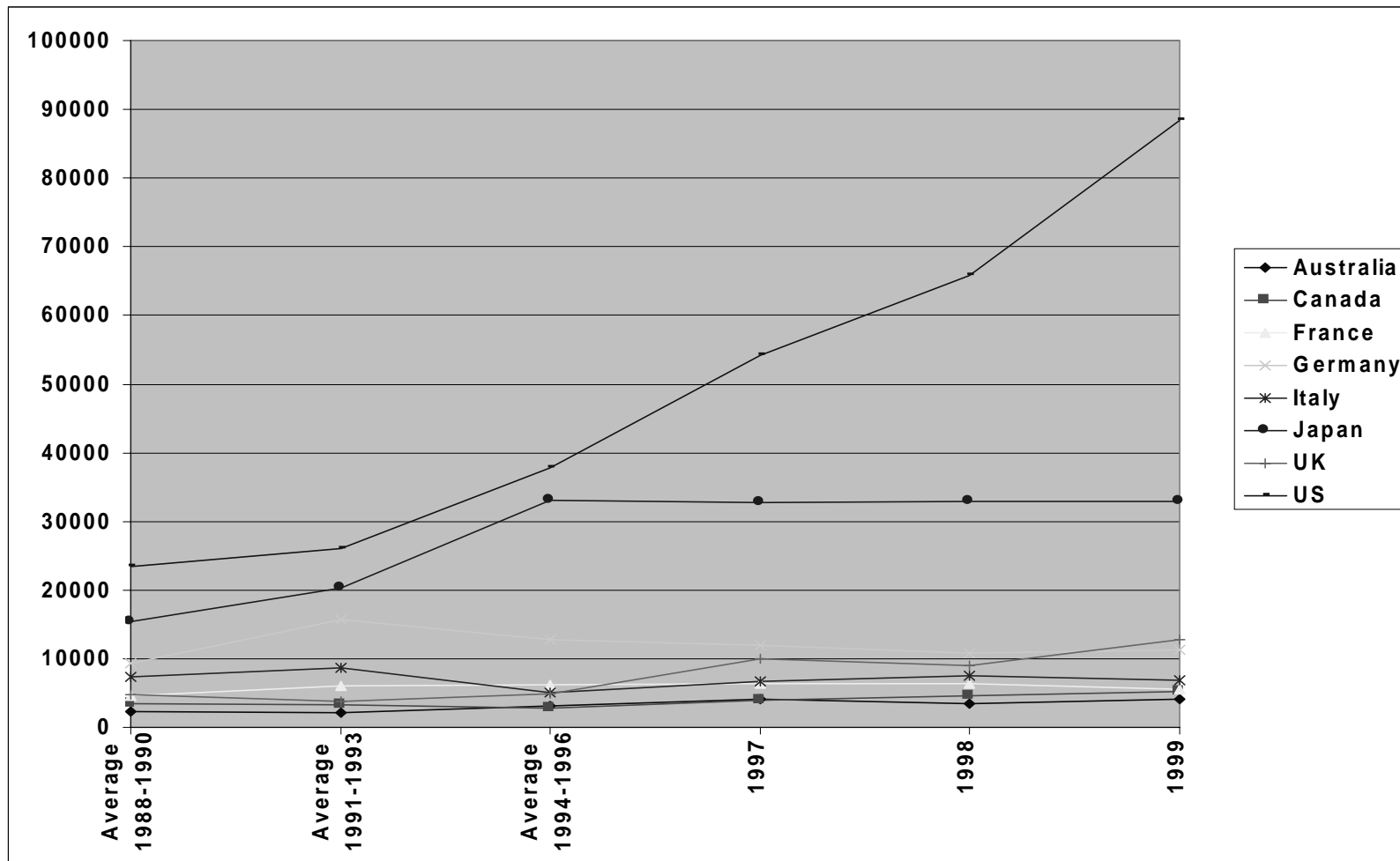
IT investment / Total Private Investment



Rapid growth of Mobile phone

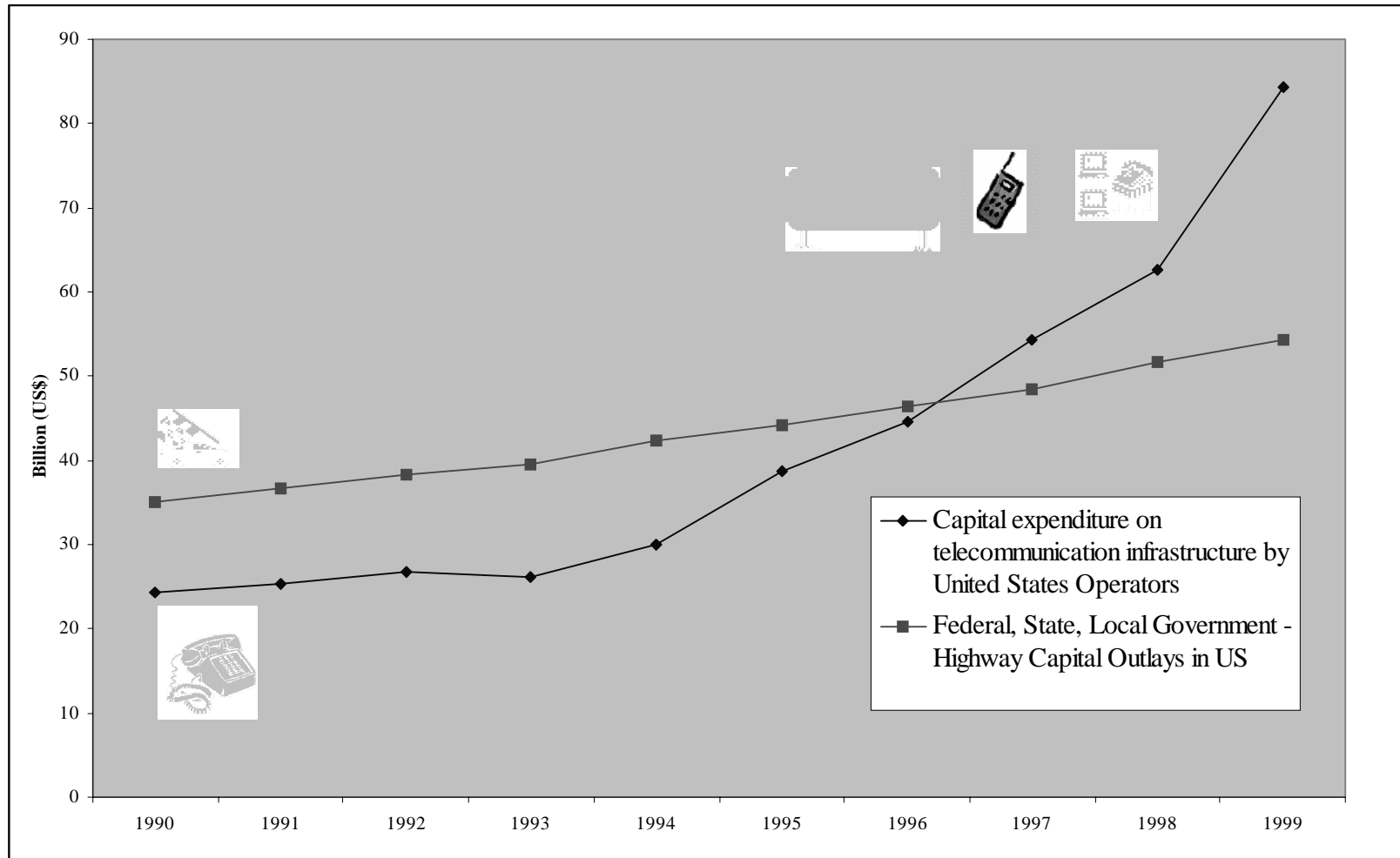


Public telecommunication investment (USD million)



Source: OECD

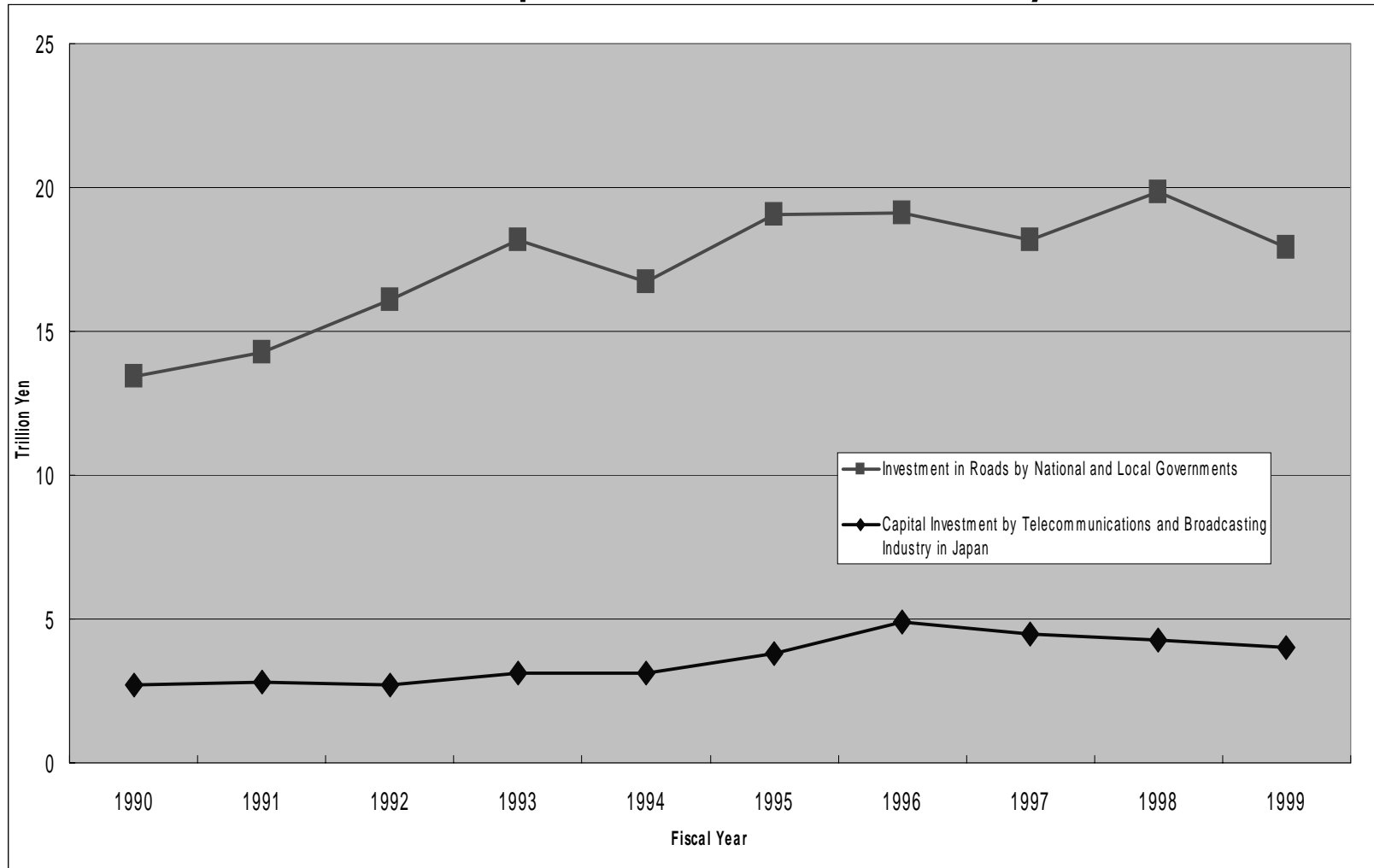
Investment in telecommunications and roads in the U.S.



Source: OECD

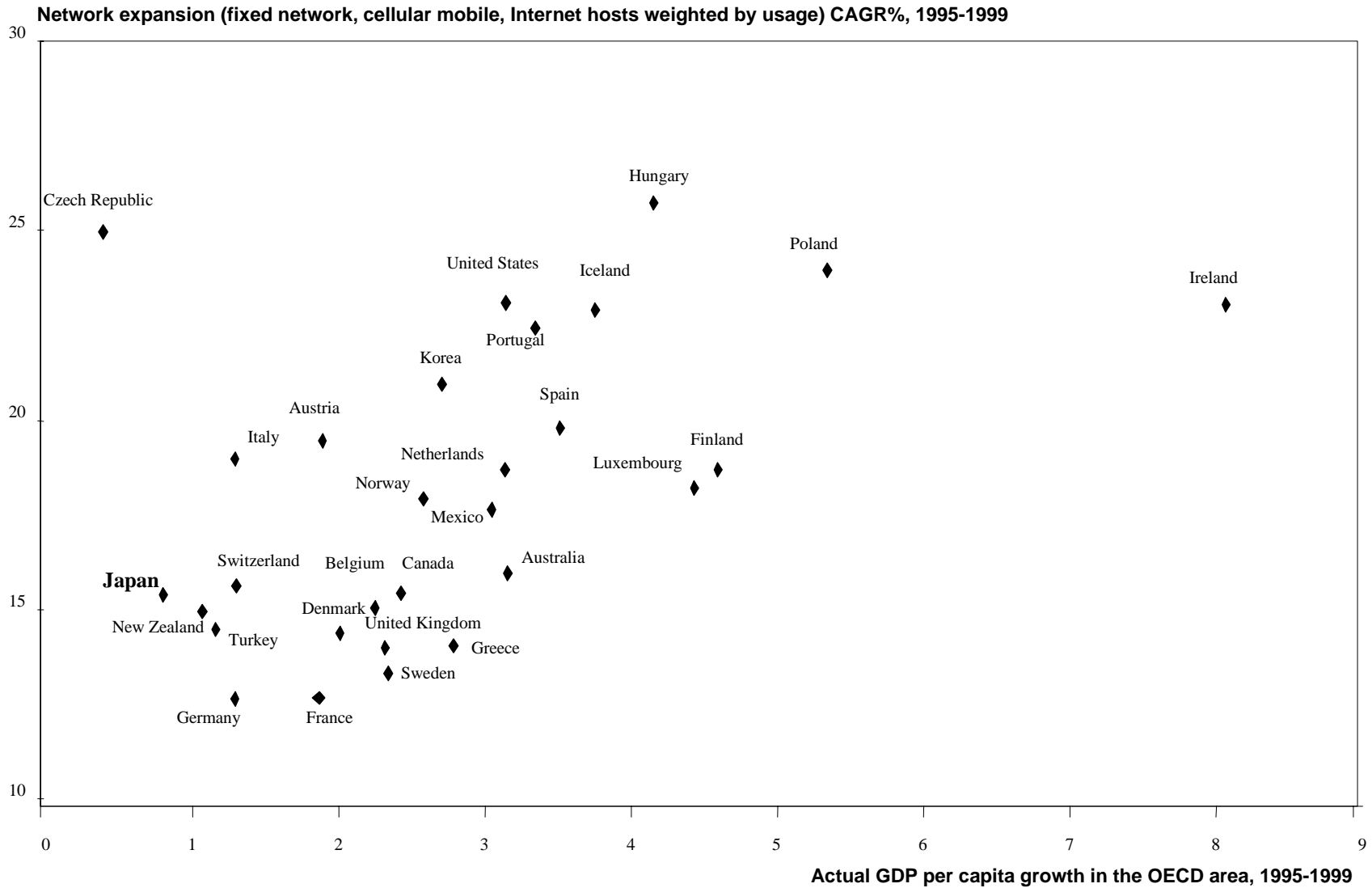
Investment in telecommunication and roads in Japan

Can we catch up with the US in five years?

