

Special Lecture with Minister Aso

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International Affairs Building, Columbia University



Taro Aso

Deputy Prime Minister; Ministry of Finance; Minister of State for Financial Services
Cabinet Office, Government of Japan

The Center on Japanese Economy and Business (CJEB) hosted a lecture by Minister Taro Aso, deputy prime minister, minister of finance and minister of state for financial services of Japan, where he discussed the current state of the Japanese economy, his role in guiding the economy, and progress that Japan has made in recent years. CJEB's director Hugh Patrick provided opening remarks, and Takatoshi Ito, professor at the School of International and Public Affairs (SIPA) at Columbia University and director of the Program on Public Pension and Sovereign Funds at CJEB, served as moderator.

Minister Aso commenced by saying that Japan did not lose two decades, but rather gained two decades. Although people point to the Nikkei that is half that of its peak as well as an economy that has barely grown, Japan has undergone a revolution, albeit quiet, over the past 20 years. He first pointed out the example of Japanese women. In 1987, the female labor participation rate was 53.3 percent, while it was 61.9 percent in the United States during that



Hugh Patrick

time. However, in 2015, the female labor force participation rate in Japan was 64.6 percent, while it was actually lower in America, at 63.4 percent. Corporate accounting is now much more transparent as well; a CEO is now much more responsive to the company's shareholders. Corporate governance has also undergone change in Japan. Eight out of ten listed companies now have more than two non-executive independent members on their boards. As a result, corporate Japan is paying a lot more to shareholders with dividends now totaling more than ¥10 trillion, or \$90 billion, some two percent of GDP. The previous record was a mere ¥6 trillion.

The Ministry of Finance is still a bastion of the best and brightest in Japan, but it has less "teeth" than it did before, and has no say over the financial industry since the Financial Services Agency now exists. Once a monopoly in the budgeting process, it now shares power with the Prime Minister's Cabinet office, which now can promote or demote high-ranking officials. Adding the operational independence of the Bank of Japan (BOJ) to the picture, Japan today is a much different place than it was 25 years ago.

The entire system was being rebuilt while waiting for a leader determined to take bold steps to shake the country out of its long malaise. This explains why the Abe administration is so strong. Its political center now really lies at the center.

Minister Aso reported both good news and bad news. The good news is that Japan's social fabric has not been torn apart after all of these years, despite the severe economic slump. People stayed calm, flexible, and even graceful. The sense of pride amongst workers is still intact, as airline crew members will not beat customers, and taxi drivers in Tokyo are still proud of what they do. Currently, the gap between the rich and poor is still relatively narrow.

As for the bad news, Minister Aso pointed out that welfare payments are now a serious burden to the country. Their gross total now stands at \$1,062 billion, which is larger than the defense spending of the United States, China, Saudi Arabia, Russia, and the UK put together. Young men and women are very risk-averse; unless they become more forthcoming, Japan cannot grow. So, how can Japan, as a mature democracy with equality under the law, best reduce the cost of entitlements? Minister Aso is determined to push for reform.

Fortunately, progress is being made. Recent efforts have reduced this growth by half over the past five years because of hope given to the young. Hope matters more



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than anything else in a country's growth. To that end, U.S.-Japan economic ties are important. So Japan proposed the Japan-U.S. Economic Dialogue, which is designed to address three areas:

1. How can these two countries – together representing 30 percent of the world's economy – best cope with the problems of the world, financial or otherwise?
2. How can these two countries best seek cooperation in the development of infrastructure, energy, and cyberspace?
3. These two countries should strive for the enhancement of fair and open markets, and investment between them and around the world. They should discuss ways to enhance the international rules-based system.

