Where is Japan heading ? Quo vadis, Japan?

Lecture by H.E. Keiichi Hayashi,

Ambassador of Japan to the Court of St James's,

at the Cambridge Union,

University of Cambridge

on Tuesday 12 November 2013

1. Introduction

The first Cantabrigian I came to know about was Bertrand Russell, when I took up as supplementary reading for my high-school English class his book entitled "Boredom and Excitement". It was actually an excerpt from his book on happiness, entitled *The Conquest of Happiness*.

He observed, "A certain power of enduring boredom is (therefore) essential to a happy life, and is one of the things that ought to be taught to the young."

I know I am feeling tense facing such an august body of elite students but I can take a little comfort from his words because, if my speech is interesting, it will be tolerated, whereas if it is not, at least I will have provided an opportunity to young students in Cambridge to learn how to endure boredom. So a warning has been issued!

I am honoured to be here today at this historical Cambridge Union. Firstly I would like to say thank you to Cambridge University. Thank you for its contribution to the selection of Tokyo as the host city for the Olympics and Paralympics in 2020. In fact, our opening speaker at the decisive final presentation in the IOC meeting was HIH Princess Takamado, who read Anthropology and Archaeology at Girton College here in Cambridge.

Her elegantly eloquent opening salvo turned out to be a crucial *coup de foudre* and gracefully grabbed the hearts of the IOC members. I do not have a record of whether she had a chance to hone her debating skills in this Union or not, but I am certain that her education in Cambridge played a critical part in her historic performance in Buenos Aires in September.

2. Japan's current challenges

Today, I would like to try to talk about Japan – where it stands now and where it is going. I hope to clarify some myths and enigmas concerning

the country by raising a few questions and then answering them.

Japan still remains No. 3 in the world in terms of the size of the economy. But for the past twenty years or so, its profile has been very low due to the sluggish growth caused by the spiral of deflation. Japan had apparently disappeared from the radar screen on the international scene until Prime Minister Abe came to power with his policy known as Abenomics at the end of last year. There is presently a surge of interest in Japan, coupled with a surge in the stock market. Let me look at the current condition of Japan's economy.

(1) What are the economic and financial conditions facing Japan?

One of the reasons why Japan had to be downgraded was its staggering fiscal condition. The Japanese Government's total accumulated debt is over ¥1,200 trillion, or 7.5 trillion pounds, or well over 200% of the country's total GDP. This is probably the worst figure among the advanced economies, while we now have a trade deficit caused by a massive increase in our energy bill due to the near shut-down of our 50-plus nuclear power plants. So it looks as if Japan was fast rolling downhill.

But not necessarily. You may wonder why the yen is still hovering around 100 yen per US dollar, instead of tumbling to 150 yen or even 360 yen like before. Why is global money still flowing to the Tokyo market?

The reason is that, although Japan may be the nation with the world's worst *governmental* fiscal deficit, at the same time it is the world's largest creditor nation with net international assets worth about 2.1 trillion pounds, which are owned primarily by the private sector. Japan's total individual financial assets amount to ¥1,500 trillion. In fact, Japan's private sector seems to be rich! Obviously I have chosen the wrong profession, but it is too late!

At the same time the consumption tax rate in Japan is still low; a universal tax with no exemption or a mitigated rate, as is the case now, can produce roughly 1.5 times more revenue than the selective taxation in effect in the

UK. A 1% increase in Japan could create tax income of ¥2.7 trillion a year, or £17 billion. A 15% increase to the UK level of 20% could theoretically generate additional revenue of ¥40 trillion, or £255 billion. That amount could easily fill the annual gap between Japan's national revenue and its budget. In other words, there would be no more *annual* fiscal deficit.

Of course that is theoretical, and such a hike could depress consumption so much that it might not generate the tax revenue as projected, while the political fallout would be incalculable. But the world market rallies around the Japanese yen despite the massive Government deficit as it sees the potential for the Japanese economy to repay the debt.

Furthermore, the composition of the Government debt is heavily domestic: less than 10% is owed to foreign creditors, which means that, despite this huge fiscal deficit, Japan's Government bonds and its currency remain less susceptible to speculative foreign interventions than, for example, those of the Euro countries.

(2) Is Japan losing its international competitiveness?

