

The goal of Abenomics: The US and Japan to take the lead in the global economy

1. I am honored to have the opportunity to speak again before the USJI today. Only 15 months ago, I spoke here of the importance of the US-Japan alliance and the path Japan should take forward, and I had a meaningful exchange of opinions with all of you. Now, from the expression in your eyes, I find you look quite different from those days. At that time, you looked at me with skeptical eyes, as if wondering whether Japan was really going in the right direction. Tonight, I see your eyes shining with the expectation of Japan's recovery and the willingness to make an investment in a country on its way toward restoration. What must be done first, to answer such expectations in the field of politics, is to bring an end to situations where you see a prime minister, having just come into office, replaced by another, year after year. We must win the Upper House election this summer to ensure the stability of the government. Now both the US and Japan have a divided government or a twisted Diet. I hope that Japan will get out of the stalemate, and that Prime Minister Abe will hold office for at least five years. Prime Minister Abe said that Japan was back. But that may not be accurate. Only after taking back its leadership in the world, can Japan declare its comeback. I hope that Prime Minister Abe will keep his job until we can say so. We have just begun a prelude. This evening, I would like to discuss just what Abenomics, the key to Japan's recovery, means, what its goals are, and its significance to US-Japan relations, from the standpoint of the Abe cabinet's economic policy-making team, which is tasked with revitalizing Japan's economy. In doing so, I will include some of my own personal opinions as well.

2. Since the start of the Abe cabinet, a correction of foreign-exchange rates has advanced from the past overvaluation of the yen. In addition, the stock prices have risen by 60% or more since their lows of last year. Although the Abe cabinet is praised for getting a rocketing start, in fact it also can be regarded as the result of the overlapping of a number of favorable conditions. For example, the external environment became favorable as the US economy has begun to improve and the European sovereign debt crisis appears to be calming down. This, together with expectations for the Abe cabinet, partly contributes to the depreciation of the Japanese yen and the rise in stock prices. The financial market conditions are eventually turning back to the situation before the Lehman shock. ~~In August 2008, the level of Nikkei average was around 13 thousand yen and the exchange rate of the Japanese yen against the US dollar was around 109 yen.~~

However, ~~looking at the highly sensitive responses of the markets to the events such as the outcome of the Italian general elections and the issues in Cyprus, we recognize the importance of setting a right policy framework and putting it into action. It appears the markets still do not have much confidence in the recovery of the Japanese economy. In particular,~~ there is a sentiment that people are willing to wait and see to what extent the government is committed to implementing a growth strategy, that is the third element of the three-pronged strategy. The goal of Abenomics definitely is not to generate an illusory or superficial economic recovery but to rebuild the economic foundation so that the Japanese economy can break free from long-term deflation and start on a full-fledged path of growth. To do so, we will take some bold, unprecedented steps that will change the landscape we see around us.

3. The “three-pronged strategy” of Abenomics refers to (i) aggressive monetary policy, (ii) flexible fiscal policy, and (iii) a growth strategy to stimulate private-sector investment. Originally, the Japanese term for this three-pronged strategy, *osanbon no ya*, which literally means “three arrows,” comes from an anecdote about a warlord in medieval Japan who ruled the hometown of Prime Minister Abe during those days telling his three sons, as a family precept, that while it is easy to break a single arrow, three bundled together are strong and difficult to break, and so the three should cooperate with each other to take up an important matter. In other words, what we want to express by using the term “three-pronged strategy” or “three-arrows” is that we cannot succeed in revitalizing the Japanese economy if even one of these three policies is missing.

4. To begin, I would like to discuss the first pillar of the strategy, monetary policy. Since the economic crisis that followed the collapse of Lehman Brothers, central banks around the world have implemented monetary easing, rapidly expanding their balance sheets, in order to stabilize functions of financial markets and to address the economic contraction. Comparison of figures before and after the economic crisis shows that the FRB expanded its balance sheet by 3.5 times, the BOE by 4.3 times, and even the ECB by 1.8 times. On the other hand, despite the fact that Japan was struggling under a lengthy period of deflation, the BOJ’s balance sheet increased by only 1.5 times. It cannot be denied that the BOJ’s monetary easing was insufficient in terms of both size and speed, and this was an important reason for deflation and the overvaluation of the Japanese yen . Immediately after the establishment of the Abe cabinet, it published a joint

statement and for the first time both the government and the BOJ would share the price stability target of a 2% increase in CPI in order to exit from deflation and to realize sustained economic growth. This implies that the BOJ decided to adopt an inflation target, something it had continued to reject for more than a decade. This can be said to have brought about a regime change in which efforts to end deflation would be devoted to a completely different degree from the past.