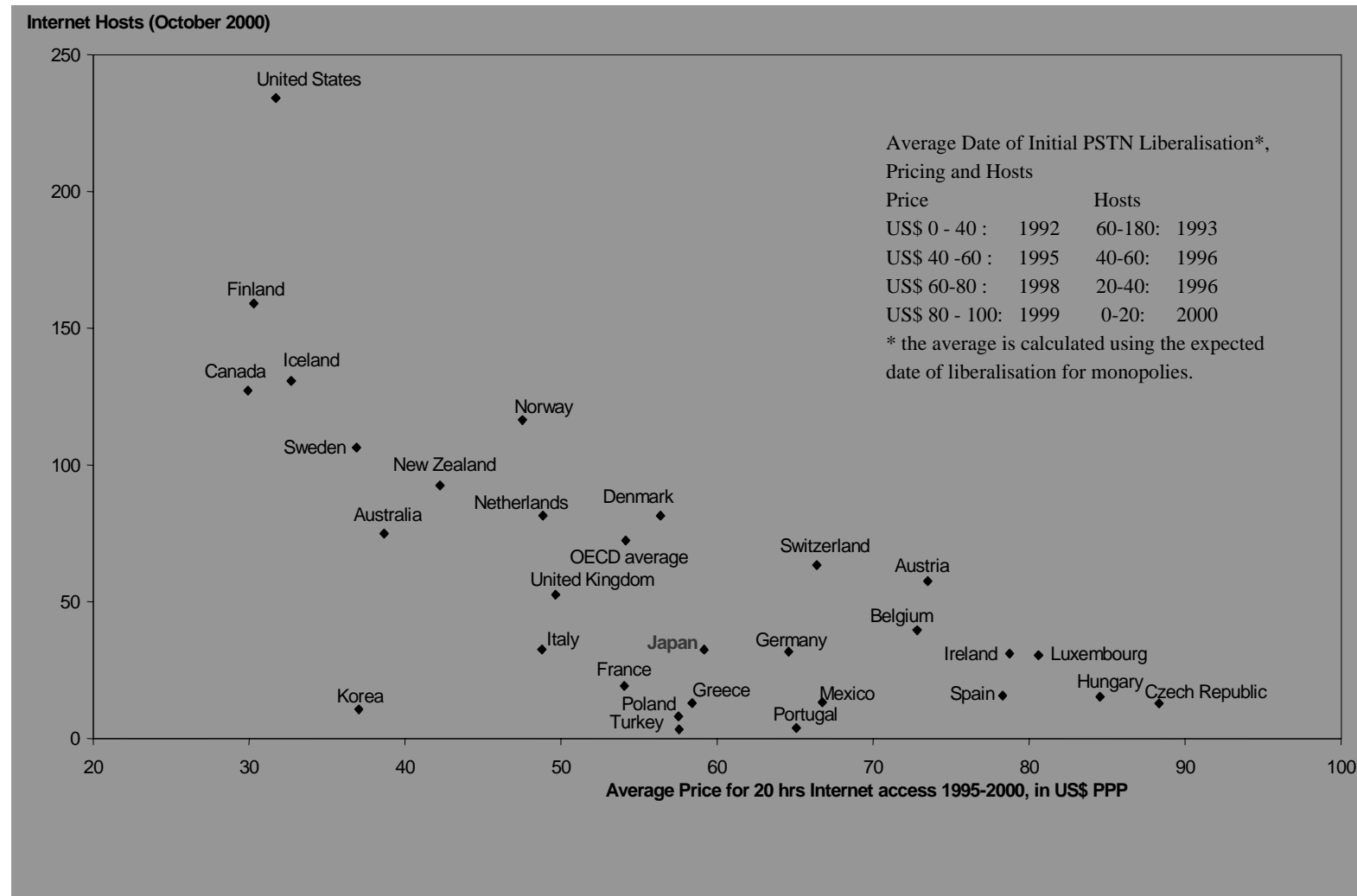


Source: OECD

Network expansion and GDP growth



Access costs and uptake of the Internet

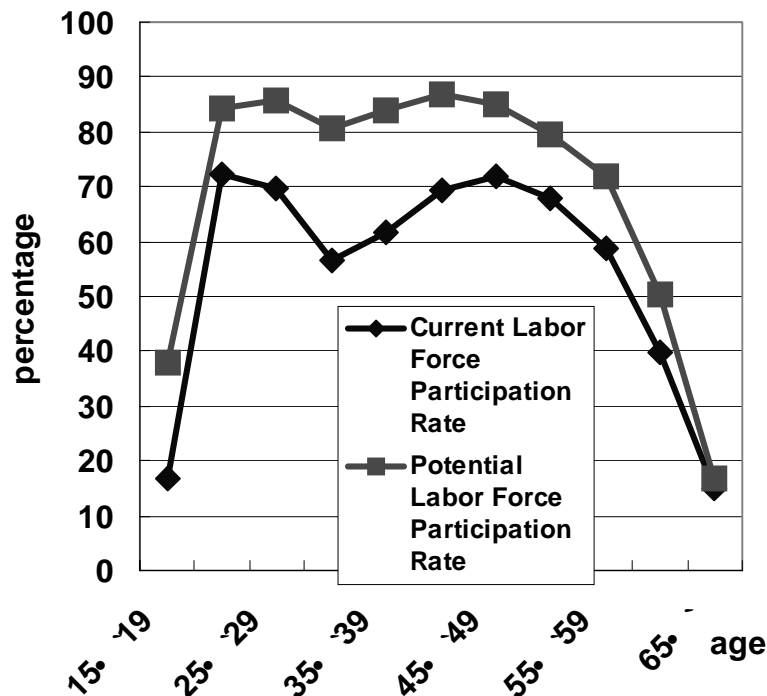


Source: OECD

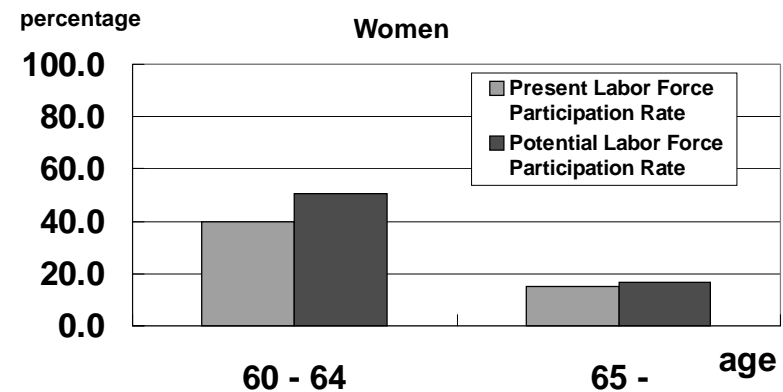
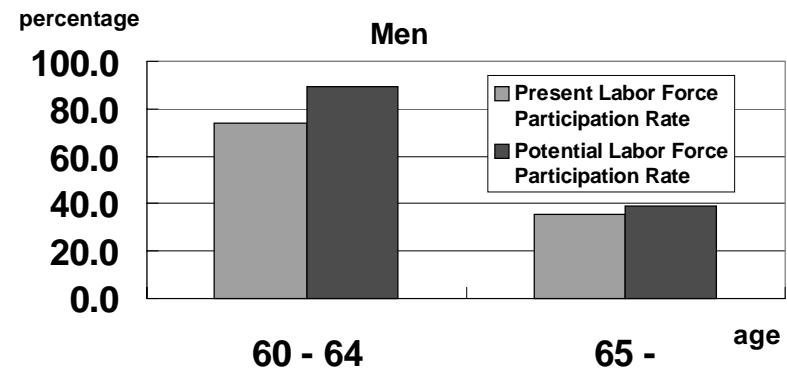
Possible Shortage of Workers in the future?

More Women & Elderly people desire to work.

Women's Labor Force Participation Rate

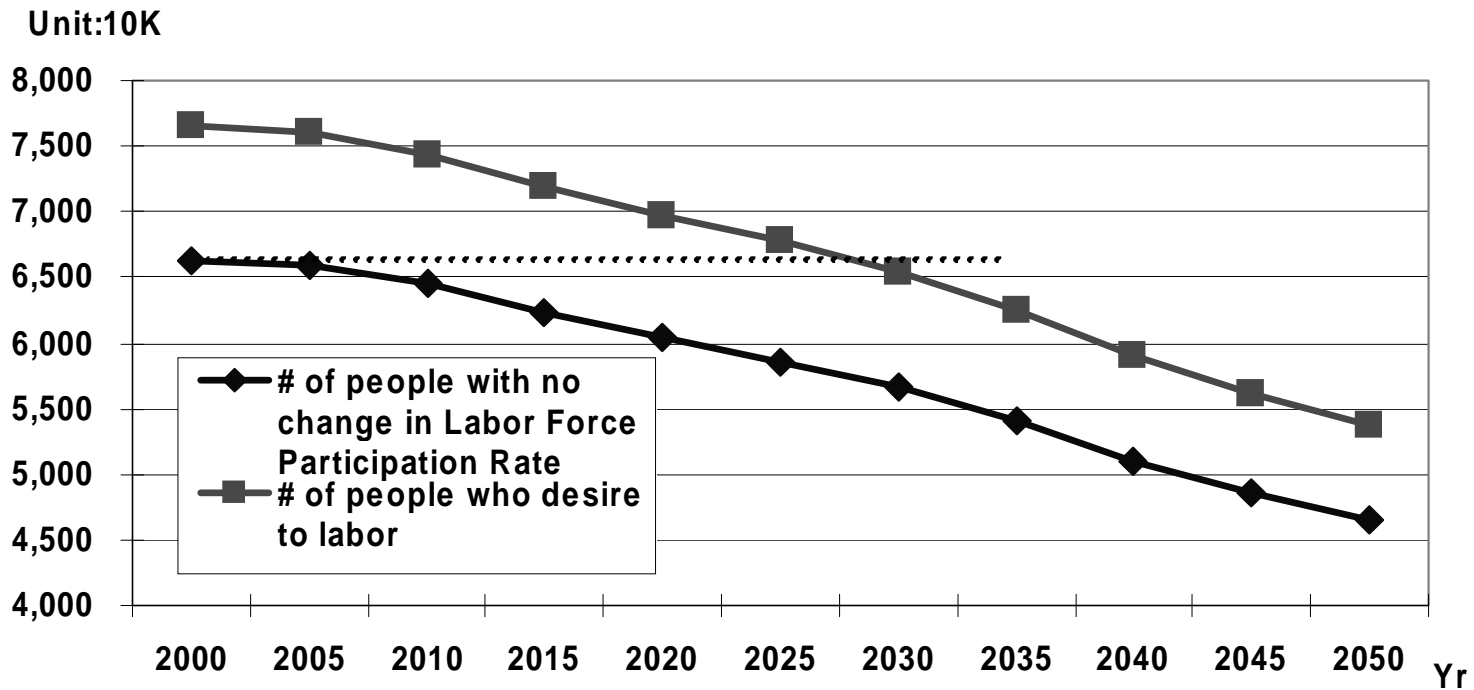


Elderly People's Labor Force Participation Rate



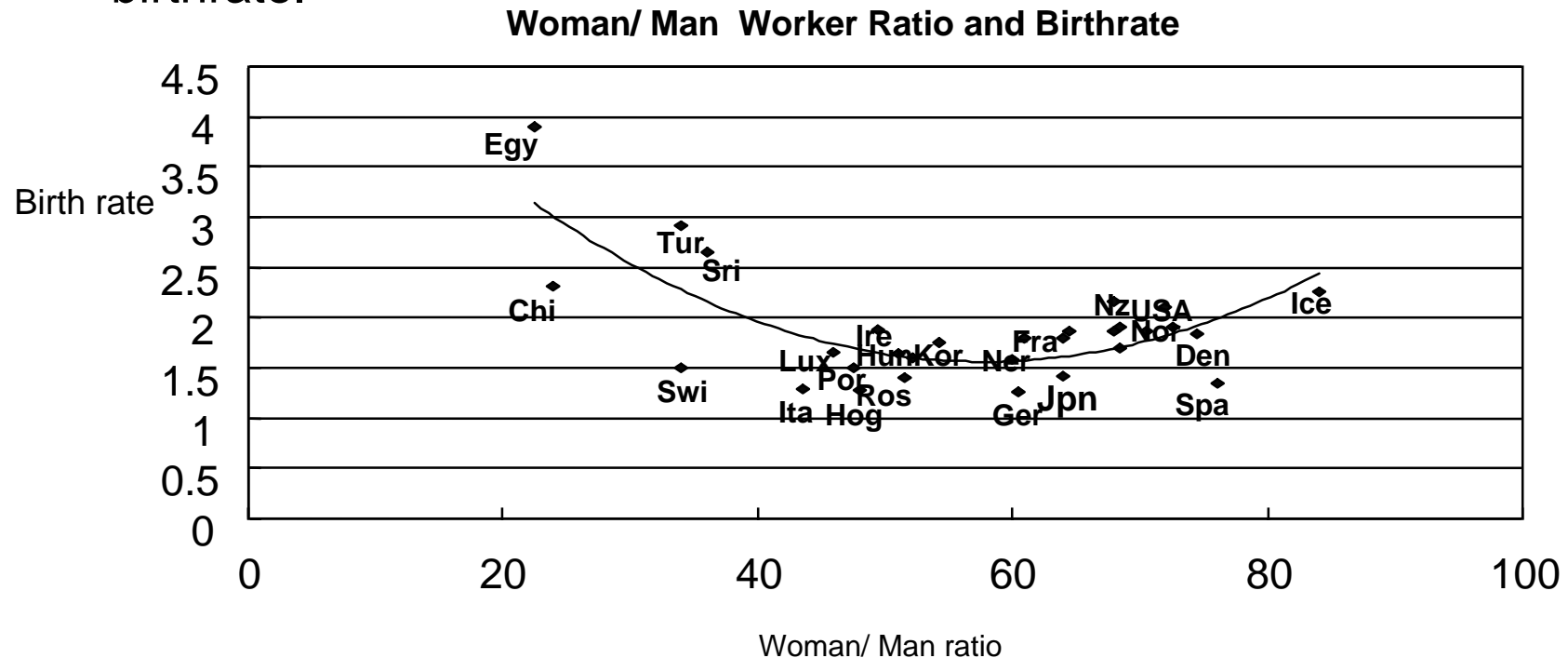
It may Shift Total Labor Force Participation Rate.

Able to maintain present labor force participation rate in yr 2025 if all of the desired people work.

