

JAPAN ECONOMIC CURRENTS

A COMMENTARY ON ECONOMIC AND BUSINESS TRENDS

Keidanren's Perspective on Japanese Constitutional Policies

by Keiichi Nagamatsu, Nippon Keidanren

Earlier this year, on January 18, Nippon Keidanren (the Japan Business Federation) released its first set of policy recommendations on basic national issues, including a revision of the Japanese constitution and diplomatic and national security policies.

The report was composed by the Committee on Constitutional Policy. Chaired by Shigemitsu Miki, the Vice Chairman of Keidanren and Chairman of the Board of the Bank of Tokyo-Mitsubishi, the committee was established in July 2004 to consider issues that Keidanren considered but had yet to resolve.

The committee's task was to address a host of problems that go to the very heart of Japan's future – a rapidly aging population and declining birth rate, as well as a variety of risks and dangers inherent in today's changing world.

The committee invited scholars and experts to contribute to its broad discussions on Japanese history, constitutional law, national security, and diplomatic policy. And the committee incorporated into its conclusions the basic policy recommendations offered by other committees of Keidanren, such as educational reform, declining population, national budgetary problems, science and technology policy, as well as energy and environmental issues.

Report Findings

Necessity for the New National Foundation

Japan faces challenges both home-grown and external and must better manage the dangers posed by terrorism perpetrated by non-state actors, natural disasters, rising crime rates and viciousness – all set against the backdrop of a national birthrate below replacement levels and an aging population. Drastic measures that will cut incisively into the basic framework on which the nation has thus far been based, are essential. Nothing short of a new foundation is required.

That said, it is important that Japan hold firm to the basic principles on which it was built – democracy, freedom and peace – acting on its own initiative to secure and attain them.

To this end, Keidanren set forth its recommendations aimed at helping Japan realize an idealized image – a state that is trusted and respected by the international community, a state that achieves economic prosperity and spiritual richness, and a state that is just, fair, secure and safe.

National Security and Diplomatic Policy

Lacking natural resources, and thus wholly dependent upon trade, it is essential for Japan's prosperity to achieve peace and stability in the international community and cooperate with other nations in solving global community problems. Using its economic and technological strengths, Japan should practice and work to preserve and expand free trade, and enhance mutual relationships focusing on economy and industry. For this, skilled diplomacy is required.

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Japan should maintain and strengthen the Japan-US security alliance. Japan should also work actively to become a permanent member of the United Nations Security Council. Beyond the security considerations, it should build closer, cooperative relationships with the US through human exchanges and candid discussions that will deepen mutual trust.

To enhance cooperation with countries in East Asian region, Japan should enter into Economic Partnership Agreements (EPAs) with South Korea, China and the ASEAN countries. In addition, an East Asia Free Economic Zone should be created as soon as possible, in which Japan should exert leadership. In promoting this, the relationship between China and Japan is quite important.

In the field of international security, Japan should engage in the fields of conflict prevention and assistance in reconstruction as well as development. Japan's Self-Defense Forces (SDF) having been highly regarded in cooperative activities with the international community, and these should be expanded. In doing so, a basic policy on SDF activities, including the scope and the extent of overseas activities, should be clearly delineated, and a general law to that

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effect – not "special measures" provisions – should be enacted.

The "Security Council of Japan" should be fundamentally reinforced. Under the leadership of the prime minister, a system should be established to deal with national security issues continually and comprehensively. Recovering a level of public safety and ensuring sea-lane security are both pressing issues. In addition, it is necessary to improve the ability to gather, analyze and control information and intelligence for strategic diplomacy, prevention of crises, and so forth. Better coordination between government ministries and agencies would do much to further these goals.

Revision of the Constitution

As it stands today, Japan's present Constitution, especially in the preamble and Article 9, seems outmoded. Among other things, debate over interpretation of Article 9 has long been "theological" and seemingly endless. Public confidence in the Constitution has substantially declined as a result.