5. However, what is important is not just the setting of goals but achieving them. From the perspective of central-bank independence, the BOJ decides on the specific means of monetary policy. This is why the appointment of the Governor, whose term was to expire this spring, was extremely important. Prime Minister Abe appointed Mr. Haruhiko Kuroda, President of the Asian Development Bank to be Governor of the BOJ. As you know, his appointment has been successful. The new Governor Kuroda has expressed the ambitious target of achieving a 2% inflation rate with a time horizon of about two years by doubling the monetary base and introducing policies of monetary easing on a different level. With this, the BOJ has been equipped to carry out a monetary easing policy comparable to those in other countries. FRB Vice Chair Janet Yellen has indicated her support for these monetary easing policies, calling them "completely appropriate."

6. In this way, the first arrow has been shot powerfully. However, unless the ample funds supplied to the market circulate in the domestic economy, they will not provide economic stimulus. This is why the second arrow has been prepared. On January 11, about two weeks after its start, the Abe cabinet adopted economic measures, including 20 trillion yen of projects. The money supplied will be absorbed thoroughly by actual demand generated through economic measures; this will serve to prime the pump of private-sector investment, as well. This second arrow is designed to function as an engine strengthening the effects of the economic recovery together with the first arrow.

7. Although monetary easing and fiscal stimulus definitely have an impact on economic recovery in the short term, I don't think that the Japanese economy can fully recover and continue to maintain economic strength over the long term with these measures alone. This year, the government projects nominal GDP growth of 2.7% and real GDP growth of 2.5%, taking into account the effects of the economic measures. To enable the Japanese economy to continue its sustained growth, there is a need to implement the growth strategy, the third arrow within this year, and put the Japanese economy on a

path toward growth. If the growth strategy successfully contributes to keeping the real growth rates of 2.5% in the future, like this year, and monetary easing results in inflation of 2%, then the nominal growth rate could reach 4.5%. While we face some very high hurdles, we will take on the challenge of realizing a 4.5 to 5% growth rate in nominal terms through implementing a bold growth strategy, a policy that is completely different on level. As the first arrow, monetary easing and the second arrow, fiscal stimulus are the policies for buying time, we will shoot the third arrow in the meantime and put the economy on a growth path led by private demand.

8. Then, from what perspective should we design the growth strategy for the future of Japan? To begin with, in Japan the population already has begun to decrease, and some are questioning if it is even possible for the economy to grow under such conditions. Since the potential growth rate is determined by the three factors of labor input, capital input, and productivity, a decline in labor input due to a decreasing population definitely would pose a serious problem for growth. However, I am confident that Japan can move forward along a path to sustained growth (albeit a very narrow one), maintain its vitality, and continue to have the economic power with which it can demonstrate leadership in the world.

9. First of all, Prime Minister Abe says that addressing the decrease in labor input is a core to the growth strategy. An important key is the employment of women. That is to say, one of the key agenda items of Abenomics is Womanomics. Surprisingly, as many as 70% of Japanese women leave the workforce after giving birth to their first child, and only 65% of female university graduates are employed. Incidentally, it appears that in the US only one-third of women leave work after having their first child. In Japan, highly capable women are an underutilized resource. One of the reasons for this underutilization is a severe shortage of day-care centers, particularly in the urban areas. In order to boldly move forward in removing this barrier, the growth strategy will increase the rate of employment of women by increasing the capacity of day-care centers for 200,000 children over the coming two years and 400,000 children over five years. If the rate of the employment of women were to rise to the same level as men, then the number of workers would increase by 8.2 million, and this could push up GDP by 15%.