Minister Aso is confident about working with Vice President Mike Pence on this initiative given the two countries' historical ties, and cited the example of the automobile trade. In the 1980s, the U.S. trade deficit with Japan amounted to some 58 percent of its total deficit, with Japan exporting three million cars each year to the United States. Then, around 1985, Japanese car makers made massive investments in the United States. By 1990, Japanese car makers were producing one million cars in the United States, and today that number is four million, far more than the number Japan sent to the United States thirty years earlier. The outstanding amount of Japanese FDI in the U.S. now stands at around \$411.2 billion, generating 800,000 jobs across America. The U.S. trade deficit with Japan amounts to only nine percent of its total deficit, while its trade deficit with China is 47 percent of the total.

The past two to three decades were a formative age for the future of Japan and for an even tighter bilateral relationship. Minister Aso concluded his speech by proclaiming that he continues to be optimistic about Japan's future.

Question and Answer session

Professor Ito then posed several questions to Minister Aso. The first was about the framework for Japan-U.S. relations that was discussed a day earlier with Mr. Pence. It was proposed by the Japanese side, and is different than the demands made by the United States in the 1980s and 1990s. What are the goals, beyond the three-point framework described earlier? Also, Minister Abe was disappointed by President Trump's rejection of TPP, and people are worried about the protectionist rhetoric of the Trump administration. Could this framework be a safeguard for securing openness between the United States and Japan?

Minister Aso replied that the conversation started in February when Prime Minister Abe and President Trump met at a summit. Minister Aso accompanied Prime Minister Abe, met Vice President Pence, and they kicked off the dialogue. Up until then, U.S.-Japanese dialogue was traditionally based on economic friction, and the U.S. side had always initiated negotiations with Japan. This process led to many trade negotiations resulting in agreements in areas such as textiles, automobiles, agriculture, semi-conductors, and other industries. However, this time, friction was not the cause of the dialogue. This is due in large part to the difference in trade deficits mentioned before. Vice President Pence knows Japanese investment well; he is the former governor of Indiana, which was the third-largest destination for Japanese investment in the United States, creating 40-50,000 local jobs. Japanese manufacturers such as Subaru and Toyota have factories there.



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Next, Professor Ito asked about monetary and fiscal policy. After four years of efforts by the BOJ, the inflation rate is still below 0.5%, far from the 2% target. Many people think there is a limit to monetary policy, and are calling for fiscal policy reforms. Some economists are calling for converting government bonds to become perpetual bonds or zero coupon bonds; others are calling for issuing more bonds without raising taxes; and others are worried about these types of fiscal policies. How does Minister Aso view these fiscal policy measures?

Minister Aso responded that their office knows very well the economic theories, such as that of helicopter money, posed by Professor Ito and others such as George Soros. But there are problems with these theories. For example, the independence of the BOJ might be undermined, as well as confidence in monetary policy. In addition, the market's confidence in fiscal discipline might also be undermined, inviting a situation where JGB rates could shoot up significantly.



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Currently, Japan's outstanding debt is double its GDP – the worst among advanced countries – so it cannot abandon fiscal discipline, because it might invite public finance to go bust, inviting more inflation. This could result in major damage and confusion to Japanese livelihood, which cannot happen. Given the low fertility rate, the aging population, and the high percentage of pensioners, if inflation gets out of hand, then this will be a desperate situation for pensioners. There is no quick answer to this matter, so they will make an effort to achieve economic reconstruction and fulfill fiscal discipline as well as to achieve fiscal consolidation.

Professor Ito's final question concerned Minister Aso's comments on female labor participation and corporate governance reform. While reforms are being made, people are demanding more reforms in areas such as the labor market, agriculture, and other aspects of the "third arrow." Investors are somewhat disappointed by how quiet these reforms are. What can foreign investors expect from the third arrow?



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Minister Aso replied that Prime Minister Abe's cabinet has been working very hard to push for regulatory reform. Many areas that people thought were impossible to deregulate – like electricity, medicines, health care – have, in fact, been deregulated. They are even undertaking the reform of agriculture for the first time in sixty years, with eight different reforms submitted to the Diet in this session. They are also introducing reforms about equal pay for equal work, as well as improving working conditions for non-regular workers by placing caps on allowable overtime work. This was decided jointly between the labor unions and big business. These reforms can result in raising the labor participation rate and productivity, which constitutes a major pillar of structural reform.