Specifically, while Paragraph 1, Article 9, which is built on the philosophy of "peace" should be retained, Paragraph 2 shows obvious divergence from the reality. The existence of the Self-Defense Forces in order to exercise the sovereign right of self-defense should be recognized in constitutional terms. It should also be explicitly stated that the role and duty of the SDF are to protect Japan's sovereignty and independence, preserve peace, and both contribute to and cooperate with the international community in activities for international peace.

The Constitution should also make clear that the right of collective self-defense may be exercised to secure Japan's national interests and international peace. At the same time, a fundamental law on security should be enacted to provide for rules and measures to limit and control the exercise of such rights – such as requiring advanced approval by the Diet, taking international situations, as well as areas and types of activities, into consideration.

Without waiting for a formal amendment of Japan's Constitution, necessary measures should be implemented immediately to lift the constraints from a rigid interpretation of the current Constitution, which would legally permit necessary activities for security.

In addition, requirements for amending the Constitution are too strict. Conditions for revision, including the motion to propose for the constitutional revision, should be eased so that necessary revisions become available promptly based on the will of the people whenever necessary. As an immediate matter, it is essential that new legislation providing for a national referendum on revisions to the Constitution be enacted as soon as possible.

As an initial step, Paragraph 2 of Article 9 (not to maintain war potential) and Article 96 (revising the Constitution) both of which diverge greatly from reality today should be revised as a precursor to an indispensable – and overdue – nationwide debate on the Constitutional revision.

Building a More Democratic and Efficient Government

In order to accurately reflect the opinions of the public, it is necessary to fairly and equally allocate the electoral seats to the House of Representatives among

each electoral district corresponding to the change in population. At the same time, new voters should be educated about social rules so that they can more responsibly participate in the political arena and engage in civil discourse.

Voluntary political contributions are important means for people to participate in politics. Political parties should use donations from the private sector to strengthen their ability to draft and promote policy recommendations. Full and transparent public disclosure of campaign finances is necessary as well. Legal and tax systems should be established or improved, including a fundamental review of the Political Funds Control Law.

Rights and obligations, freedom and responsibility, are two sides of the same coin. Accordingly, government itself must become more efficient and accountable. As to the legislative branch, the functional distinction between the House of Representatives and the House of Councilors is blurring. The roles and functions of each House must be distinguished based upon each unique character, and the legislature must utilize the benefit of bicameral system. At the same time, Members of Diet should not depend too much on the government's bill proposals and

drafting. Instead, they should enhance their policy making ability and actively engage in legislative drafting.

As to the executive branch, it is necessary to review the reorganization of ministries and agencies comprehensively, to strengthen the functions of the Cabinet Office, to eliminate bureaucratic sectionalism, to drastically reform the civil service system, to expand political appointments and to seek the sources of government officials widely from the private sector.

And as to the judicial branch of government, it is necessary to strengthen the Supreme Court's power to determine the constitutionality of a law. Relationships between the government and local municipalities should be reviewed.

Other Fundamental Issues

Education

Moving beyond the concept of homogeneous human resource development – the foundation of Japan's post-war prosperity – Japan should carry out bold education reforms based on the principles of diversification, competition and evaluation. It is important that a system be established that allows diverse parties to participate in education. A system should be

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introduced to distribute subsidies for education based on the choices by the students and their parents. It is also important to review education related to tradition, culture, history, politics and religion, and to evaluate teachers and schools.

Decline in Population

As of 2007, Japan will experience, for the first time in its post-WWII history, a declining population. Accordingly, it should

new industries for the prosperity of the nation. Human resources must support the development of science and technology. Reformation of the education system so as to secure the necessary people in technical fields is urgent.

National Budget

Japan's national budget is in a critical state. Action is simultaneously needed in three areas: controlling government spending; securing revenues by

that are also likely to generate vigorous energy demand. Japan should also make further efforts to develop energy and environment related technologies.

Japan also depends on other countries for food. It should ensure a stable supply of food by appropriately combining imports, stocks, improvements to the competitiveness of domestic production, and international cooperation.