~~10. Furthermore, the proactive use of human resources, not just from Japan but from overseas as well, will increase Japan's competitive strengths in industry, science, and~~

~~technology. Specifically, we will review preferential treatment systems to accept larger numbers of highly skilled human resources from overseas, moving in the direction of thoroughly expanding such systems. We will improve conditions for international study, aiming to accept 300,000 international students into Japan and to send 150,000 Japanese students to study abroad. Also, in order to capture overseas demand it is important that a large number of tourists and other travelers visit Japan. For example, we will aim to realize a world leading visa system as a tourism based country through means such as the introduction of long stay visas, like those adopted by Australia and other countries, which enable long term stays by the wealthy.~~

140. Next, there is a need to increase capital input by expanding private-sector investment opportunities. One plan for doing so is the “Abenomics strategic economic zone.” We are carrying out a variety of studies to take bold measures to make these special economic zones directly connected to economic growth, unlike existing special economic zones that provide only a limited extent of deregulation and preferential tax measures. For example, the Okinawa Institute of Science and Technology Graduate University opened last year in Okinawa, providing an environment for education and research on world-leading science and technology. Forty talented students and researchers learn and make studies, competing with each other. One idea is to use this institute (OIST) as an international base for innovation and to form a cluster of businesses in areas including IT and logistics through a bold move to set up a special economic zone. Also, last month the US and Japan agreed on a plan to repatriate US military bases in the Okinawa Prefecture located south of Kadena. It is conceivable that in the future Okinawa could grow as a hub for Asia, in combination with measures to put the former sites of military bases to effective use.

121. Needless to say, investment in the cities is important, too. The floor-to-area ratio in Tokyo is no more than 330% even in the central city. On the other hand, in New York City the ratio is 1,400% in Midtown Manhattan. We will make Tokyo a more attractive city by encouraging investment through means such as the bold deregulation of floor-to-area ratios. It is also important to create an environment where Tokyo can strengthen its function as an international financial center and allow for 24 hour financial transactions by designating Tokyo as an Abenomics strategic economic zone.

132. Furthermore, we have an idea with regard to the Abenomics strategic economic

zone in the Kansai area, in the western part of Japan. As a first step, we would like to promote the coordination and integration of managing ports and airports in an integrated manner. In order to make more effective use of the existing infrastructure and strengthen international competitiveness, we will extend the scope of the integral use of facilities to include Osaka port and Kobe port, Kansai International Airport and Itami Airport, which was already decided, and further to include Kobe Airport, as well. Based on this, we will aim to realize the plan of Osaka bio bay in accordance with the proposal made by the Liberal Democrat during the election campaign, by creating a special zone connecting the Medical Industrial city in Kobe, which is equipped with a super-computer at the RIKEN Brain Science Institute, Integral Medicine in Awaji-shima, ōSAITOō a cluster of regenerative medicine and pharmaceutical industry led by the Osaka University, and the Center for iPS cell Research and Application (CiRA) of Kyoto University led by Prof. Shinya Yamanaka. In this way, we will promote the significant growth of the medical industry. Another idea is to locate a part of the function of the Pharmaceuticals and Medical Devices Agency (PMDA) in the Kansai area. Furthermore, operating a Casino in Osaka Bay will attract tourists in wealthy class, particularly from Asia. Although it has been already designated as an International strategic economic zone, in order to support this plan, it will be effective to adopt the Abenomics strategic economic zone to cover the Osaka prefecture and Hyogo prefecture surrounding Osaka bay in an integrated manner and to allow some independent status, which is a key feature of the Abenomics strategic economic zone. In some sense, this could be a step forward to the introduction of Do-shu-sei, a plan of creating more independent and larger local states, which the Abe-administration promotes. We will establish a working group to make an institutional design of the Abenomics strategic economic zone in the middle of May.

134. As for healthcare and medical science, Japan has strengths in the field of regenerative medicine, as demonstrated by aforementioned Mr. Shinya Yamanaka, Professor of Kyoto University, who won the Nobel Prize in Physiology or Medicine for his study of iPS cells. To help make Japan's medical sector, which includes iPS cell technology, as well as new drug development and medical equipment and instruments, more competitive as a business, we will revise relevant laws and reform the system, for instance, to substantially reduce the period of approval.. We will also learn from the experience of the US and set up a Japanese-version NIH as a control tower for the development of cutting-edge medical technologies.