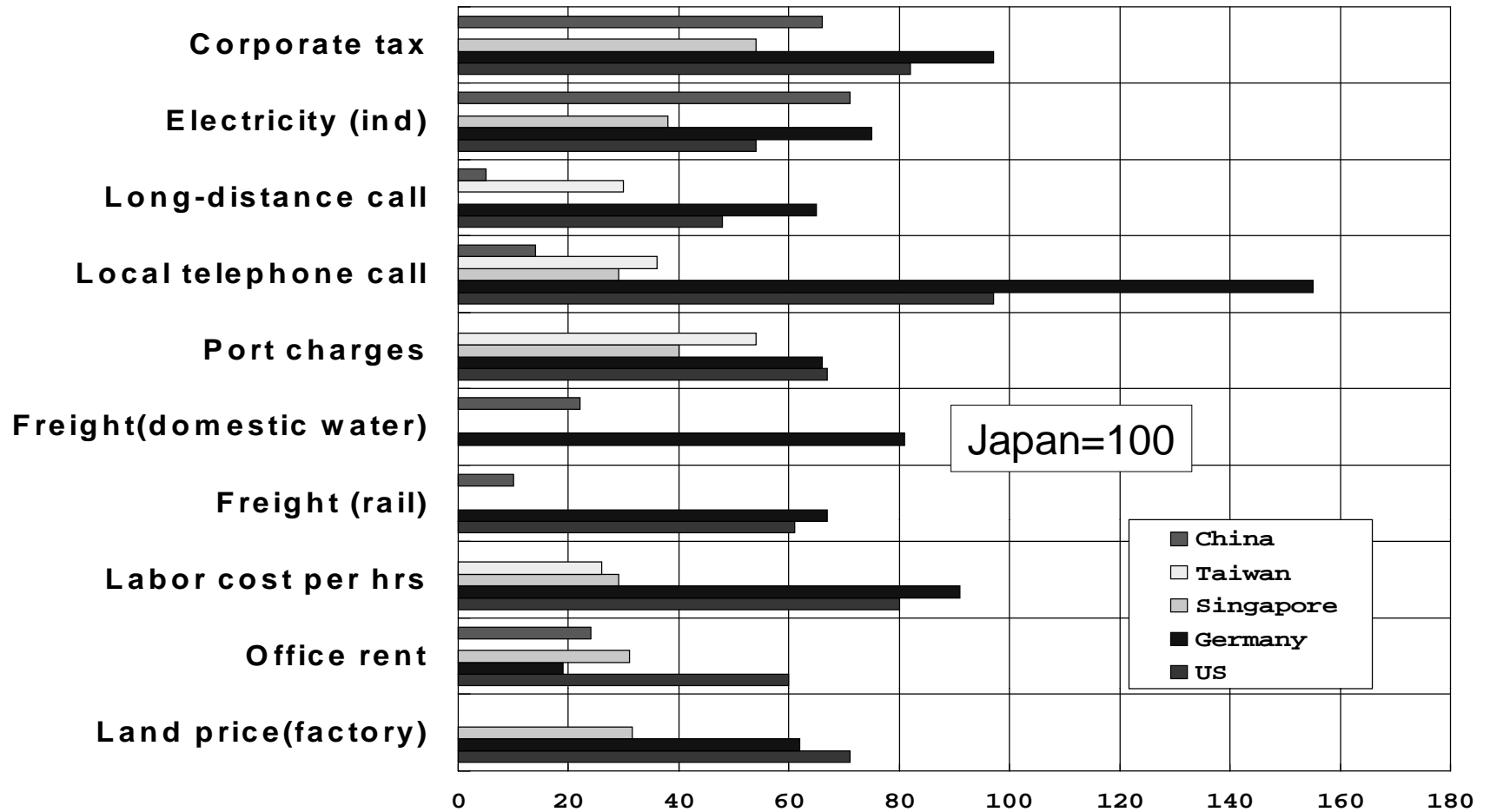


Policy Implication to Labor Force Participation Rate Problem

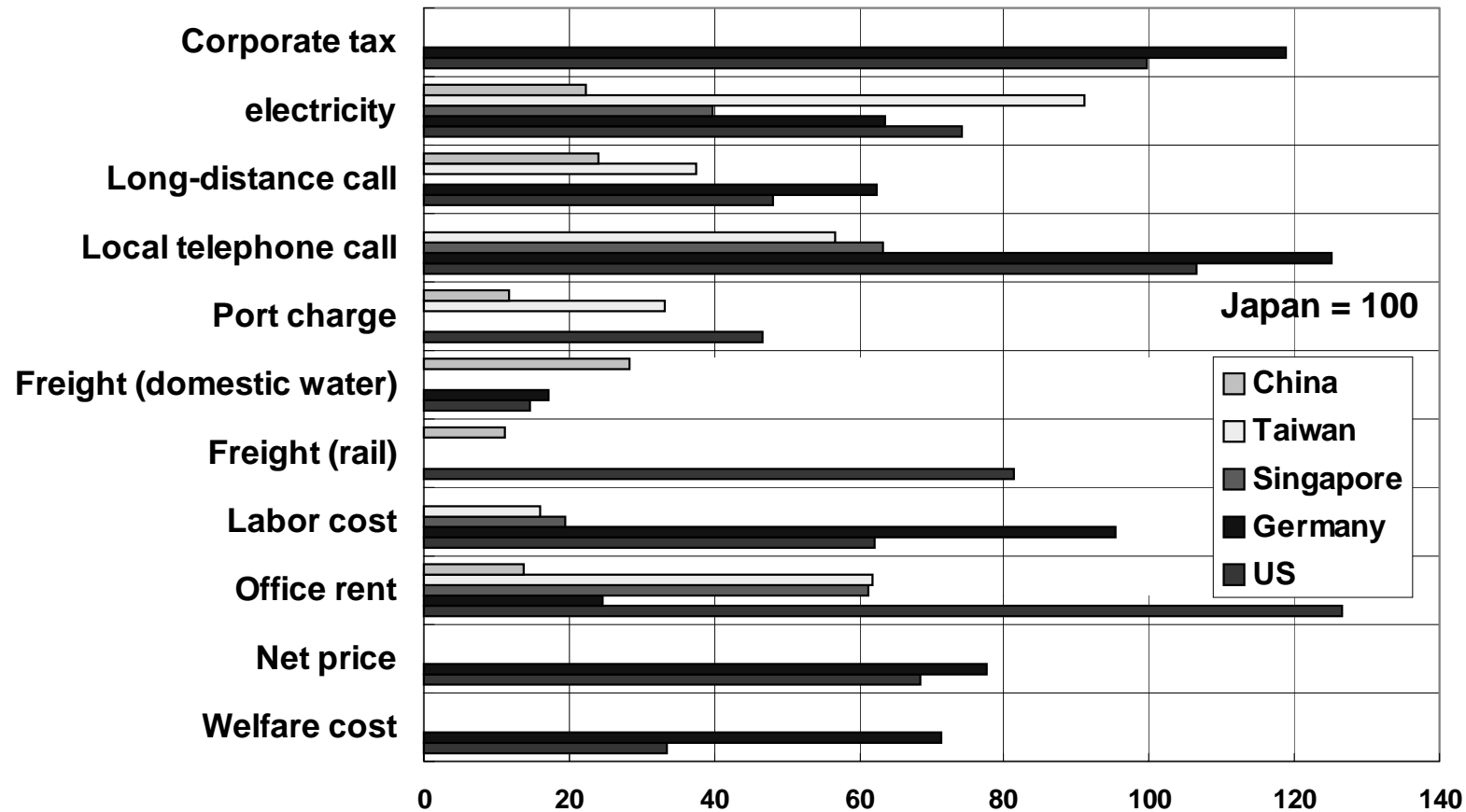
- Possible to maintain present labor force Participation Rate in year 2025, if improve in environment of work condition for women and elderly people is applied.
- Arranging work condition for women would slow the declining of birthrate.



High Cost Structure (1) Yr1996



High Cost Structure (2) Yr2000

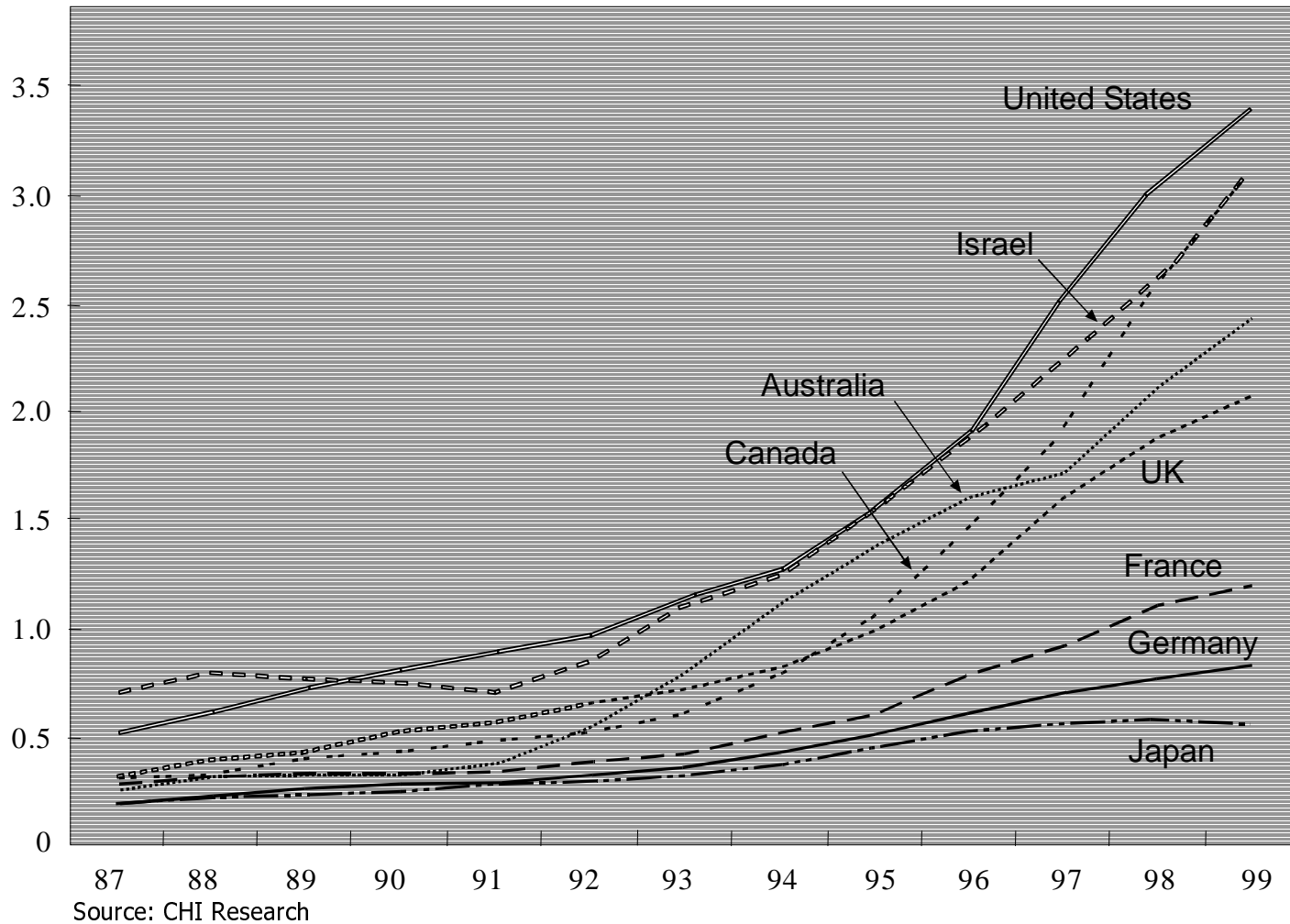


A Survey of Japan and Foreign Countries in Terms of the Cost of Industrial Intermediate Goods and Services, MITI

Is Innovation System working?

Science linkage in selected countries

Measured by average number of scientific papers in US patents



Environmental Protection as a Driver of Economic Growth

Zero Emission Society

- Establish “Zero Waste or Emission” as a leading concept to rebuild our society
- Product Recycling Laws (Bottles 95, Electric Appliances 98, Auto 01?)
- Ecological Towns (gov support for construction of recycle plants in 13 designated towns)
- Other Environment-friendly technology (hybrid cars, fuel cell, photo-solar power generation, top-runner energy conservation law)

Challenge of GLOBALIZATION & Mega-Competition

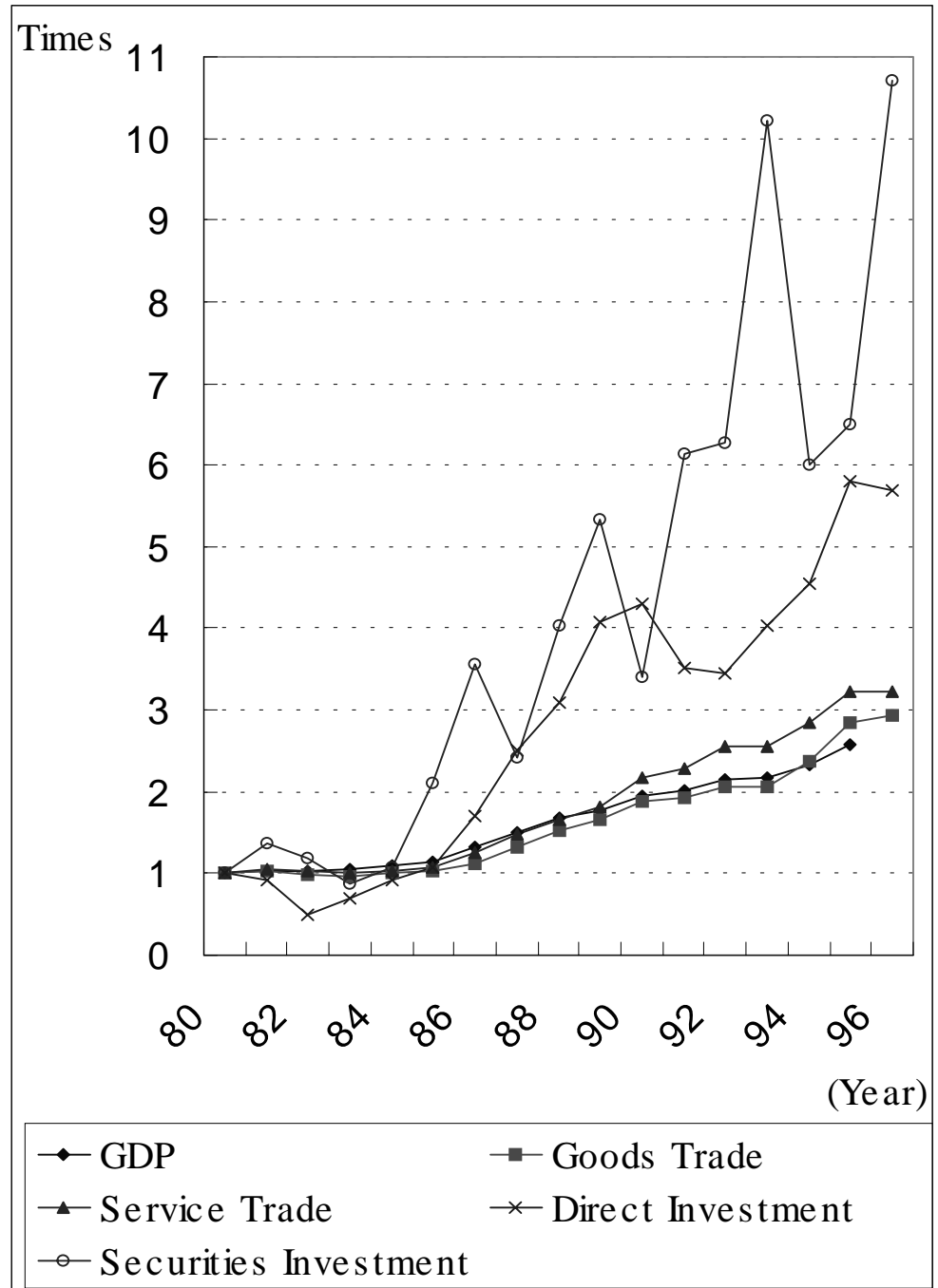
- It is essential to build an efficient and functional industrial infrastructure within the Japanese economy which is consistent with international standards in order to respond to the increasing globalization of the world economy.
- Now corporations can....choose the country.

