

JAPAN ECONOMIC CURRENTS

A COMMENTARY ON ECONOMIC AND BUSINESS TRENDS

Japan 2025: Nippon Keidanren's Blueprint for a More Open, Diverse Japan in the 21st Century

by Hideaki Tanaka, Keizai Koho Center-USA Office

But for a couple of years of growth in the mid-1990s, the Japanese economy has trended downward since the "bubble" burst more than a decade ago. Japanese industry and consecutive governments have tried to put the economy back on a healthy track by adopting several economic and social reforms, although their efforts have yet to reverse the economy's poor performance.

Why have bold reform policy proposals failed to bring any apparent results? Why have Japanese lost confidence in their ability for so long? It isn't for lack of trying – definitive changes have taken place on several fronts:

Individuals and companies have broadened their perspective internationally and governments have overhauled laws and regulations. But change has been painfully slow and doubts remain.

Nippon Keidanren, the Japanese business federation, is not complacent about economic stagnation. To the contrary, Chairman Hiroshi Okuda has repeatedly called for bold reform – pointing out that even solid policy proposals have failed to gain traction or have been bogged down by bureaucracy and politics, because of lack of a clear vision for the future of Japan.

Nippon Keidanren's policy paper, *JAPAN 2025 Envisioning a Vibrant, Attractive Nation in the Twenty First Century* seeks to offer such a vision. The paper sets forth the challenges Japan faces and provides a range of policy recommendations on economic, social, and foreign policy matters.

In JAPAN 2025, Nippon Keidanren projects a Japan where diverse values come together to foster dynamism and creativity and the country becomes a beacon to people around the world and a

model for development of all nations in the new century.

"This environment will have deep roots on the level of individuals, being built on the trust between people and their empathy for one another. It will provide chances for those individuals to enjoy true affluence, both economically and in terms of their personal achievement. And it will make Japan a place where individuals from around the world want to spend their leisure time, invest their assets, build their careers and live their lives."

The means by which to realize this new Japan are explored in Japan 2025 and specific recommendations to translate the Nippon Keidanren vision into a reality fall in three key areas: the economy, social structures and international ties.

Economic Policy

The Japanese economy must be reinvigorated to provide the energy to drive the remolding of the nation. Specifically, Keidanren proposes to pursue a "made by Japan" policy in which Japanese business interests, positioned in a broader global context, provide

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present

Economic Policy

The reforms and policies needed to seed new, sustainable growth led by the private sector

- Introduction of a system of taxpayer identification numbers, enabling collective payment of taxes and social security contributions
- Reform of income taxation to spread the burden more equitably and make it lighter
- Lowering of second-tier public pension benefits by 5% in fiscal 2004
- Launch of annual 1% hikes in the consumption tax starting in fiscal 2004, bringing the rate from 5% to 16% by 2014
- Strengthening of cooperative ties between industry and academia
- Deregulations aimed at sparking development of new technologies
- Rethinking of the government's approach to research and development spending
- Major reductions in corporate tax rates
- Promotion of ecologically sound corporate management
- Construction of recycling-based social systems
- Development and implementation of resource-reuse and new energy technologies
- Construction of high-quality new housing and promotion of residential relocation
- Fundamental reform of the tax system to boost new home ownership

Social Structures

The changes required to realize a society where individuals make full use of their talents and energies

- Improvement of corporate governance in Japan
- Establishment of strong corporate identities for Japanese firms
- Improvement of capital markets
- Promotion of mergers of local administrative units
- Stimulation of latent demand through cooperative regional market activities
- Provision of wide-ranging educational services based on competitive market principles
- Introduction of diverse working styles
- Creation of an environment allowing people to both work and rear children
- Legal reform to allow married couples to keep separate surnames
- Conclusion of bilateral and regional agreements on cross-recognition for qualifications in specialist and technical fields

International Ties

The steps needed to form an integrated East Asian economy and strengthen global competitiveness

- Promotion of global economic liberalizations
- Establishment of leaders' and ministers' meetings among 13 East Asian nations (ASEAN and China, Japan, and South Korea); to be held twice annually through 2015
- Formulation of a shared vision for constructing an East Asian free economic sphere

2010

2015

2020

2025

- Reduction of public pension benefits by 11% in fiscal 2011
- Formation of an international system for recycling resources
- Creation of global rules making Japanese firms' knowledge and technologies more marketable around the world
- Construction of urban environments rooted in shared values

- Establishment of Japan as a global center for creating added value
- Expansion of business models based on concepts of recycling

- Potential reduction of the consumption tax rate to 10% (assuming that average annual growth is 3.8% nominal, 2.6% real, and that policies are implemented to augment Japan's shrinking labor force)