Looking Ahead

Keidanren will continue to promote its efforts to widen civic discourse on these wide-ranging issues by publicizing the report at various appropriate occasions in order to widely promote and stimulate the discussions on the constitutional policies of Japan. We sincerely hope that the report will contribute to raise the awareness of the people and lead to the building of the better nation in the future. ■

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create social mechanisms enabling the fuller utilization of women and the elderly. At the same time, as it expands measures to deal with a falling birthrate, it should promote the acceptance of foreign workers.

Science and Technology

The government's role in science and technology is manifold: to promote long-term and/or large-scale research and development projects that are too costly for private industries to adequately pursue; to maintain and develop technologies the nation must possess for its technological security; and to provide the infrastructure for, and guide the development of technologies into,

increasing the consumption tax; and stimulating economic growth. The most important issue in control of government spending is reform of the social security system. The most effective way to secure revenue is to raise the consumption tax rate.

Energy, Environment, and Food

Japan's Achilles' heel is energy. A stable energy supply must be secured, consistent both with environmental and economic concerns. Sources should be diversified to avoid the risk of over-concentration. Japan should strengthen its cooperative efforts to secure energy, and to develop energy resources, etc., with China and other countries in East Asia,

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The Adjustment of Global Payments Imbalances

by John Williamson, Institute for International Economics

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The dollar peaked about three years ago, near the beginning of 2002, and has since fallen by some 16 percent on the Fed's broad real index (up to the beginning of February 2005). Combined with the much more robust growth of the US economy than most other countries (except China), the high value of the dollar induced a massive current account deficit in the United States. This was over \$600 billion in 2004, some 5.6 percent of GDP. Even if the deficit did not grow further as a proportion of GDP as US debt—and therefore debt servicing—builds up, the debt/GDP ratio would on these figures grow to over 100 percent, assuming a growth rate of nominal GDP of around 5 percent.

Such a level, if sustained, would by all historical precedents lead the United States into crisis.

The counterpart surplus is spread around most of the rest of the world: in Japan, China, the new industrial economies of East Asia, most other Asian economies, the euro area, Switzerland, Denmark, Sweden, Russia, Canada, the Middle East, and even traditional deficit regions like Latin America. Adjustment will require the surplus countries to move toward deficit; arithmetic says that this is a

necessary counterpart to any reduction in the US deficit.

Policy-wise, adjustment requires both actions to relocate demand from the United States to the surplus countries, and exchange rate changes to induce spending on tradable goods to be redirected from the surplus areas to the United States. Dollar depreciation without the accompanying changes in spending (and thus saving) would result in inflation in the United States and deflation in the surplus countries.

Changes in spending and saving without the exchange rate changes would mean the opposite: too little demand, and thus wasteful deflation, in the United States, and excessive demand, and thus a

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threat of inflation, in the present surplus countries. Successful adjustment with continuing non-inflationary prosperity requires changes in both exchange rates and aggregate demand (both in the United States and the surplus countries).

Last May the Institute for International Economics (IIE) held a conference where there was a large emphasis on trying to get a fix on what sort of exchange rates would help to foster an adequate US adjustment. We concluded that, despite the fall in the dollar that has occurred in the past three years, there would be a need for a substantial further decline yet. The 16 percent decline that has already occurred takes us about half way to where the dollar probably needs to go, although there is some danger that, to counter the very adverse trends that come from asymmetrical elasticities, the much higher level of imports than exports, and the growth of debt servicing obligations, even this will not be

enough. However, some currencies—those of European countries and the Anglo-Saxons—have so far carried the overwhelming bulk of the burden of adjustment. Asian countries will need to contribute the bulk of the

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change in phase II of the decline of the dollar.

We regard the Chinese renminbi (RMB) as a key currency in this connection. This is not because we imagine that an appreciation of the RMB will cause a large relocation of jobs and production from China to the USA, but because we believe that all other Asian countries—even including Japan to some extent—look over their shoulders and worry about the danger of an excessive loss of competitiveness vis-à-vis China. Hence to get other

number of years in the 1990s and early in this decade the country suffered from a shortage of aggregate demand, despite expansionary fiscal and monetary policies. Under these circumstances it seemed unrealistic to expect Japan to contribute in a major way to the international adjustment process. If it were impossible to engineer a demand expansion, then a yen appreciation would have led to unemployment and wasted resources.

understand that this need imply little further appreciation in the effective rate if it occurred in conjunction with revaluation of the RMB and appreciations of other Asian currencies.