The unemployment rate is currently below 3 percent. This gives them a great opportunity to enact further reforms, so labor reform is the number one priority. The Abe Cabinet's high approval ratings create a good opportunity to enact reforms.

Professor Ito then opened the floor to the audience. Professor Patrick asked what was the most difficult part of his job. Minister Aso immediately answered, "Personal relationships." He explained that there are many different factions and subjects of expertise represented within the same party, so strong personal relationships are essential for legislating good policies.

Professor David Weinstein, Carl S. Shoup Professor of the Japanese Economy at Columbia University and associate director at CJEB, then asked about Japanese debt levels. It seems that there are three tough choices: the first is to raise taxes, the second is to cut healthcare or pension benefits, and the third is to raise inflation rates, which has proven difficult. What of these three are people most likely to see in the future, if any?

Minister Aso said that they have to work on all of them. The first pertains to the area that has been covered. Considering the lower fertility rates and aging society, the social welfare budget will keep on increasing by 9 billion dollars per year if left unattended. By law, it has been cut in half. Those are the budget items that were reduced, but other budget items need to be increased. For example, the situation developing in the East China Sea means the maritime defense budget needs to be increased, to be followed by air and land defense forces. On the

other hand, the revenue side needs to be increased. The decision has already been made to increase the consumption tax in 2019, but the economy needs to improve enough to be able to sustain this tax.

Lastly, Minister Abe focused on the two percent inflation goal. This effort started when oil prices were at \$100 per barrel, but they are now at half that price. This worked negatively for the price level, but did not work negatively for the economy as a whole. Japan is also the only country since World War II to have experienced deflation, so the challenge is to fight against deflation. There are signs that this will be successful in the second half of 2017.

Merit Janow, dean of the School of International and Public Affairs (SIPA) at Columbia University, then asked what Japan would like to achieve in regards to energy and cybersecurity in the dialogue with America.

According to Minister Aso, currently only Japan and the United States are capable of responding to cyber threats. In talking with Vice President Pence, he emphasized the importance of cooperating on this issue. In regards to energy, because of the shale revolution in the United States, more liquefied natural gas can be shipped to Japan. The demand for energy is constantly increasing, so this could alter the trade balance between the two countries.

Shang-Jin Wei, N. T. Wang Professor of Chinese Business and Economy at Columbia Business School and at SIPA, asked about policies addressing GDP growth in Japan. Are there more government programs to help promote bigger families, and are there plans for immigration reform?

Minister Aso replied that Japan is not currently making plans to accept more immigrants. However, they are considering three policy options. The first is to raise the female labor force participation rate, and to allow the older population to continue working in a comfortable way. The next has to do with robots. They are now on university campuses and in corporate offices,



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and can help with jobs that require heavy lifting. Finally, they are looking at artificial intelligence, or AI. There has been much progress in this area; new super computers can be cooled with water instead of air, and are much smaller than previous supercomputers, using less energy.

A graduate student from Columbia University next asked whether the current political climate would allow for the passage of a consumption tax. He also asked if Japan would continue pursuing the Trans-Pacific Partnership (TPP) without the United States.

Minister Aso responded that, since the economy has improved recently, the climate is more conducive to the consumption tax; this is quite different from the last time the tax was introduced. In addition, the Olympics will be held in Japan in 2020, and this will help boost the economy. Regarding TPP, Japan can go ahead without the United States and continue with the remaining 11 countries, but they need to hold extensive discussions with them. Because of its multilateral framework, there are significant benefits and gains which are conducive to growth. So this is preferable to a bilateral route.

Professor Weinstein then thanked Minister Aso for an engaging discussion that gave new insights into Japan's future.



Left to right: Amb. Reiichiro Takahashi, Taro Aso, Hugh Patrick, Takatoshi Ito, David E. Weinstein, Ryoko Ogino



Left to right: David E. Weinstein, Takatoshi Ito, Taro Aso, Hugh Patrick



Taro Aso with Columbia University students