- Reduction of the overall tax burden of the people to below 50%
- Achievement of average annual nominal growth of 3.0% and real growth of 2% over the first quarter of the century
- Implementation of new energy supply systems

- Drastic improvement of residential and urban environments throughout Japan
- Achievement of an economically healthy Japan with strong environmental awareness and deep ties to the rest of the world economy

- Establishment of a system allowing individuals to opt for voluntary euthanasia
- Finalization of a system for bringing foreigners to work and live in Japan

- Formation of broad-based networks in the areas of medical and elderly care through linkages between institutions offering various services

- Shift from a prefectural system under a strong national government to a system of independent states

- Achievement of a diverse nation where individuals can live according to their own choices and extend their abilities to the fullest

- Advancement of the five freedoms—in goods, people, services, capital, and information—and two forms of cooperation, to solve economic problems and boost regional growth

- Actualization of the free economic sphere in East Asia, with most nations taking part

- Remaining nations to join the free economic sphere by 2020

- A Japan that has realized its third national opening in the modern era

- Achievement of a vibrant, integrated East Asian economy

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knowledge and technology to drive economic development around the world – not just on Japanese soil. Japan should use its principles of corporate management, native innovation and technology while investing in and sourcing from abroad.

Japan should remold its economy by focusing on sustainable environmental development while fostering industrial competitiveness.

And Japan should create comfortable, high-quality living conditions, especially in urban settings, for its people.

Social Structures

Japan must tighten the corporate governance of its companies and create an economic environment where individuals can fully extend and benefit from their talents.

In the area of politics, Japan should transform itself from a system of largely autonomous states by transferring power from the central government to local authorities. This will go far to extend regional autonomy and strengthen communities.

Japan should create an environment in which the lifestyle choices available to Japanese citizens are expanded and a society that accepts diversity is promoted.

International Ties

For the third time in its modern history, Japan should open itself to the world by providing broad access to its markets and sparking competition and economic growth.

Japan should lead the way in creating a free trade sphere in East Asia, a region of tremendous vitality and diversity that will become a major hub of global economic activity.

And finally, Japan should strengthen East Asian integration by ensuring the free movement of goods, people, services, capital, and information.

I feel confident that by adopting Nippon Keidanren's blueprint and achieving a real economic growth rate of 2 percent per year through 2025, Japan will indeed realize the vision of becoming a "vital, attractive nation." ■

Hideaki Tanaka is the Director of the Keizai Koho Center's US office.

Nippon Keidanren, born in May 2002 as a merger of Keidanren (Japan Federation of Economic Organizations) and Nikkeiren (Japan Federation of Employers' Associations), is Japan's most influential private sector organization in Japan. Nippon Keidanren is a sister organization of Keizai Koho Center, the Japan Institute of Social and Economic Affairs. The KKC-USA office represents Nippon Keidanren's interests in the United States.

The report and its accompanying timeline to achieve a "vibrant, attractive nation" by 2025 can be found at: www.keidanren.or.jp/english/policy/vision2025.pdf

Defusing Japan's Demographic Time Bomb: The Medical Technology Solution to Japan's Impending Healthcare Crisis

by Raelyn Campbell, The Advanced Medical Technology Association

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With the elderly portion of its population expected to eclipse 25 percent by 2025, Japan is sitting on a demographic time bomb. This phenomenon has broad implications and will require bold new solutions if the Japanese government hopes to prevent a precarious situation from developing into a full-blown crisis.

In its recently released "Vision for the Medical Device Industry," Japan's Ministry of Health, Labor, and Welfare (MHLW) points to medical technology as an attractive solution. Medical technology can go far in helping meet Japan's demographic challenges, of course, but a fundamental shift in Japan's approach to healthcare is necessary to make critical systemic improvements.

Japanese healthcare is at a turning point. The universal coverage and high quality of care that have been the hallmarks of Japan's national health insurance (NHI) system are threatened by the financial pressures that stem from dramatic growth of its aging population. Like all advanced countries, Japan's medical system has shifted from managing infectious diseases such as polio, smallpox, and tuberculosis to lifestyle diseases like diabetes,

heart disease, and cancer. With the skyrocketing prevalence of long-term chronic illness, the total system costs of treatment have soared. The success of its improved patient survival rate has put the NHI system in financial jeopardy, and the situation will only get worse before it gets better.

The Japanese population remains relatively healthy and boasts the longest average life expectancy rates in the world – 77.6 years for men and 84.6 years for women in 2000. But the burden that this growing cadre of elderly imposes on Japanese society is rising sharply. While only 12 percent of the population was in the over-65 age bracket in 1990, this proportion has reached 17.6 percent. Demographers expect the over-65 population to climb to around 30 percent by 2025.