It is one thing to identify the exchange rates that would be consistent with adjustment, but in the real world today most currencies float. Markets, not governments, decide what exchange rates will be. Given that fact, one can ask whether it is helpful to think about what exchange rates would be needed to achieve certain outcomes. We think this is excessively nihilistic.

Some governments (notably those of China, Hong Kong, and Malaysia) still maintain fixed exchange rates, and it is an important policy question whether the rates being fixed are in the national and world interest. (And it is quite unpersuasive to assert that this is an exclusively national question that the rest of the world has no right to "interfere" in: an exchange rate is by definition the ratio of the value of TWO national currencies, and is thus inherently an international and not an internal question.)

Other governments, including most Asian governments and

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countries to undertake, or allow, a revaluation of their currencies, it will be necessary to persuade China to participate.

Conversely, if all the Asian currencies move together, then a change in their dollar parities will bring only modest losses to their overall competitiveness. They will all be able to afford relatively large appreciations against the dollar.

The particular feature of the Japanese situation is that for a

One of the implications of last year's growth recovery in Japan is that this is no longer true. It is becoming increasingly natural for the world to treat Japan as a normal country, which can and should allow the yen to appreciate along with the other Asian currencies, while it prevents that leading to the growth of unemployment by an expansion of demand. The sort of yen level that was felt to be appropriate was around 90 yen to the dollar, though it is important to

certainly that of Japan, make a practice of sometimes buying or selling reserves against their national currency with the objective of influencing the exchange rate. We had one paper at the IIE conference that presented evidence that such intervention could be effective in influencing exchange rates if it were undertaken when these deviated in an extreme way from equilibrium. Another paper argued that governments could hope to influence their exchange rates by oral intervention ("jawboning", as it is sometimes called) as well as buying or selling foreign exchange.

Our view is not that intervention is wrong and should be outlawed in favor "real" floating, but that intervention should be undertaken in order to further internationally agreed exchange rate objectives

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rather than on national whims. That means one needs a mechanism to establish international agreement on what objectives would be reasonable, but that is for a future agenda, rather than something that is discussed in our book.

As emphasized above, achieving supportive exchange rates is only half the issue. The other half is to persuade countries to adjust their aggregate demand policies—typically fiscal and monetary policies—in such a way as to be consistent with the needs of both domestic growth and the balance of payments.

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For the United States, this would mean restrictive demand policies. Most economists would dearly like to see a more restrictive fiscal policy. In practice this would mean reversing the Bush administration's tax giveaways to the rich, but this seems politically unlikely, at least in advance of a crisis. Hence the conclusion that US interest rates are at some stage likely to rise a lot more sharply than is currently being discounted by the market.

For China, there would be no need to expand demand, which is already tending to be excessive. The Chinese government could use an RMB revaluation as an alternative to the administrative measures it implemented in late 2003 to restrain demand. All it would need to do simultaneously with revaluation is to relax the clampdown on bank lending, which would be restrained instead by the ending of the speculative inflow once the market was convinced that there was no further prospect of big gains from currency revaluation.

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In contrast, other surplus countries would need to expand demand, in order to increase the demand for non-tradables to offset the fall in demand for tradables when their currencies appreciated. In a number of cases, notably in the European Union and even more in Japan, this would be a policy challenge. Fiscal expansion is constrained in Europe by the Growth and Stability Pact. There is limited room for monetary expansion, though the most the European Central Bank seems inclined to do at the moment is to delay the rise in interest rates longer than it might otherwise do.

In Japan fiscal expansion is constrained by the high level of public sector debt, while monetary expansion is impractical because the interest rate is already zero. There is no question that this makes expansionary policy more difficult than under other circumstances, but it is too defeatist to assume that it rules it out. Financial innovations that allow the elderly to increase consumption by drawing on their accumulated wealth (e.g. using a reverse mortgage to finance an annuity) seem particularly promising.

What is needed seems fairly clear. Whether it will happen, and if so when, is another matter. ■

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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.

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