~~15. I won't go into these in detail any further due to time constraints, but one point I would like to make is that we have resolved that these efforts represent our last chance. Although the LDP has returned to power for the first time in three years, Prime Minister Abe and many members of the Cabinet and the Diet share the feeling that if we do not reward the support of the voters this time, then they will not trust us with the reins of government again. Also, any further delay in reform would be fatal to the Japanese economy. So we will make our best effort, recognizing that this could be our last chance. With these growth strategies, we will boldly take on challenges that previous LDP governments were unable to take on or did not address sufficiently.~~

164. Revitalization of the Japanese economy is likely to be very beneficial to the US, as well. A stronger Japanese economy should be more attractive as a market, and an environment more conducive to doing business in Japan, supported by efforts such as regulatory reform and special economic zones, would generate significant business opportunities for American firms as well. An increased growth rate in Japan also would help US exports to grow. Japan's economy is projected to grow this year by a rate in the high 2% range, and this alone probably will increase US exports to Japan by roughly USD 5 billion. By steadily carrying out the growth strategy in the future, we would like to generate further gains for both the US and Japan, through broadening and facilitating flows of people, things, and money between the two countries.

175. We also must thoroughly implement fiscal consolidation. Amid falling tax revenue, growing expenditures, and increasing dependency on public debt is mainly driven by the need for funding of social security. Further delay of fiscal consolidation could lead to continual increases in interest rates as the market thinks that fiscal conditions are unsustainable. When interest rates rise due to economic growth, increase in expenditures for servicing of government bonds can fully be covered by increased tax revenue. However, interest rate rises due to loss of confidence in fiscal sustainability must be avoided in any way possible, because they are not accompanied by increasing tax revenue. We are committed to firmly maintaining fiscal discipline over the mid- to long term. Monetary easing also contributes to lower interest rates. Over this period, we will carry out fiscal consolidation through rising revenues and expenditure cuts in a well-balanced way.

~~18. The keys to increasing revenue are the planned hike in the consumption tax rate and the steady implementation of the growth strategy. If the economy is not capable of~~

~~withstanding a tax increase, then it could have the opposite effect and damage the fiscal situation. As I mentioned earlier, in order to avoid such a situation, we will build, through the growth strategy, an economic structure that can withstand a tax increase. Also, the dividends of economic growth will be received in the form of increased tax revenue.—~~

~~19. As for expenditures, it is doubtful whether uniform spending cuts would be effective. Without the prioritization, for example, by boldly investing resources in growth areas, the effects of the growth strategy would be diminished. At the same time, there are some reforms to expenditures that have been left mostly untouched until now. In particular, use of Information Technologies in the government has been delayed, and this results in high costs. These initiatives have been slow to advance, despite the fact that they have been proposed numerous times up until now. For instance, when I went to the US 20 years ago to study at the University of Maryland, I was given a social security number. I remember how useful the number was as, among others, it allowed even a foreigner to open a bank account without difficulty. It is expected that at last Japan will introduce a Social Security and Tax Number System, a project which so far has met with failure on several occasions. We will use the system as leverage to aspire to the top ranks of e-government. We will reduce the cost of the government rigorously. We want to open up the government sector, such as airports, harbors, and water supply and sewerage systems to the private sector by concession and promote efficiency in these sectors. I hope that you will actively invest in these sectors.~~

1620. Next, regarding our economic diplomacy, we already have demonstrated our resolve in the form of participation in the TPP negotiations. My speech in January of last year was made at a time right in the middle of the debate on Japan's participation in the negotiations. I mentioned that Japan should join the negotiations quickly and that the role of the TPP was important as one opportunity for boosting the sluggish Japanese economy and for the development of the Asia-Pacific region. While it took more than one year after that, Prime Minister Abe made a firm decision that the DPJ government had been unable to make. These negotiations involve sensitive products such as agricultural products in Japan's case and motor vehicles in the case of the US and the attention of the public and the media always tends to be paid to the area of tariff negotiations. However, I would like to emphasize that tariff negotiations are only one part of the TPP negotiations, and what is more important is the fact that the TPP represents the making of international economic rules for a new era. Japan, together