(Industrial Structural Council of MITI, 1995)

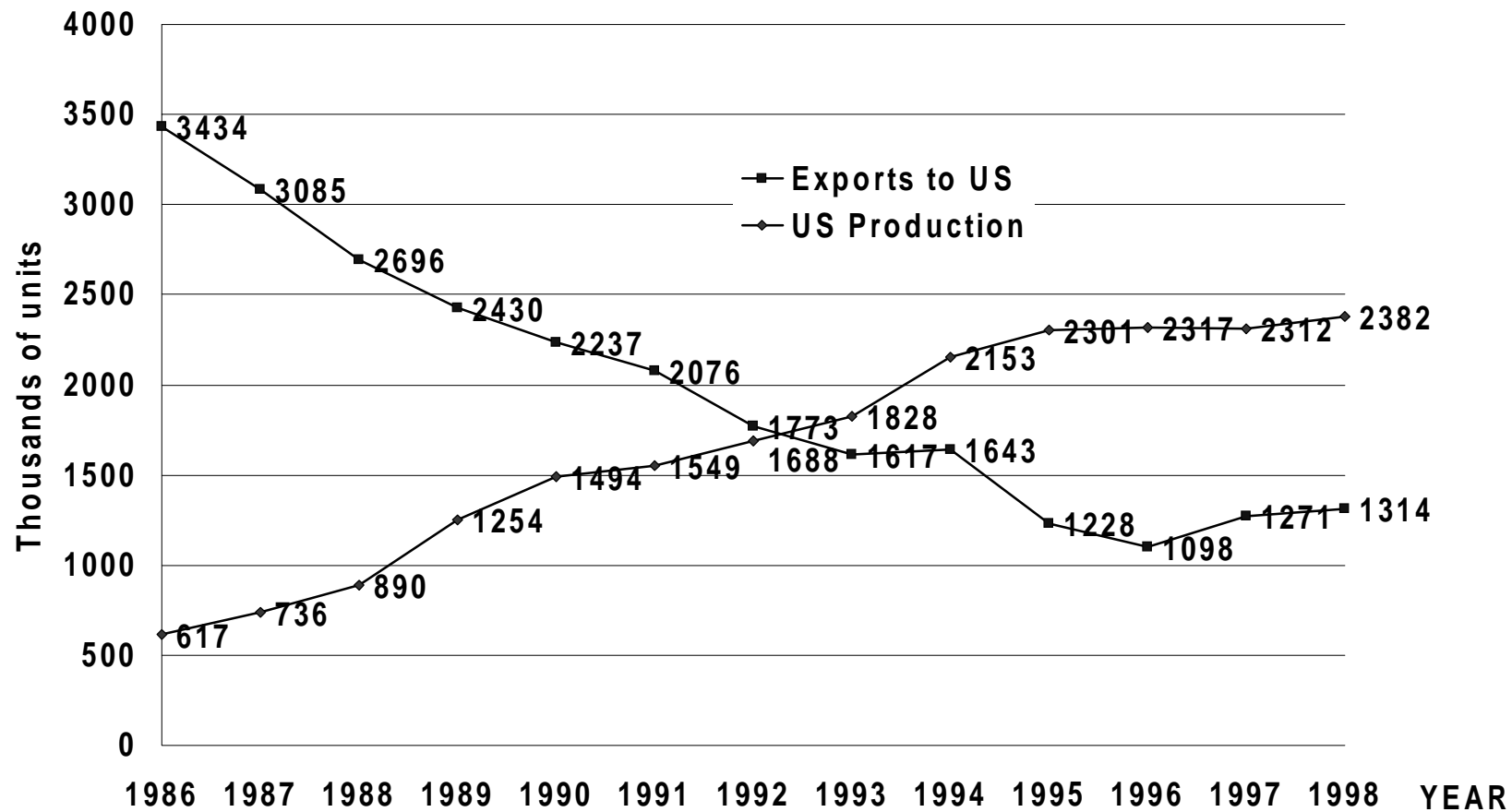
GLOBALIZATION

4 Service trade has outgrown trade in goods.

4 Capital flow, esp. securities investments outpaced others.

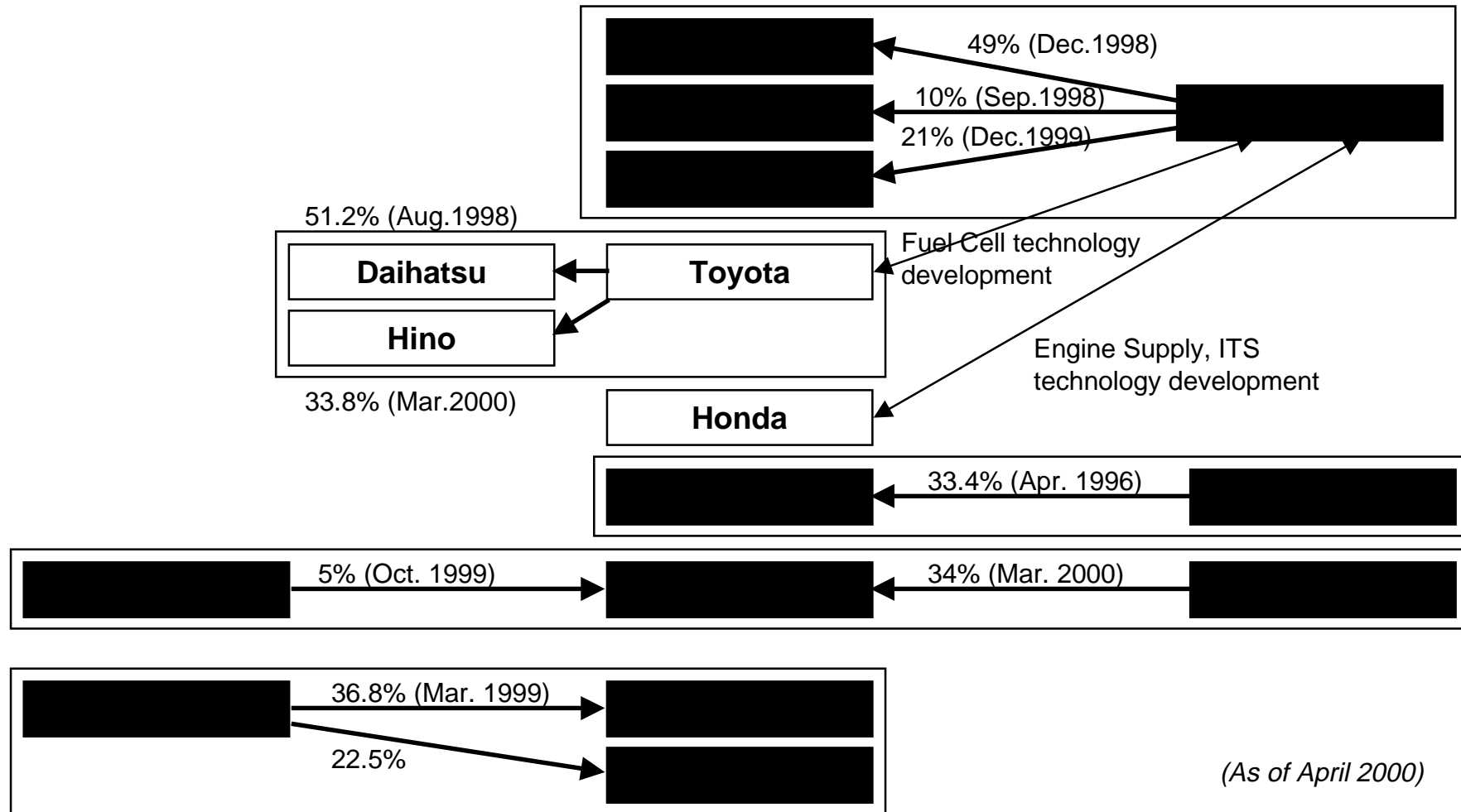


Declining Japanese Motor Vehicle Exports to the US Coupled with Rising Production in the US Locally Manufactured Vehicles Accounted for 65% in 1998

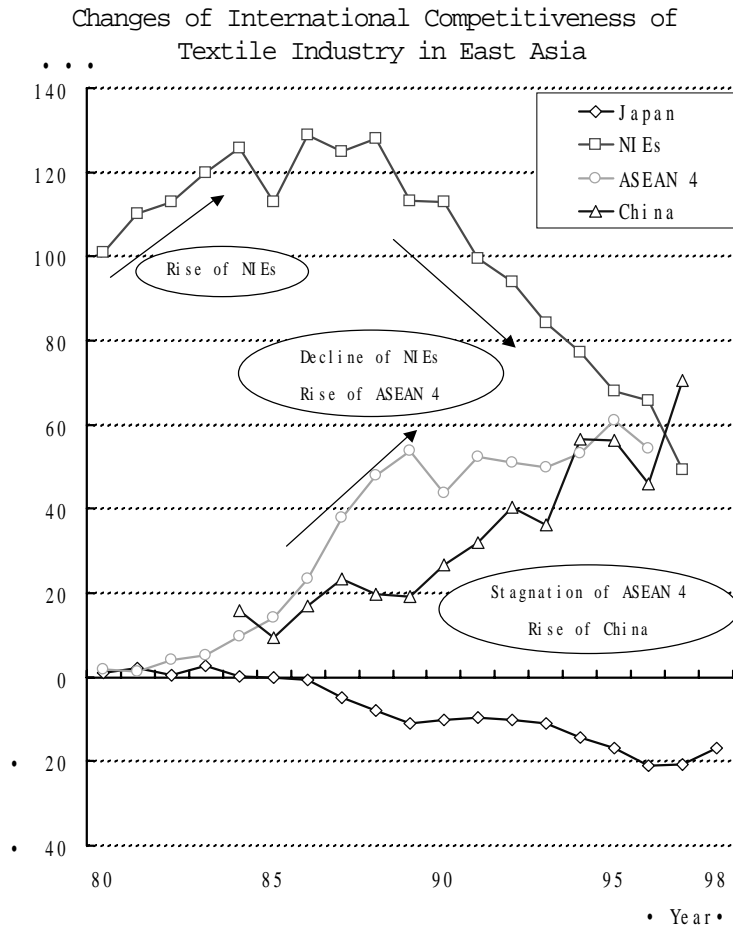


Source: JAMA

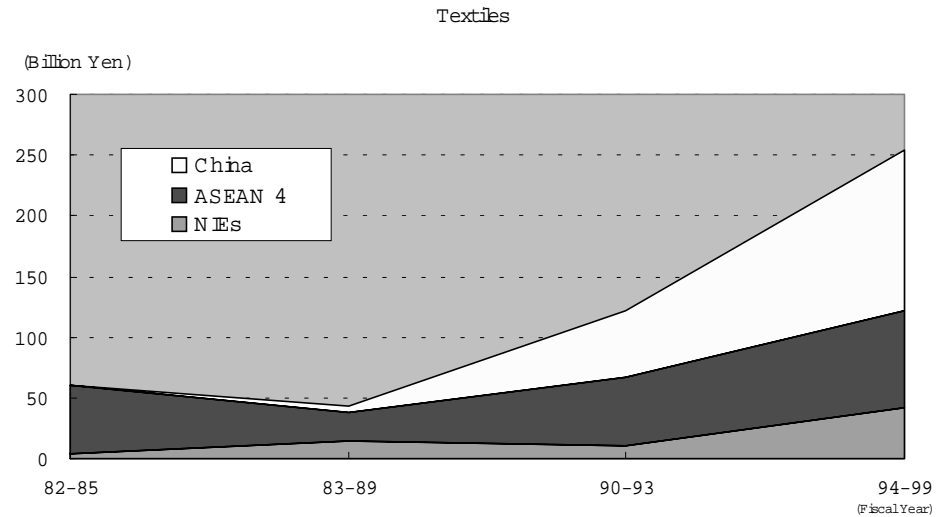
The world automotive industry is now facing dramatic global and borderless capital/business alliance. Seven out of eleven Japanese auto companies has pursued business alliances with foreign capital since 1995.



Textile Industries in East Asia



Japanese Textile Industry's Direct Investment toward East Asia



2001 White Paper on International Trade, METI

Source: Institute of Developing Economies • AIDXT • UNIDO • ISD
 Note: For explanation of ratio, see the note on chart 1.

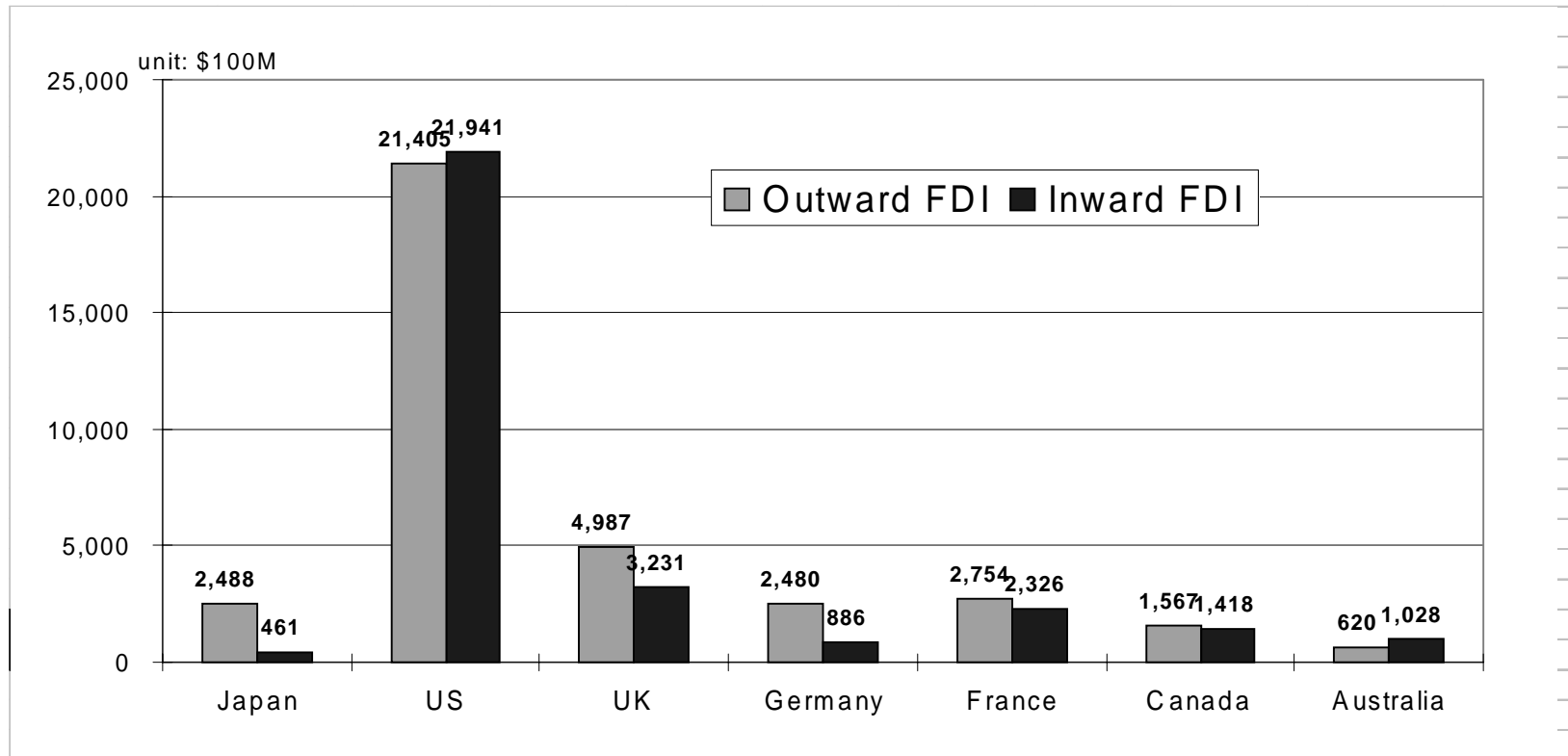
NIEs= South Korea, Taiwan, Singapore, Hong Kong
 ASEAN4= Thailand, Philippines, Indonesia, Malaysia

Inward FDI, a Good News.

Is Japan chosen by foreign corporations?

- sparking the reform
- brought many benefits to our consumers
- the Government of Japan even more welcomes foreign direct investment
- Privatization of “GAIATSU”?
- “NAIATSU” (Internal Pressures)?

Inward FDI / Outward FDI (accumulated investment balance) Comparison by Country



	Japan	US	UK	Germany	France	Canada	Australia
Outward/Inward	5.4	1.0	1.5	2.8	1.2	1.1	0.6

Notes: Used 99 year end currency rate of 102.20yen/\$ for Japan. Others IMF.