In the meantime, Japanese birth rates have plunged to 1.3 children per woman, an all-time low, and the working-age (15 to 65 years old) portion of the population has been shrinking since 2000. The ratio of working-age Japanese to elderly Japanese will fall dramatically in the next 20 years – from 3.9:1 to 2:1.

During that same period, annual spending on healthcare will soar

from ¥30 trillion to over ¥80 trillion. Clearly, an increasingly smaller group of workers will have to provide the financial support for a healthcare system with ballooning costs related to care for the elderly.

Beyond the direct financial costs of maintaining the health of a graying population, there are numerous indirect costs of providing care for large, chronically ill patient populations that typically go unmeasured. Currently, over 1.6 million Japanese elderly suffer from senile dementia and more than 800,000 of the elderly population are characterized as "netakiri roujin" (the bed-ridden elderly) who require full-time care at home, often by family members. The demands of caring for this demographic group are substantial. In addition, enormous time and resources are devoted by family caregivers to caring for this population — caregivers who otherwise could be wage-earning workers.

One source of solutions to the growing problems of chronic long-term care and other healthcare burdens is the use of new technologies that allow the healthcare system to maximize the use of available resources.

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But access to the latest technology in Japan is hampered by regulations and other barriers that have blocked the growth of the medical technology industry. The absence of a venture capital culture and a good capital accumulation environment hinder investment and growth. Private investment in healthcare-related industries in Japan is remarkably low by international standards: while U.S. medical technology companies invest 13 percent of sales in research and development, Japanese investment levels in this sector stand at less than 5 percent. Businesses are struggling, and the "hollowing-out" phenomenon that is prevalent in other industries in Japan has taken a heavy toll in the healthcare sector as companies have in large part relocated research functions and production facilities overseas.

There is growing awareness of the impending crisis in Japan. Demands for reforms to help Japan's healthcare system and medical technology industry adapt to the needs of the 21st century are widespread. The Japanese government has responded by issuing its "Vision" document for the industry, and by calling for reforms to the health insurance system and a doubling of foreign

direct investment (now accounting for only 1.1 percent of Japan's GDP).

Unfortunately, while these initiatives have succeeded in identifying clear and admirable goals to foster the growth of the medical device industry, developing a sustainable high-quality healthcare system, and promoting the growth of key industries through investment, they all have stopped short of offering prescriptions for how these goals can be achieved.

What Japan needs is a fundamental shift in its approach to healthcare, a shift away from a system that fosters inefficiency rather than innovation. For the most part, medical technology has been an untapped resource in Japan where healthcare is predicated on antiquated assumptions of short-term treatment needs. The insurance system rewards frequent visits and long hospital stays, while providing poor returns for more advanced procedures with the potential to contribute to better quality of life for patients and their families and reduced long-term costs. Not surprisingly, the result is poorly allocated resources, including considerable funds spent on hospital lengths-of-stay averaging 41 days – almost three times longer than the average for other wealthy industrialized countries (OECD Health Data 2002).

Heretofore, medical technology has been viewed as a cost-driver, due to the focus on the immediate cost of a product rather than a more holistic consideration of the broader long-term benefits of the use of the product to the patient and the patient's family, society, the healthcare system, and the economy. This approach overlooks the fact that technology can contribute much to resolving the challenges of an aging population – if the healthcare environment provides the right incentives for its use.

Research shows that access to the newest therapies can actually reduce or eliminate disability in older patients and curtail the need for the most expensive, long-term chronic care. A 2001 Duke University study¹ found that the adoption of technology-based healthcare solutions was a likely factor in a significant drop in the number of disabled seniors in the United States (from a projected 9.3 million to an actual 7.0 million in 1999) that contributed to a reduction in disability and an estimated savings of \$19 billion on chronic care in 1999 alone.

(See chart on page 7)

Moreover, by reducing hospital stays and disabilities among workers, medical technologies can help increase economic productivity. For example, studies have shown

that access to just three types of minimally-invasive medical procedures – gallbladder removal, hysterectomies, and hernia repair — in the U.S. provided an estimated total savings of almost \$2 billion per year to employers of working-age patients.²

Current policies in Japan stifle innovation and are counter-productive to the stated goals of enhancing quality of care and fostering the growth of an industry that is so key to addressing the needs of Japan's aging society and stagnant economy. On the regulatory side, approvals of new technologies currently take far more time on average than such reviews in Western systems; there are even cases of products on the Japanese

market being generations behind models that are available to patients in foreign markets.