China and South Korea are now the dominant forces in supplying the global consumer goods market. Samsung and Haier have become familiar household names, apparently driving out Japanese products. But by looking at the situation more closely, you will see a slightly different picture. Japan's global share of R&D spending is the world's third largest (at £110 billion); Japan's global share of patent applications is 22.5%, second only to the US.

As an example of Japanese technological superiority, I would like to touch on some facts about Japanese railways. Japan's high-speed rail network, the Shinkansen, is the crystallisation of the most advanced technology and system software as well as the highest level of professional dedication. The Shinkansen, operated by the Japan Railways company JR Central, connects the distance of 550 km between Tokyo and Osaka, slightly longer than the distance between London and Edinburgh, in two and half hours. It is operated with a daytime frequency of almost one train every four minutes, with a typical train having 1,300 seats. But it has an annual

average delay of only half a minute.

Another Japan Railway company, JR East, carries 17 million people, including 13 million in the Metropolitan Tokyo area, per day, which is the largest such number for any railway company in the world. In total the Shinkansen has carried over 10 billion passengers since the start of operations in 1964, while maintaining a perfect safety record of "zero passenger fatalities" for 49 years.

It is a well-known fact that, when the 2011 Great Earthquake and Tsunami struck, all of the 19 Shinkansen passenger trains running in the affected area of Tohoku, including two running at the maximum speed of 270 kph, stopped safely with no derailments and no casualties at all. This was largely because JR East's Urgent Earthquake Detection and Alarm System sensed early signs of a big earthquake and immediately slowed down the trains just seconds before the full tremor hit the area. We have developed a technological system where the highest speeds are achieved, but never at the expense of safety.

Japan still maintains a large global share of some key components of consumer and capital goods, including machine tools. For example, more than 90% of hybrid automobile motors and almost 90% of SAW (surface acoustic wave) filters, which are key components for smart phones, are from Japan. China may now be the leading producer of machine tools in terms of the total volume, but Japan's global share in CNC (computerised numerical control) automated lathes, highly advanced mother machines, is still around 80%. In the area of construction machinery, a number of Japanese firms maintain top-ranking global shares. Seven Japanese companies remain in the list of the leading 25 producers of semiconductors.

What is happening in relation to the business pattern affecting Japan is: (a) the changed production system in the world with an increasing division of labour among East Asian producers; and (b) the continued excellence of Japanese technology in key areas.

(3) Is China perceived as a threat to Japan as it overtakes Japan in economic terms?

Let us take a brief look at the post-war history of the Japan-China economic relationship. Japan was very keen to provide economic aid to China after the normalisation of ties in 1972, while the country was still very poor and faced with the massive task of development. Our official economic assistance to China has exceeded 30 billion pounds over the last 30 years. The international airports in Beijing and Guangzhou, steel mills in Baoshan and the underground system in Beijing were all made possible through Japan's financial and technical assistance. I am not saying that China's modernisation would not have been possible without our aid, but it is also a fact that we helped to remove the bottlenecks for development and to smooth the process of modernisation. We are happy and in a way even proud to have made such a significant contribution to China's development.

Now numerous Japanese businesses make many of their products in China. In doing so, these companies based in China import many components that are made in Japan for producing finished products to be exported to the global market, including Japan. This is evident in our trade data. Up until the late 1980s, when the share of Japan's trade with China was hovering at around 6% of our total trade volume, Japan used to export more than it imported vis-à-vis China; the mainstay of Japanese imports comprised natural resources or cheap everyday goods, while Japan exported finished products and machinery. This reflected what could be called a vertical division of labour.

However, this structure has undergone a fundamental change since the 1990s. With China opening up for foreign capital investment, there has been a massive influx of Japanese and other foreign capital into China to establish manufacturing businesses taking advantage of low labour and other costs. Japanese companies have also swarmed in to shift their production bases there, exporting to China technology and key components as well as high-value-added products directly or through subsidiaries in Southeast Asia and then in turn exporting from China competitive finished products to other countries, including Japan.

China has thus been Japan's No. 1 trade partner, ahead of the US, since 2004, and for China Japan ranks as No. 2. As we note that exports of

finished products from China to the US have dramatically increased over the same period, it can be assumed that many of the finished products made in China using Japanese technology and key components are eventually sold to the US.