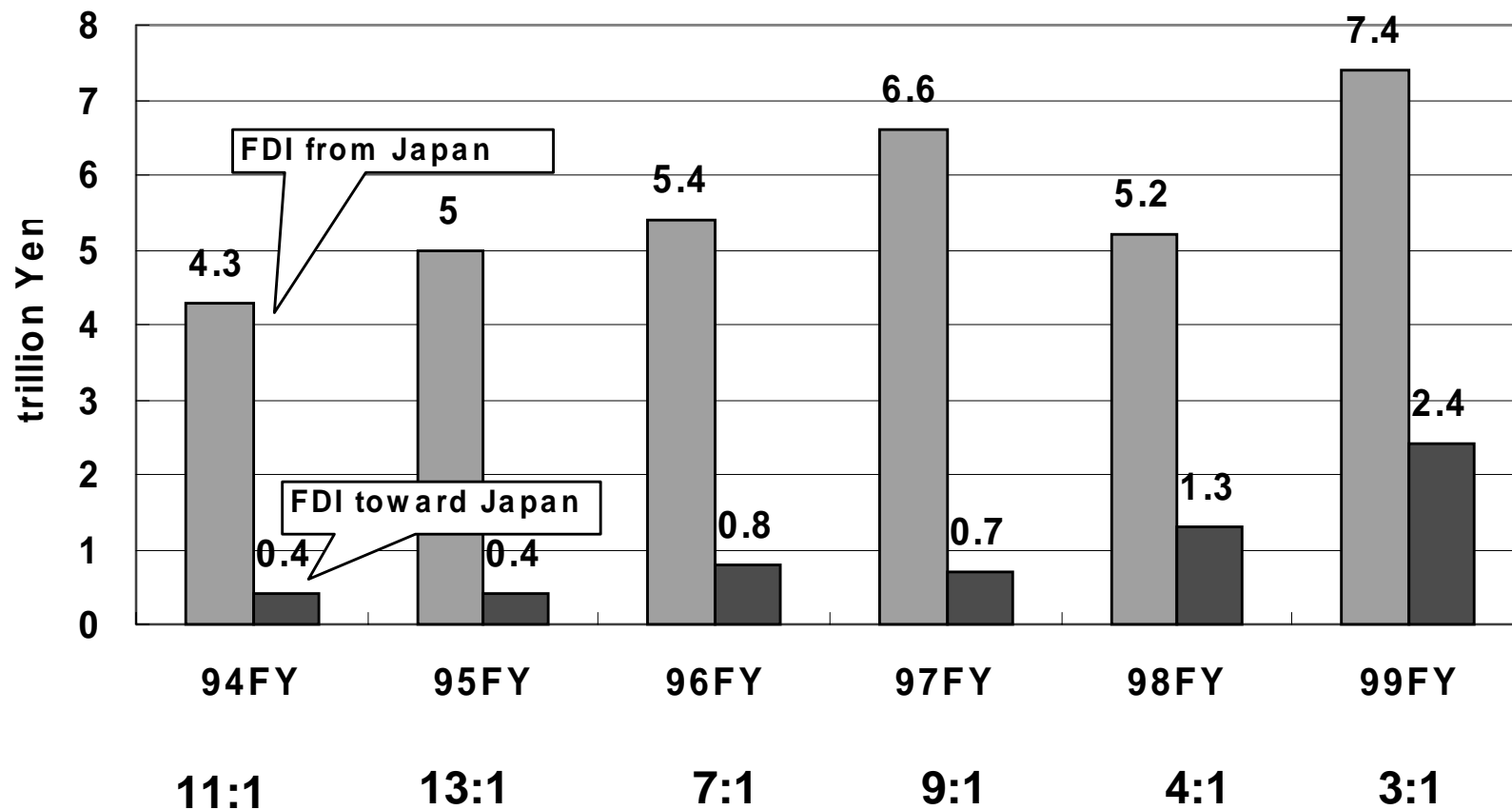
Japan 99CY, Germany 97CY, Others 98CY.

Source: Japan - Statement of balance of payments (99CY)

Others - International Financial Statistics (IMF)

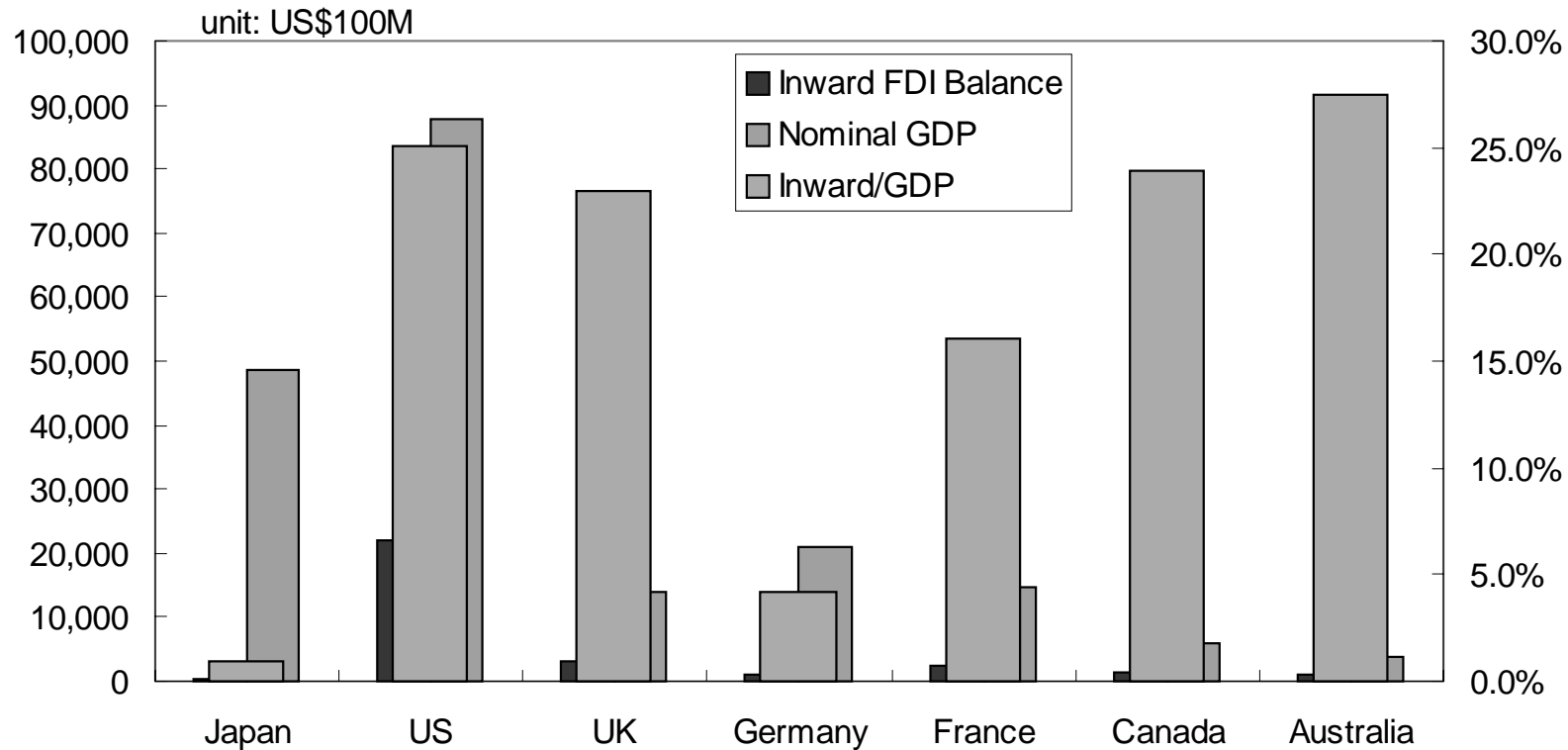
Foreign Direct Investment into & from Japan

Substantive increase in Inward FDI relative to Outward Flow.



Inward FDI by country

(Accumulated investment balance / Nominal GDP)



Notes: Used 99 year end currency rate of 102.20yen/\$ for Japan. Others IMF.
Japan 99CY, Germany 97CY, Others 98CY.

Source: Japan - Inward FDI Balance: Statement of balance of payments.

Nominal GDP: Economic Planning Agency, SNA related data.

Others - Inward FDI Balance: International Financial Statistics (IMF)

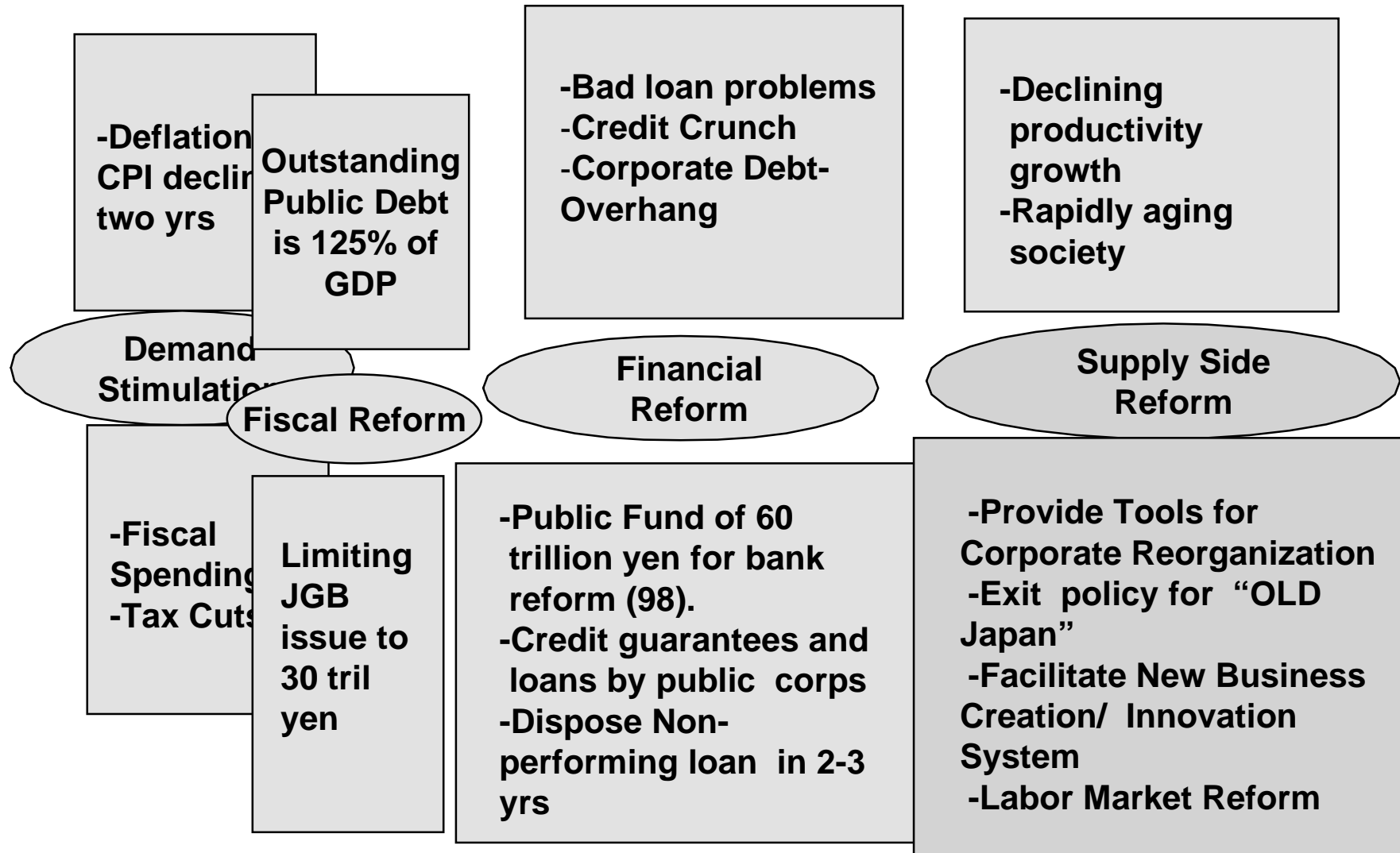
Nominal GDP: Economic Planning Agency, National Economic Accounting

Speech by then-MITI Minister Kaoru Yosano at US - Japan Business Council Meeting

San Francisco, July 12, 1999

-the Government of Japan even more welcomes foreign direct investment in various fields in our country.
-Renault and Nissan....IDC and C&W. In fact, the only voices heard were those welcoming the fact that foreign firms have finally begun to participate in the management of Japanese enterprises.
-Toys "R" Us and the GAP, are sparking the reform of the Japanese distribution industry. We commend the entry of US firms in to Japan because they have brought many benefits to our consumers.
-Goldman Sachs and Merrill Lynch, is spurring major transformations in Japanese financial sector,..
- These, I believe, are ample proofs that, conditions in Japan are rapidly changing today.

The Four Pillars of Japan's Economic Policy



Creating Business Environment for Choice and Concentration

Reform of the Legal Framework

- (1) Utilization of Holding Companies
- (2) Mergers and Acquisitions
- (3) Spin-offs and Split-offs (Corporate Divestitures)
- (4) Enactment of Industrial Revitalization Law
- (5) Enactment of Civil Rehabilitation Law : Japanese
Chapter 11
- (6) Stock Options
- (7) Corporate Tax Systems
- (8) Corporate Accounting Rules
- (9) Corporate Governance Rules
- (10) Pension Funds and Employment Policy

Reform of the Legal Framework (1)
Utilization of Holding Companies
Revisions to Corporate Law

Amendment of Anti-Monopoly Law in 1997

Allows establishment of holding companies on the condition that the extent of market does not become excessive.

Amendment of Commercial Code in 1999

Allows easy formation of holding companies by means of transfer of shares.

Reform of the Legal Framework (2)

Mergers and Acquisitions

Revisions to Corporate Law

Amendment of the Anti-Monopoly Law in 1998

⇒ Reduced the number of M&A that was reported to JFTC

Issuance of a new Guideline by JFTC in 1998

⇒ ★ Abolish old threshold of 25% market share
★ Consider various factors

Amendment of the Commercial Code in 1999

⇒ 100% acquisition possible by means of exchange of shares

Reform of the Legal Framework (3)
Spin-offs and Split-offs
(Corporate Divestitures)
Revisions to Corporate Law

Amendment of the Commercial Code in May 2000

1. Spin-offs and Split-offs

A company is divided into two and the shares of the new company are distributed to the shareholders of the old company.

2. Establishment of subsidiaries (Simplified procedure)

A company is divided into two and the shares of the new company are continue to be owned by the old company.

Reform of the Legal Framework (4)
Industrial Revitalization Law
Revisions to Corporate Law

Simplified Reorganization Procedures

Enactment of Industrial Revitalization Law in 1999

Submission of a reorganization plan by companies



- ★ Plans consist of mergers, making subsidiaries, sale of business, closing of old facilities, etc.
- ★ Relaxation of certain Commercial Code obligations, tax reductions, low interest funds are provided.
(Debt Equity Swap, EBO, MBO)

Reform of the Legal Framework (5)
Civil Rehabilitation Law
Revisions to Bankruptcy Law

■ **Bankruptcies**

Enactment of Civil Rehabilitation Law in 1999

DIP style restructuring

Commencement of procedure is relaxed.

Payments on debts can be stopped at once.

Flexible restructuring plan

DIP finance is given priority.

Since April 2000, nearly 300 cases have been filed.