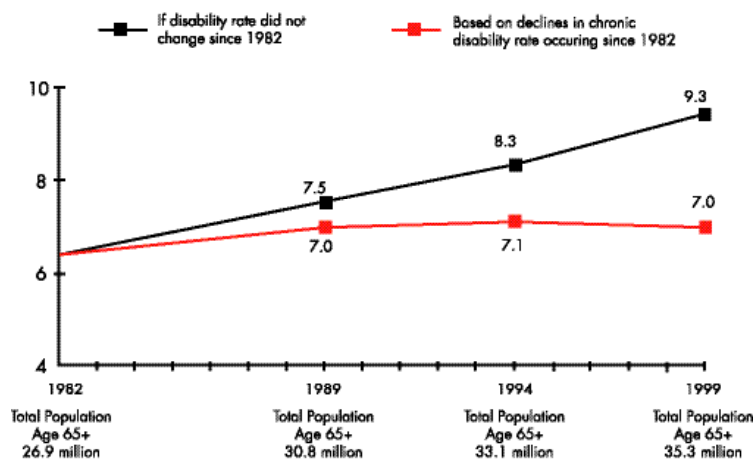
Moreover, existing payment practices, such as the tendency to set pricing for most new products at the same level as precedent models regardless of innovations that may contribute to improved quality of life or cost-savings, naturally fail to provide incentives for investment and innovation.

Innovation is the foundation of medical technology, but development of a product involves more failure than success, at considerable cost to companies. Policies that encourage and reward innovation are necessary; reforms to promote such, including streamlined reviews and premium pricing

incentives for innovative products, must be implemented if the Japanese government expects to stimulate the investment and innovation it is seeking.

A shift in Japan's approach toward a longer-term view on healthcare should underpin such changes. As a starting point, leaders should recognize that becoming old is not the problem – becoming disabled is. Japan cannot prevent its society from aging. With the adoption of policies that reward innovation and promote rapid access to new technologies, it can, however, minimize the amount of disability and long-term costs of care and transform its aging "problem" into an opportunity for growth. ■

PROJECTED VERSUS ACTUAL DISABLED ELDERLY NUMBER OF CHRONICALLY DISABLED AMERICANS AGE 65 AND OVER (IN MILLIONS)



SOURCE: MANTON, ET AL.

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¹ Manton, K., Gu, X., "Changes in the Prevalence of Chronic Disability in the United States Black and Nonblack Population Above Age 65 from 1982 to 1999," Center for Demographic Studies, Duke University. May 22, 2001.

² "The Importance of Indirect Benefits When Evaluating New Medical Technologies: A Case Study," by DRI-McGraw Hill for the Health Care Technology Institute. February 1995.

Hideaki Tanaka Farewell Message

Time goes by so very quickly. Since my arrival in the United States three years ago, my colleagues and I have worked hard to promote a better understanding of Japan, especially recent economic developments.

To this end, we initiated several new lecture series, including the Japan Business Dialogue program, the annual Japan Caravan, and Heads Up on Hot Topics Affecting the US and Japan, launched a monthly newsletter *Japan Economic Currents* about important matters in Japan and the United States, and created a Website to provide a wide range of information about Japan.

During my tenure in Washington, DC, I have made many good friends, enjoyed many frank discussions and, hopefully, have contributed in some small way to better understanding on both countries. Our shared activities have been constructive and need to be continued in the months and years ahead, by both sides of the Pacific.

Though the Japanese economy remains weak and reforms are only slowly taking root, important changes are underway. Japan of course, still is the world's second largest economy and remains America's closest and strongest ally in Asia. Twenty years ago, Ambassador Mike Mansfield famously declared, "The U.S.-Japan relationship is the most important bilateral relationship in the world, bar none."

His words ring just as true today. Economic ties between our two countries have been dramatically strengthened during last 30 years. The U.S. is Japan's largest trading partner and the largest recipient of investment from Japan. More than 820,000 American workers were employed at Japanese owned U.S. companies. And Japan is the third largest buyer of American products, after neighboring Canada and Mexico.

After three exciting years, my family and I will be returning to Japan later this month. Mr. Katsunori Nemoto will succeed me as Director of the U.S. office and will carry our important task of deepening understanding and cooperation between America and Japan. I wish to thank you for your support and ask if you would extend the same friendship and hospitality to Mr. Nemoto.

Hideaki Tanaka, Director

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Keizai Koho Center (KKC) is an independent, non-profit organization designed to promote the understanding of Japan's economy and society at home and abroad. Its financial resources are derived entirely from the private sector.

KKC fosters a deeper understanding of Japan's basic social structure. Furthermore, it conducts public affairs activities to improve the Japanese people's recognition of Japan's global role.

The views expressed in this newsletter are of the contributors and do not necessarily represent those of the Keizai Koho Center.