with the developed and emerging countries in the Pacific region, including the US, Canada, Singapore, and Mexico, is making the rules that will govern economic activities in the 21st century, including trade, investment, intellectual property, government purchasing, and dispute settlement. By encouraging other countries including China and Russia to comply with these international rules through APEC, ASEAN+6 and Japan-China-South Korea FTA negotiations in the future, we will expand an environment for free trade and investment worldwide. In fact, Japan's stance of participating in the TPP negotiations has stimulated China, resulting in the start of negotiations on an FTA between Japan, China, and South Korea. Furthermore, negotiations have begun on a Japan-EU EPA, as well as a US-EU FTA, at the same time as the TPP. Thus, it means that the US, Europe, and Japan are going to begin simultaneous and parallel discussions on economic partnerships. It is impermissible that Japan would not be included in the TPP negotiations while developed countries are discussing the creation of rules in this way.

~~1721.~~ In addition, I would like to share my opinion about Japanese farmers. Regardless of the TPP, agriculture itself needs to change in Japan. The average age of agricultural workers is 66 years, and uncultivated farmland has grown to account for about 10% of all agricultural land in the country, an area about the same as that of the US state of Rhode Island. However, agriculture in Japan has the potential to be a growth sector once reform is implemented. You know how many food items Japan can offer that delight your taste. What is also critical is strategic thinking, such as introducing Japanese food culture and other intangible aspects to the world as a way of promoting the export of food materials from Japan. At the same time, the Netherlands, which has no more than one-half the agricultural land of Japan, is the world's second largest agricultural exporter. Taking the Netherlands as an example, we will work to improve the productivities of agriculture by introducing information technologies, and expanding the exports of agricultural products. We also will work to become the third largest country exporting agricultural products. ~~As for rice, the relative price of Japanese rice has fallen to about three times that of foreign rice. If we further grow the available agricultural land we should be able to improve export competitiveness. Toward that purpose, an idea to promote the accumulation of farmland is making use of a trust of farmland and securitize its beneficiary right, what we call farmland REIT, as a financing tool. We will work to make the agriculture sector more competitive by making effective use of expertise and capital in the private sector.~~

~~22~~18. Lastly, I would like to emphasize that Japan's participation in the TPP not only will benefit Japan but will also greatly benefit the US and the world. According to a study by Professor Peter Petri of Brandeis University and others, if Japan does not participate in the TPP then the long-term benefits of the TPP to the US would only be 2.4 billion dollars per year, while if Japan does participate then that figure would rise to 7.7 billion dollars. Furthermore, looking at the world as a whole, the benefits of the TPP would rise from only 7.5 billion dollars to 22.3 billion dollars with Japan's participation. I hope that you can see from this the very large economic global benefits from Japan's participation in the TPP.

~~19~~23. Today I have discussed the basic concepts of the economic policies known as Abenomics. Jim O'Neill, who coined the term "BRICs" in 2001, foresaw a shift in the role as driver of the world economy from the US, which in 2001 was shaken by the collapse of the tech bubble and 9/11, to emerging markets, led by the BRICs. It is true that over the past 10 years growth in emerging markets has been impressive. However, in recent years, growth in emerging markets has slowed, and furthermore, each emerging market faces a variety of challenges of its own. Now the BRICs have somewhat stepped down as star players of the global economy. Meanwhile, US recovered reflected the shale gas revolution. If Japan also revitalized, a partner in Asia that shares common values, would make a considerable difference to the stability of East Asia and the entire world, not only in economic terms but also in terms of diplomacy and national security. Today, I do not have sufficient time to talk in detail; I am also responsible for issues concerning the PKO and the abduction of Japanese nationals by North Korea. I will work to establish closer cooperation between the US and Japan in the field of diplomacy and national security. Soon, I will visit South Sudan to see Japan's PKO activities there. In Africa, Japan also has several units of Self-Defense Forces stationed in Djibouti to protect the ships of countries around the world from piracy when they sail off the coast of Somalia. I will devote my efforts to Japan's economic recovery, so that the US and Japan can contribute to the peace and prosperity of the world as world leaders. It is the return of the US and Japan, replacing BRICs. However, the truly crucial stage is yet to come. Fortunately, we have the enthusiastic cooperation of many people in the worlds of business and academia. I would like to conclude my speech by noting that I will do all I can so that I will be able to say with confidence that Japan's economy has recovered, the next time I have an opportunity to speak to you here. Thank you very much for your attention.