Reform of the Legal Framework (6)

Stock Options

Revisions to Corporate Law

■ Stock Options

Amendment of the Commercial Code in 1997

Stock options to employees

Limited to 1/10 of total outstanding stock

Enactment of the Industrial Revitalization Law in 1999

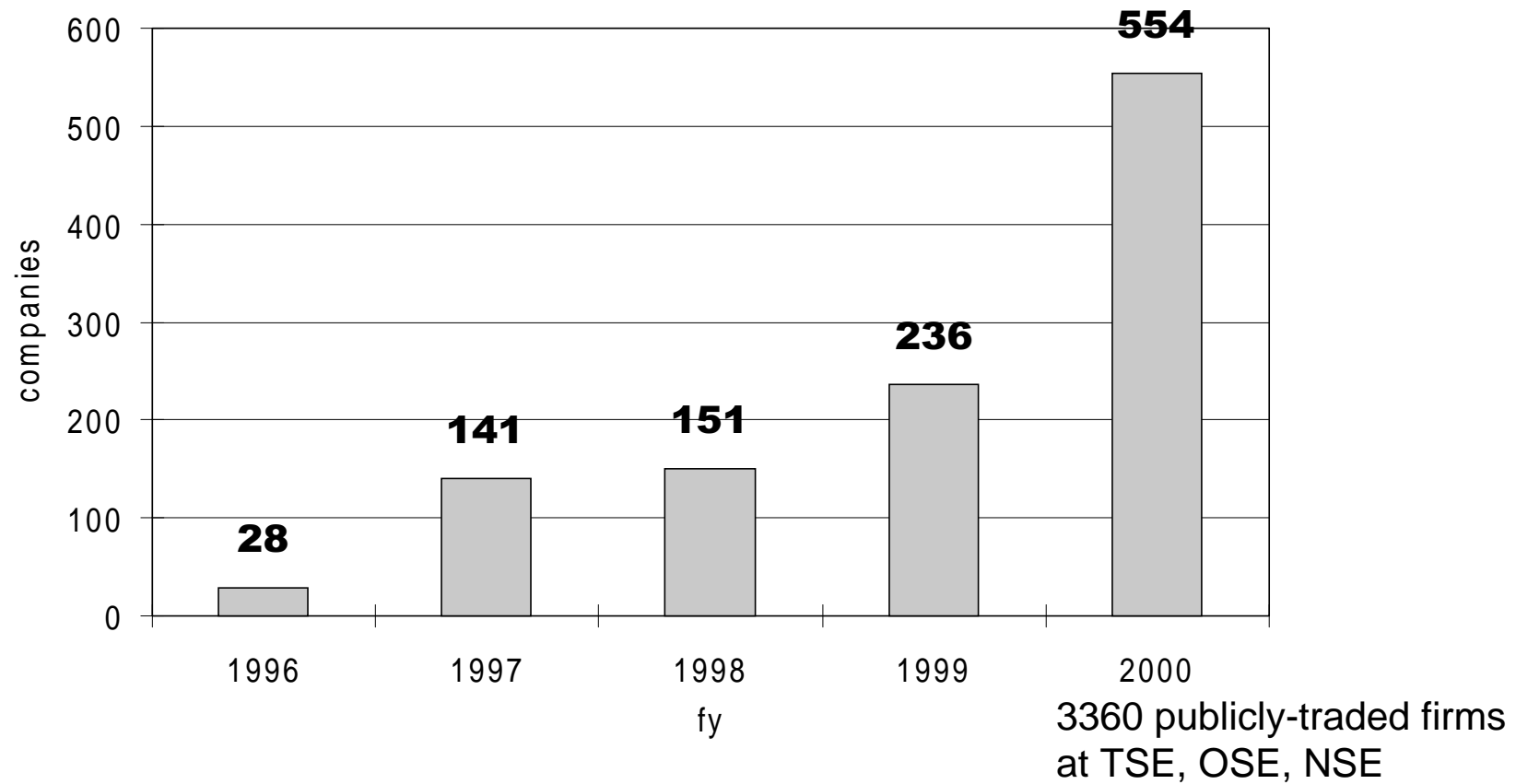
Stock options to employees of subsidiaries

Enactment of the New Industry Establishment Law in 1999

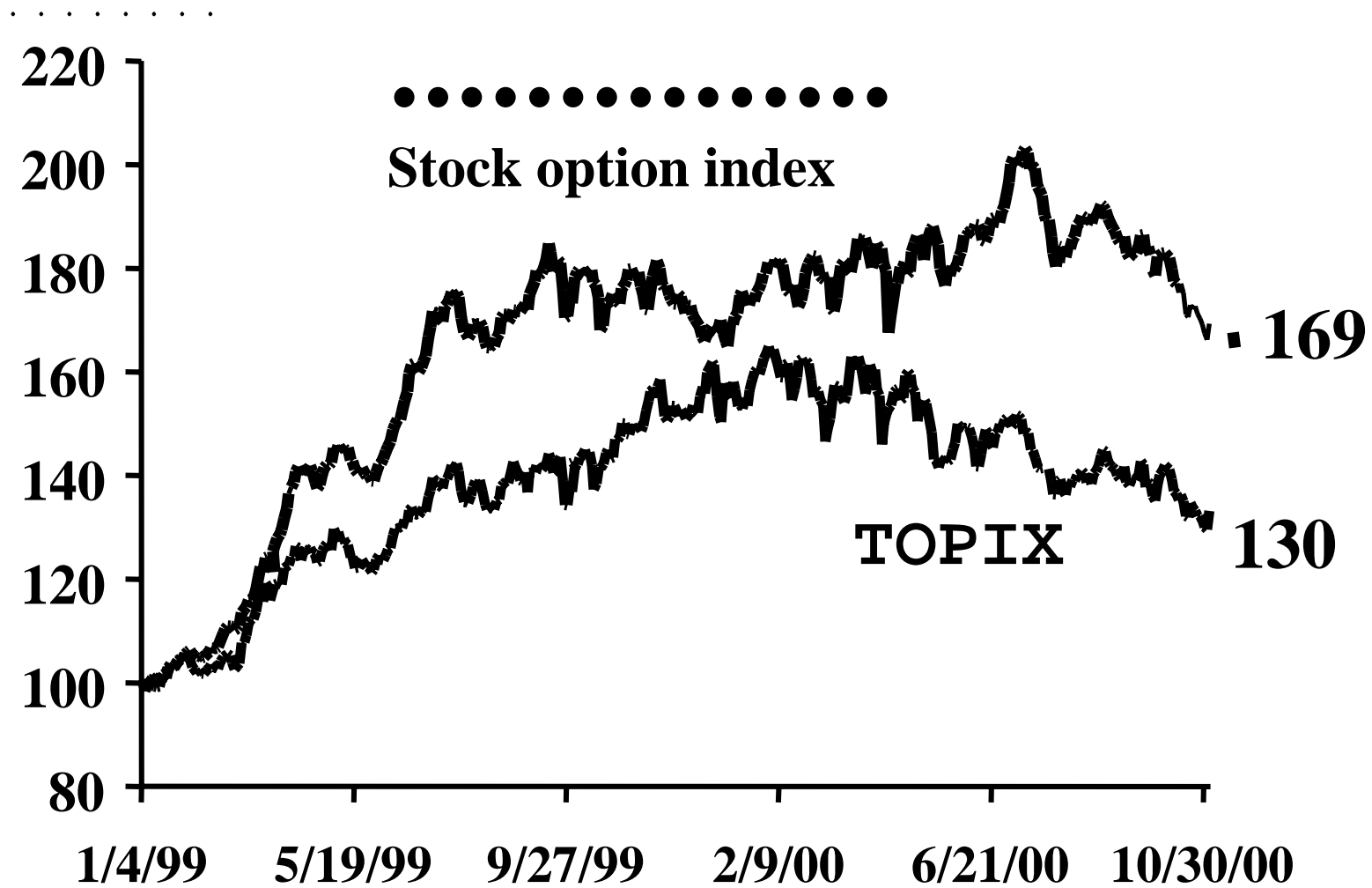
Stock options to consultants and others

Raised the limit to 1/3 of total outstanding stock

Number of Companies that has introduced Stock Options. is now 17 % of all publicly-held firms



Incentive Payment means OUT-PERFORMANCE

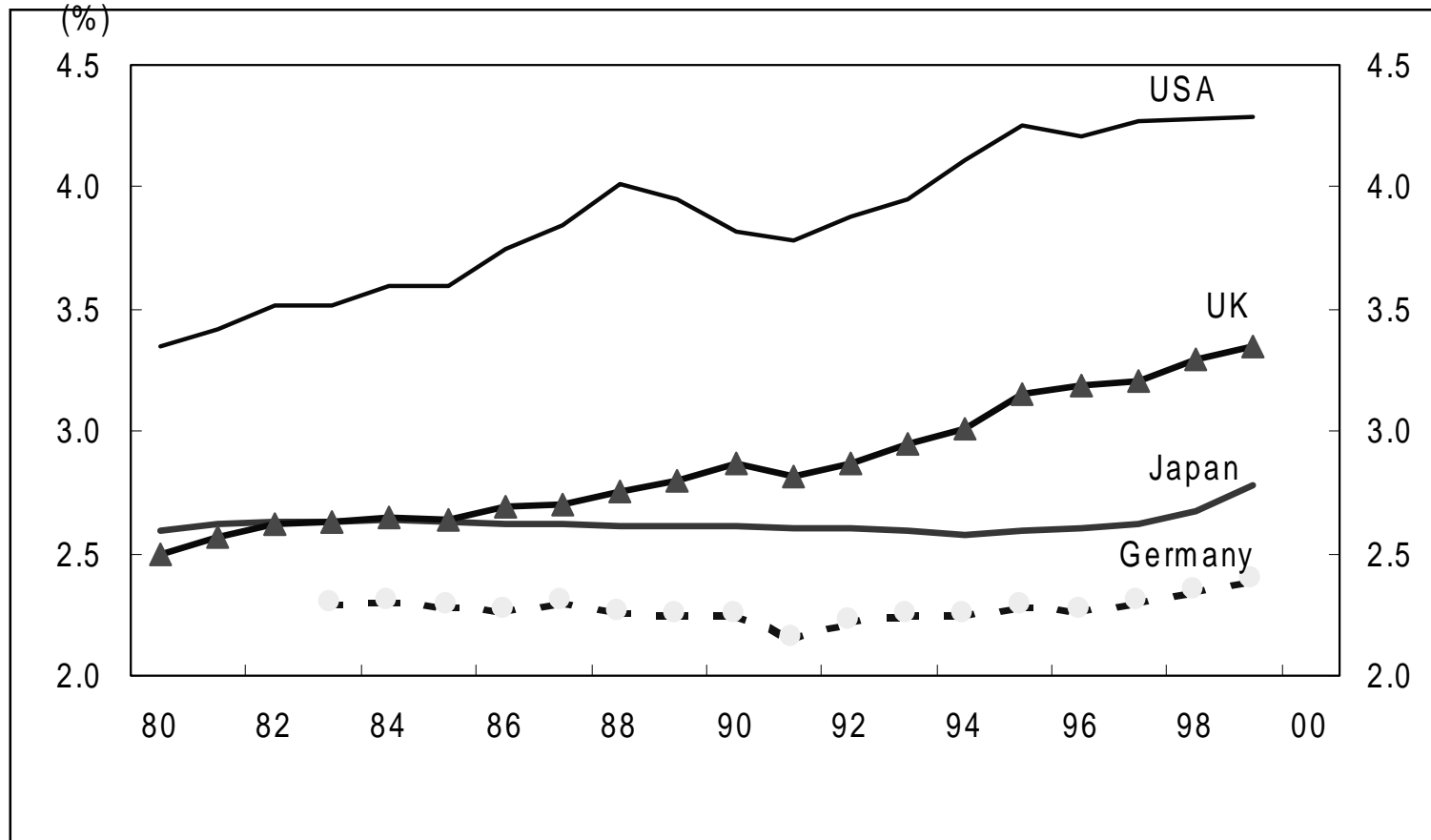


Goldman Sachs

The New Japan Reality: The Need For Specialists, Not “Salarymen”, Creates Rising Income Inequality

Earnings Gap - Top 10% and Bottom 10% Wage Earners

Times



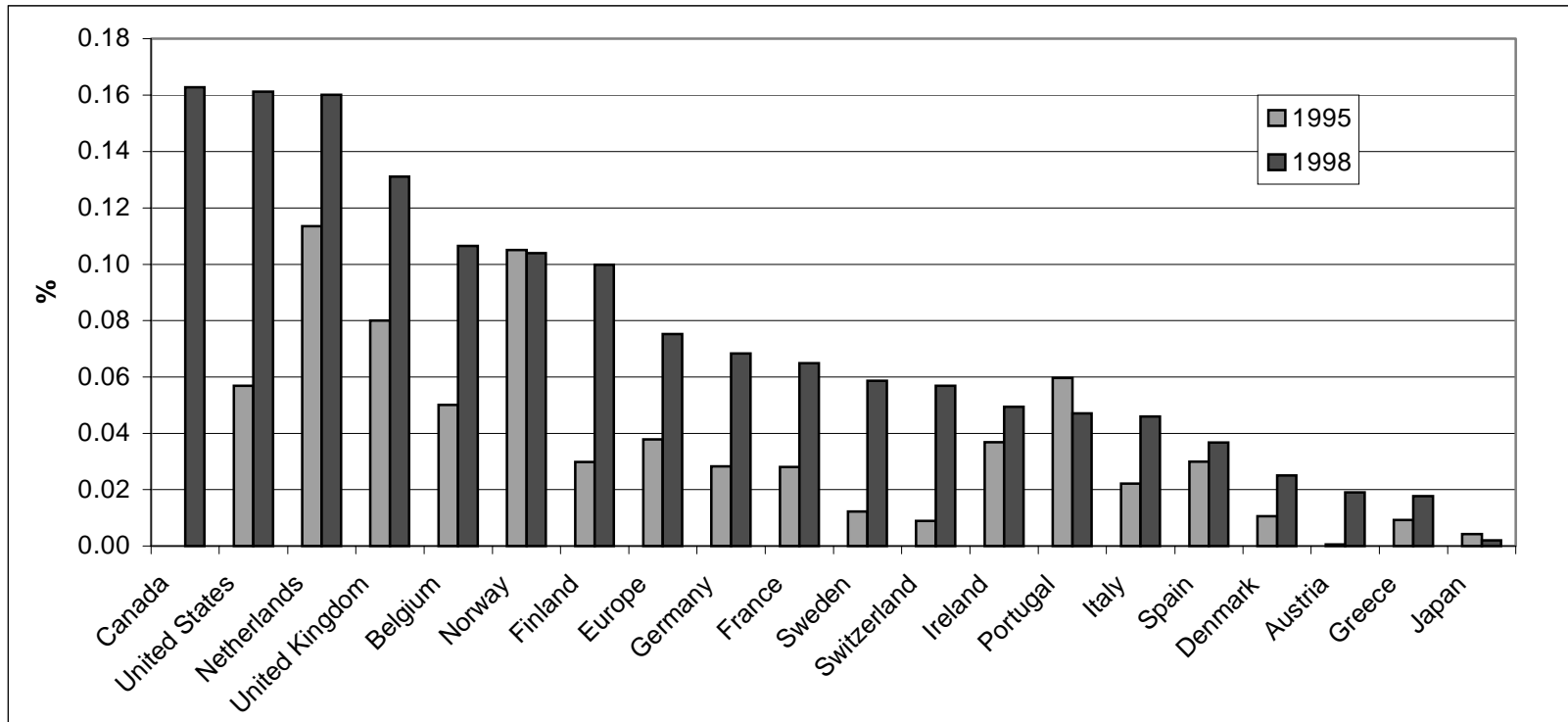
Source: OECD & ML Estimates

Merrill Lynch Japan

Encouraging New Business Creation

- Expanding use of Stock Option Plans
- Deregulation of Service Sectors
- Spin-Offs
- Japanese SBIR (Small Business Innovation Research) System
- Limited Liability Partnerships for Venture Capitals
- University - Business linkage / TLO law
- Loan, Loan Guarantee Programs

Venture Capital Investment in Early Stages and Expansion as a Percentage of GDP



Source: European Private Equity and Venture Capital Association (EVCA) 1999 Yearbook, National Venture Capital Association (NVCA), 1999 Venture Capital Yearbook, Ministry of Trade and Industry Japan.

Outline of the New Small and Medium Enterprise Basic Law

The Previous Small and Medium Enterprise Basic Law

[Policy Concept]

- Rectify the Gap between LE & SMEs in terms of productivity

[Policy System]

Upgrading in Structure of SMEs (Improving Productivity)

- Modernization of Facilities
- Improvement of Technology
- Rationalization of Business Management
- Optimization of Corporate Scale
- Arrangement of Joint Operation for Business
- Commercial and Service Sectors
- Change of Business
- Labor Related Policies

New SME Basic Law

[Policy Concept]

- Developing and growing a wide range of independent SMEs for greater economic vitality

(Expectation of SMEs)

- Creation of New Business
- Promotion of Market Competition
- Increase of Attractive Job Opportunities
- Vitalization of Regional Economy

[Policy System]

Supporting Self-help Efforts for Business Innovation and Start-ups (Support for Ambitious Enterprises)

- Promoting Business Innovation (Support for Technology, Equipment, Intangible Management Resources, etc.)
- Promoting Start-ups (Information Services, Training Programs, Facilitating Fund Supply, etc)
- Promotion of Venture (R & D, Supportive Human Resources, Fund Raising through Stocks, Bonds, etc.)

Reform of the Legal Framework (7)

Revisions to **Corporate Tax Systems**

- Tax Treatment on Spin-offs and Split-offs

Amendment of Corporate Tax Code in 2001

- Consolidated Tax Return

Introduction of Consolidated Tax Return by 2002?

Reform of the Legal Framework (8)
Revisions to
Corporate Accounting Rules

- Consolidated Financial Statements by March 31, 2000
- Recognition of Deferred Tax by March 31, 2000
- Market Pricing of Marketable Securities by March 31, 2001
- Disclosure of Under-funded Defined-benefit Pension Plan by March 31, 2002

Reform of the Legal Framework (9)
Revisions to
Corporate Governance Rules

■ **Changes of corporate management**

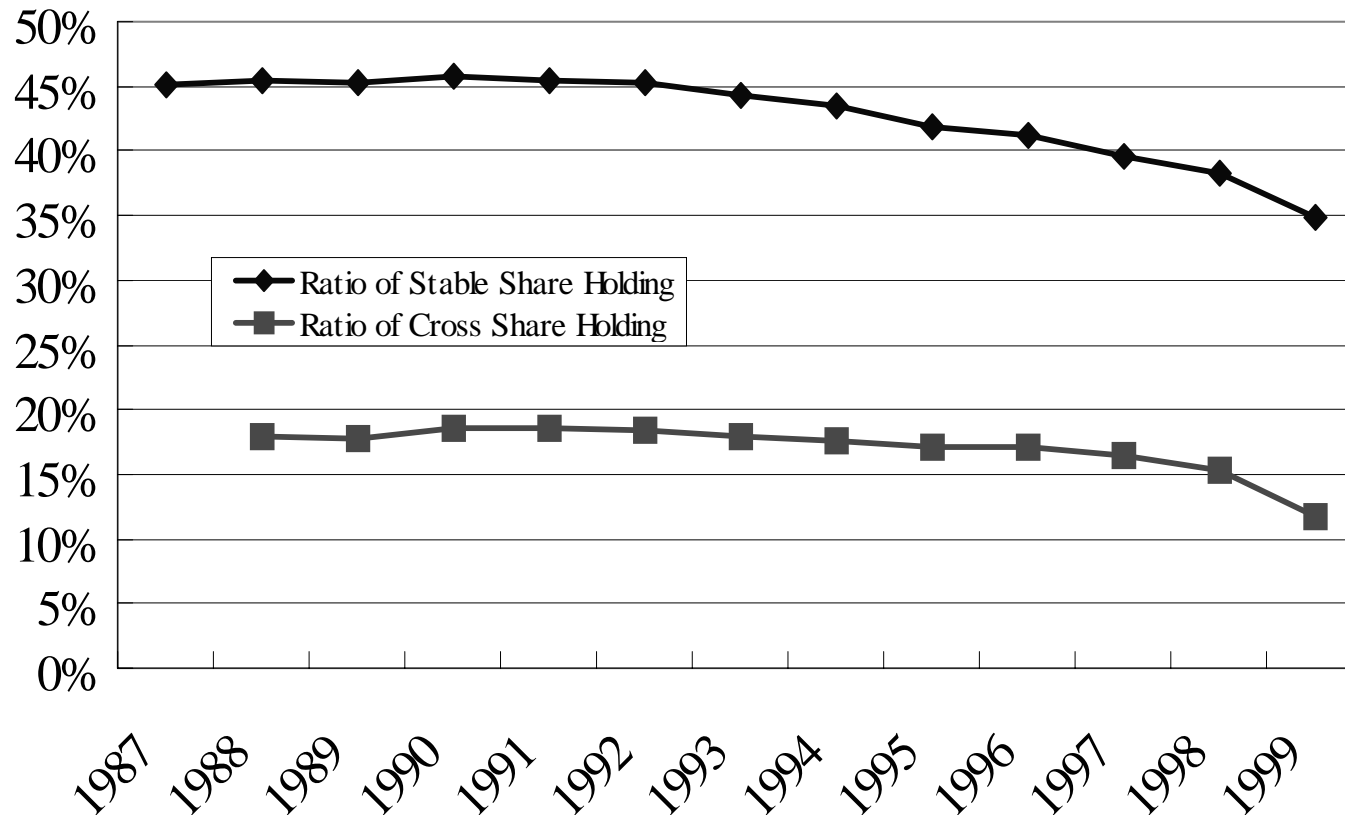
- ☆ Cross-shareholdings decreased.
- ☆ More than 200 companies separated the board and the management

■ **Revision of the Commercial Code**

Deregulation of the Commercial Code is necessary.

MITI has made a set of proposals.

Ratio of Stable Share Holding and Cross Share Holding

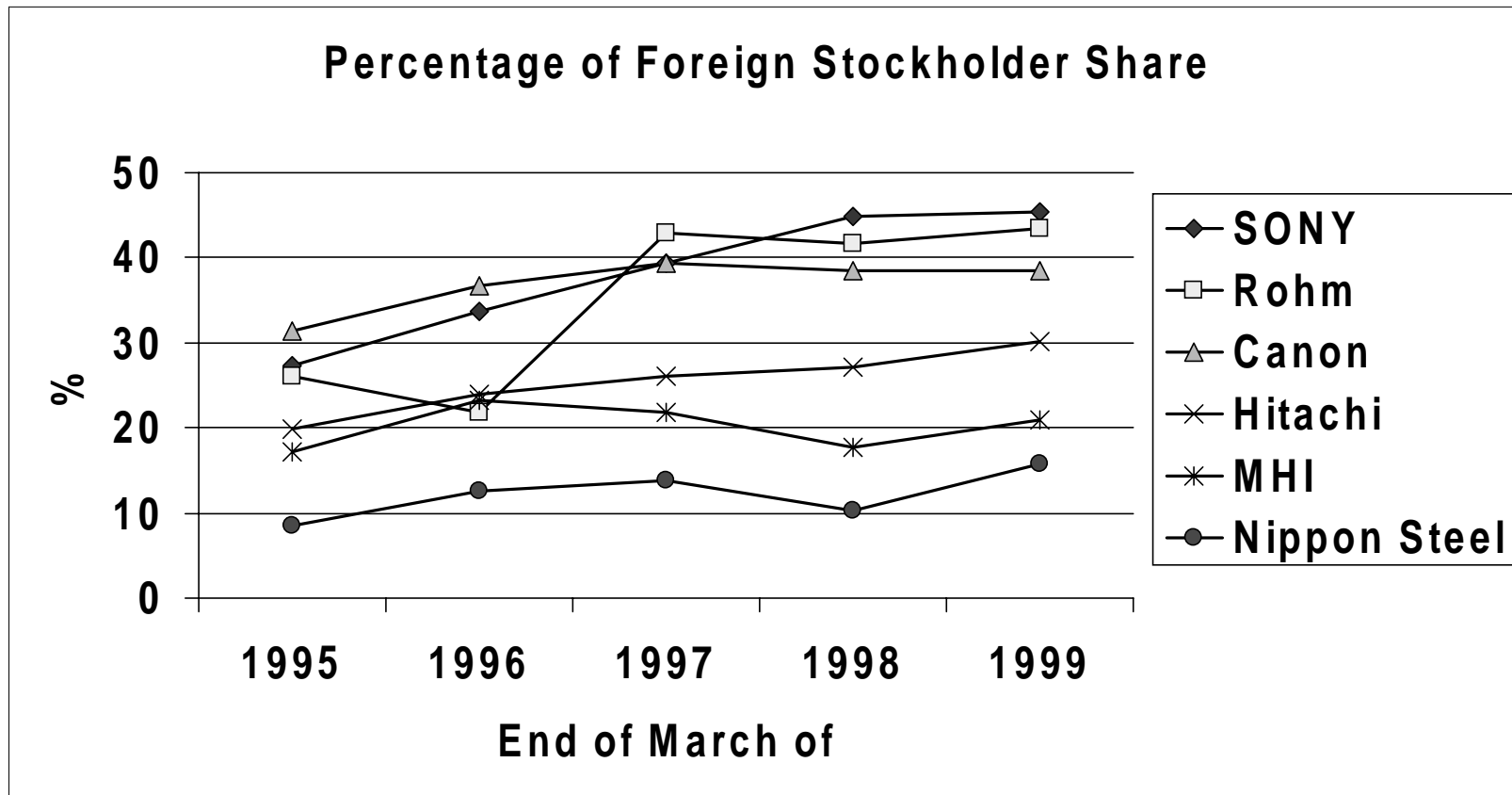


Cross Share Holding: Shares held mutually between two corporations.

Stable Share Holding: Total of cross share holding and share held by financial institutions and share of financial institutions held by corporations and shares held as related companies.

Source: NLI Research Institute

Increase in Foreign Stockholders



Reform of the Legal Framework (10)
Revision of
Pension Funds and Employment

- Introduction of Defined Contribution Pension
being discussed in the Diet
(Japanese 401K plan)
- Deregulation of Job Placement Business and
Temporary Work-force Supply Business
- Revision of Employment Policy to increase
Mobility in Labor Market
- Special Assistance and Training Program

Other Examples of METI's initiatives

from The Action Plan for New Economic Growth

(Dec 1, 2000)

- Introduce “Non-Action Letter” system
- Outlaw “Age Limits” in recruiting
- Paperless “Commercial Papers”
- Reform of the Commercial Code

Five Aspects of Fundamental Commercial Code Reform

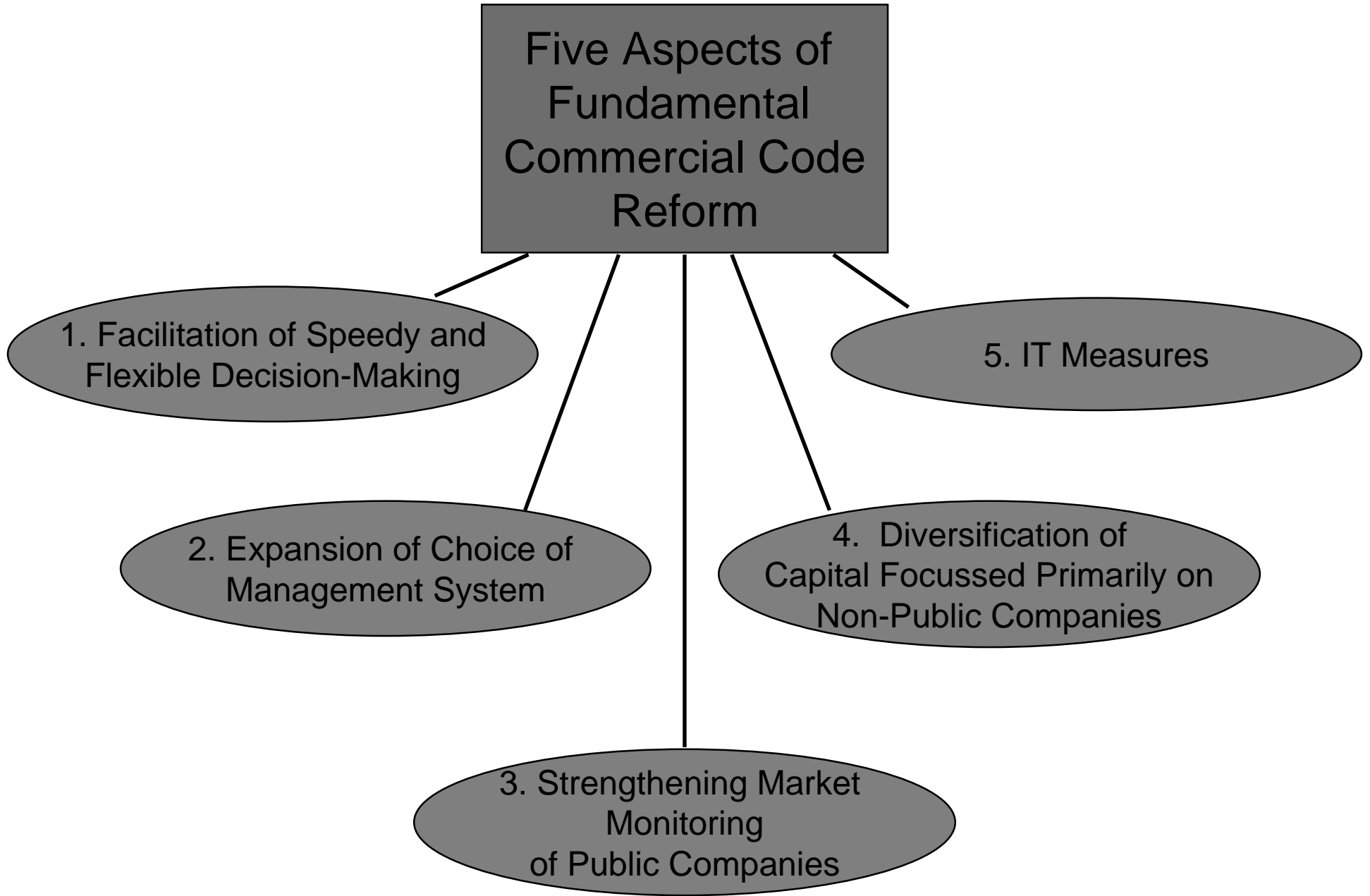
1. Facilitation of Speedy and Flexible Decision-Making

2. Expansion of Choice of Management System

3. Strengthening Market Monitoring of Public Companies

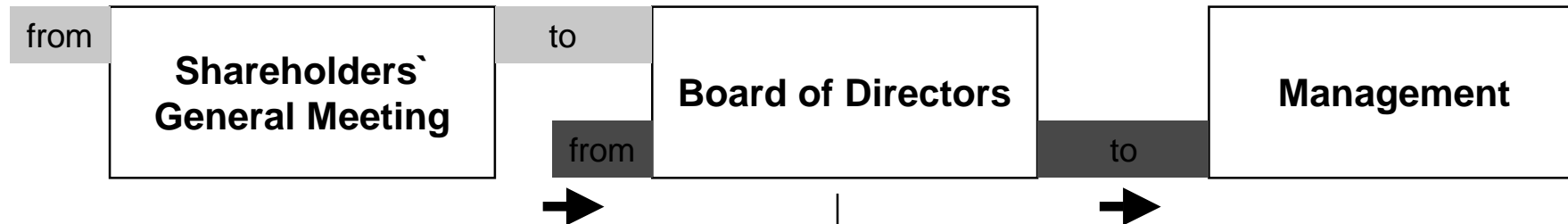
4. Diversification of Capital Focussed Primarily on Non-Public Companies

5. IT Measures



1. Measures to Facilitate Speedy and Flexible Decision-Making

Transfer of Responsibility for Certain Matters



Business transfers (from an important part of the business to greater than 20% of total net assets)

Mergers, share exchanges, corporate divisions, etc. (from greater than 5% of total net assets to greater than 20%)

Disposal of property, etc.

Establishment of branch offices or important organizations, appointment of managers or important employees, etc.

Issuance of new shares, warrants, convertible debentures

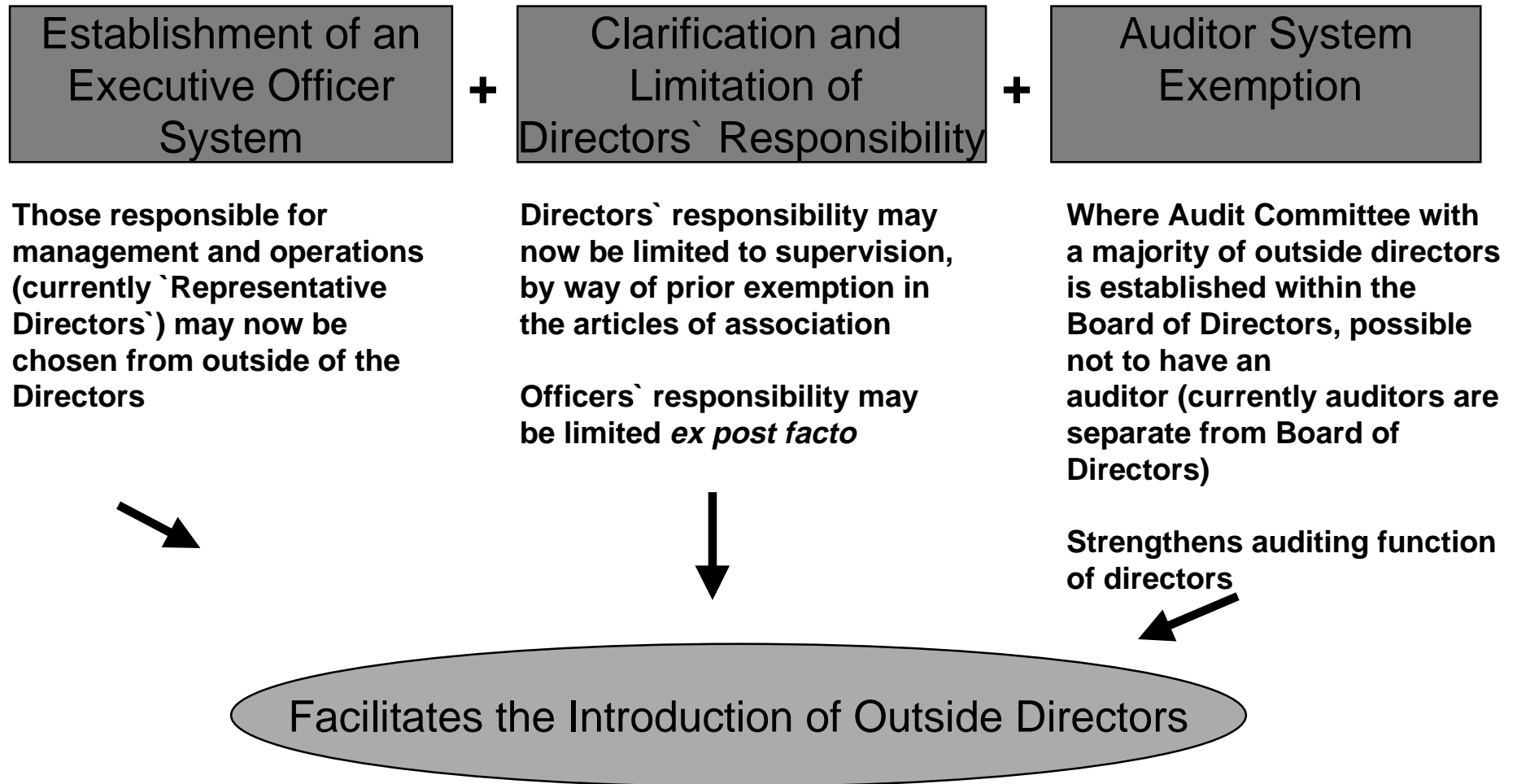
Quorum Revision for Special Resolutions of Shareholders' General Meetings

Majority

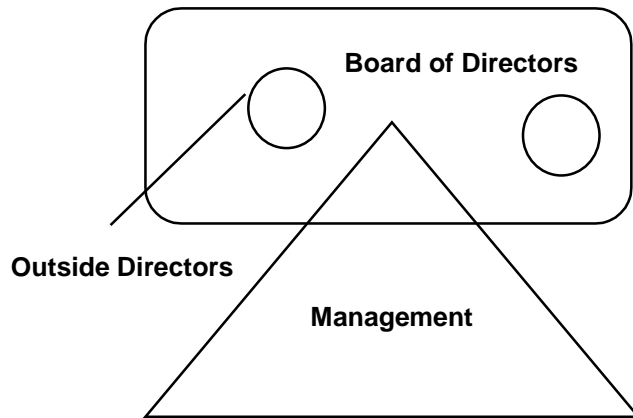
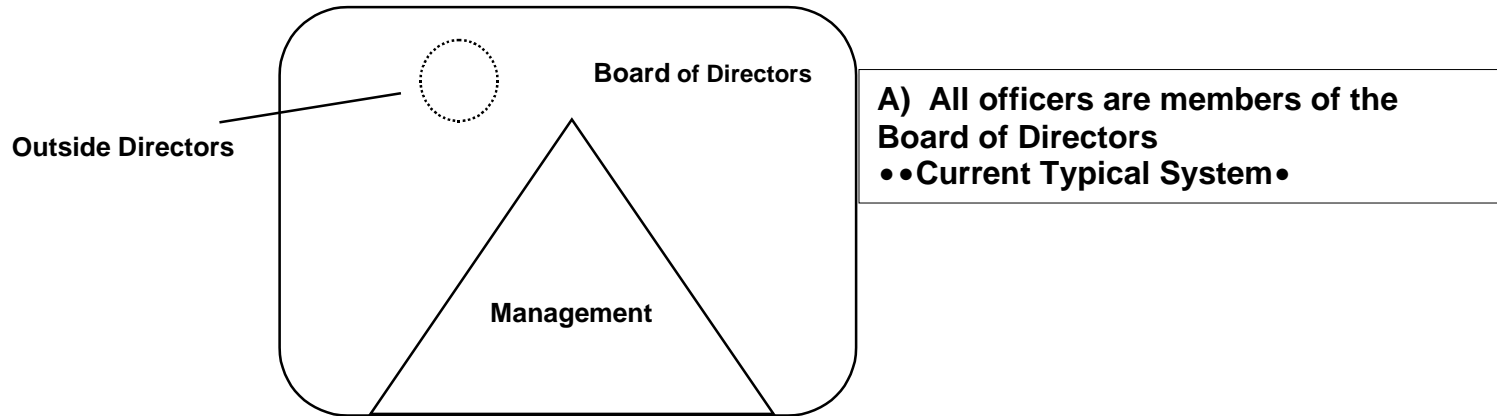


Greater than or equal to 1/3

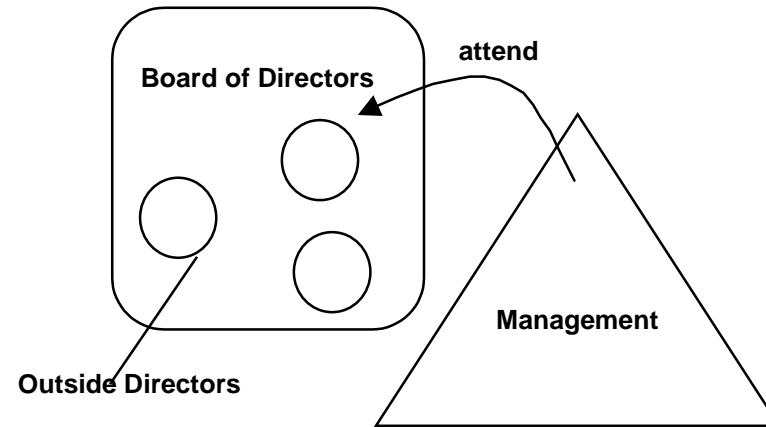
2.(a) Expanding the Choice of Management System



Examples of Possible Management Systems



B) Only a portion of the officers are members of the Board of Directors - many of the directors are outside directors



C) A portion of the officers attend Board of Directors Meetings and create management reports etc., but do not possess voting rights

2.(b) Expanding the Choice of Management System

Improvement of Stock Options

Elimination of regulations prescribing maximum amount of stock options permissible and limiting those eligible for stock options

3. Strengthening Market Monitoring of Public Companies

Recognition of the importance of appropriate market evaluation and of feedback to management



Measures to Ensure Adequate Disclosure of:

Management System

Extent of the introduction of outside directors

Status of internal compliance

Incentive System

Disclosure of Directors` actual total remuneration (including stock options)

Consider appropriateness of individual disclosure of those whose actual total remuneration exceeds a certain amount and/or of those with the highest remuneration among directors and officers

Company Audit Info etc.

Ensure coordination of disclosure provisions in Company Law and Securities Exchange Law

Information with respect to corporate grouping

4. Diversification of Capital Focussed Primarily on Non-Public Companies

Elimination of the net asset regulations with respect to share splitting (greater than 50,000/share)

Creation of voting-type share classes

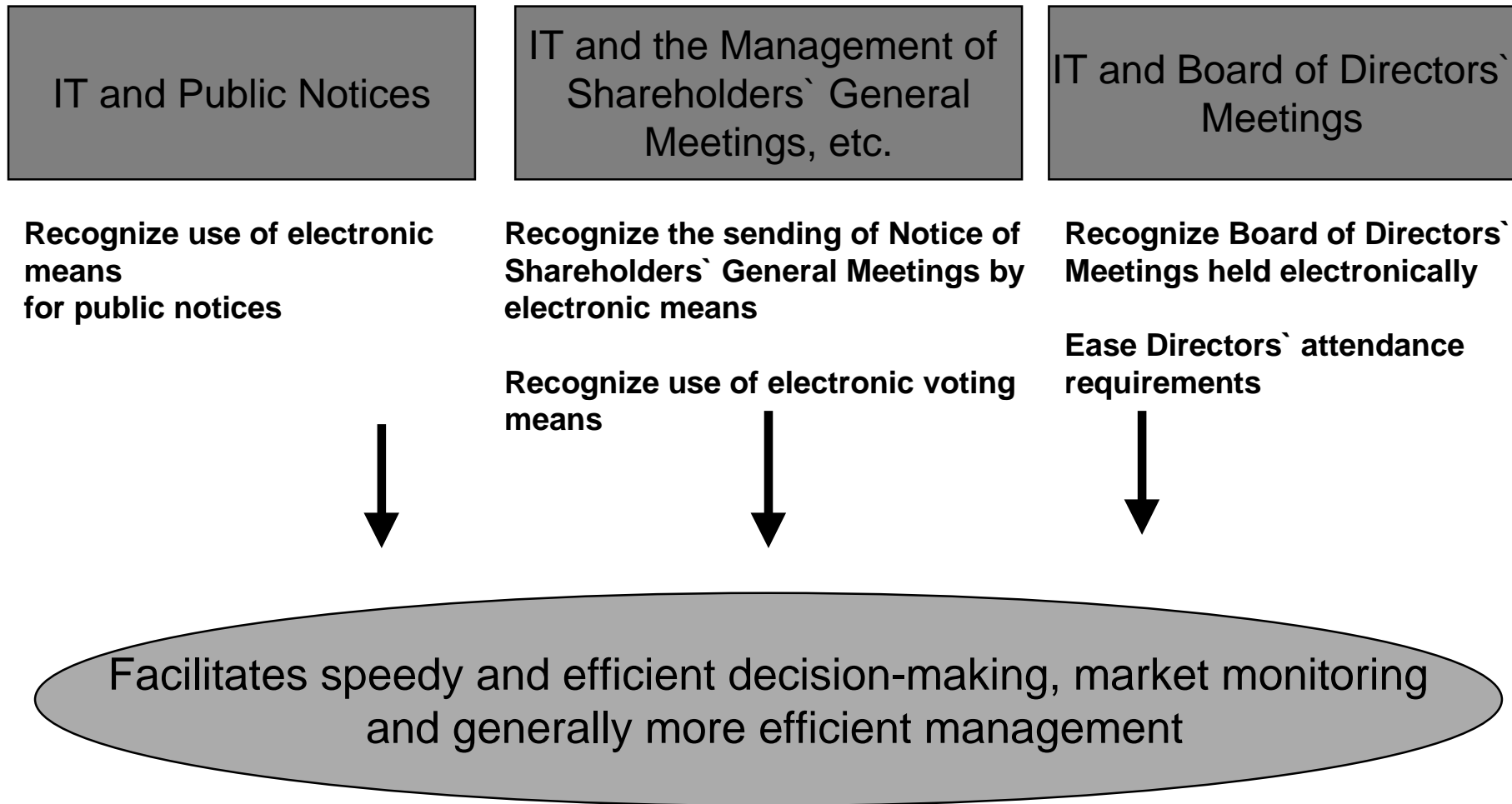
Elimination of limits on capitalization (currently 400% of issued capital) for companies with limits on share transfer

Reduction of the notice period for Notice of Shareholders' General Meeting for companies with limits on share transfer



Facilitates business management which employs the appropriate source of capital

5. Information Technology Measures



Japan is facing an Institutional Crises

Institutions as shared mind-set

- Life-time employment, main bank system, etc.
- “The government ought to, and does, help and protect the weak and the troubled.”

Institutional crisis as shared beliefs shaken

(ex Bureaupluralism and contingent governance)

. . . Dr. Masahiko AOKI

Message To the Business

Need for Speed

While restructuring our Company in the 1980s, we spent much of our time talking about the accelerating pace of change: in world politics, in technology, in product introduction and in the increasing demands of customers. We don't have to do that anymore. Change is in the air. Newspapers and networks hammer it home daily. GE people today understand that pace of change, the need for speed, and the absolute necessity of moving more quickly in everything we do, from inventory turnover, to product development cycles, to a faster response to customer needs. They understand that slow-and-steady is a ticket to the boneyard in the 1990s.

(To Our Share Owners", 1990 GE Annual Report)

Message to the Bureaucracy

New METI

- Ministry of Economy, Trade and Industry is established in January 6 of 2001.
- New mission is Economic Reform or Restructuring.
- Three Basic Principles to Re-allocate Resources
 - 1) from Public to Private
 - 2) from Regulation to Liberalization &
 - 3) from Monopoly to Competition.
- To Revitalize Japan's Economy.

Message to Think-tanks

What is RIETI?

- Research Institute of Economy, Trade and Industry, IAI
- Unique Policy Think-Tank in Japan
- “Team B” in the Policy Market of Kasumigaseki
- Blue-printing the Restructuring of Japan



Message to the Politics

“The conflict between Second and Third Wave groupings is, in fact, the central political tension cutting through our society today. Despite what today’s parties and candidates may preach, the infighting among them amounts to little more than a dispute over who will squeeze the most advantage from what remains of the declining industrial system. Put differently, they are engaged in a squabble for the proverbial deck chairs on a sinking Titanic.”

Alvin Toffler, “The Third Wave”(1980)

Seeking a Friend Indeed

Only Japan, China and Korea are left without any regional initiatives

A Case for Regional Economic Integration. . .