Admittedly this is an oversimplified explanation of our mutual dependence, but the essence is there. China and Japan have now come to enjoy a truly mutually-beneficial and mutually-dependent relationship. All in all, Japanese private investment to China is estimated to have exceeded £60 billion. There are more than 22,000 Japanese companies operating in China, exceeding those from any other country. And those companies have created more than 10 million jobs in China. Crucially, they have constantly transferred technology so as to enable the local businesses to continually upgrade the level of their products.

Accordingly, the production pattern in East Asia has changed. It is now a more horizontal international division of labour. The East Asian economy is now more unified and Japan provides advanced technology and plays a key role in it. Our economic relationship is now so intertwined that it would be impossible for us to divorce without incurring huge damage to both sides. Cooperate and co-prosper: that is the principle we have adopted now.

(4) Is the fast ageing of its society a fatal long-term factor for Japan?

The ageing of society is proceeding apace in Japan, with a marked decline in the birth rate (to less than 1.4 in recent years), and seems to be threatening the future of social security and medical care in the country. In fact, in 2005 Japan became the most ageing society in the world. It is estimated that about 25% of Japan's total population is now over 65 years old. What a stark contrast to the time I was born 60+ years ago, when the same age group accounted for just about 5%!

Of course, undoubtedly similar challenges will present themselves to the UK and many other advanced economies as well as currently emerging countries like China or even India, as higher incomes will almost inevitably spur longevity and encourage smaller families. But it looks as if Japan is

leading the pack in this apparently ominous race.

But is the ageing of society coupled with a shrinking population really a bad thing for Japan? In fact, employing and feeding a growing population has been a nightmarish task for some nations. Is longevity going to prove as serious a nightmare, or even worse? What are the cures? The possible answers we might have in Japan are: women, old people and foreigners, or a combination of these.

(a) First, let us look at the role of women in Japan. Fortunately or not, the social and economic participation of the female population is still low in Japan for an advanced economy. It has been pointed out that, in terms of the access to tertiary education as well as employment conditions in the private sector, Japanese women have been put in a much inferior position to men compared with the situation in other advanced countries. For instance, only around 5% of senior management positions are held by women in Japan, which is fairly low compared to the figure of around 20% in the UK.

There is nothing to be proud of in the current situation in my country, but it does provide potential to be cultivated, and that is the point Prime Minister Abe made when he coined the term *Womenomics* in his address at the United Nations General Assembly in September. He declared that Japan will now make social changes to encourage far greater participation by women in the process of its economic revitalisation. Thus he said, "I wish to bring about 'a society where women shine'." It is widely believed and argued that Japan's economic growth rate will increase to the extent that we boost women's participation in society.

Mr Abe will push such a policy. Now the Japanese Government is trying to create an environment where it is much easier for women to work. For example, many mothers in Japan are currently having difficulty in finding childcare while they are working because there are simply not enough of the necessary facilities such as accessible crèches for their children. Our Government is now trying to resolve such problems. We are also trying to make it easier for women to return to work after having children.

(b) Second, what about silver power?

Japan is aiming to turn this social liability of ageing into an economic asset. If necessity is the mother of invention, we can say we are in a way set to be in pole position as regards creating services, industry and technology suitable for such a mature society.

In order to take care of the aged and disabled, new commercial opportunities will emerge in developing care robots, or robot suits and other ageing-related businesses; already some experimental businesses have been set in motion in this regard. We expect that the market scale for businesses involving health, nursing care for elderly people, medical supplies, medical devices and regenerative medicine will expand dramatically. The market size for robots for care and welfare alone is projected to reach £250 million in 20 years. Prime Minister Abe has announced plans to establish an equivalent of the US's National Institute of Health to drastically accelerate medical research and development.

(c) Thirdly, Japan is faced with a policy choice of whether to relax its relatively stringent immigration controls to allow more foreign workers. Even the UK, which is way ahead of us on this issue, thanks, perhaps, to its long experience of colonialism and liberalism, has been faced with considerable difficulty in recent years. For Japan, which has traditionally placed great importance on its sense of homogeneity, it is not an easy decision, particularly considering the demographic and politico-economic situation in East Asia.

But there will be a serious debate in this regard as economic necessity in the ageing society will demand the easing of bottlenecks among both highly-skilled personnel such as top-class engineers and manual labourers such as construction workers as well as care workers. The Abe Government has announced plans to address this issue by introducing legislation to further ease the requirements for highly-skilled foreign labour and for permanent residency.

(5) What is Abenomics, then? Will it succeed or fail, particularly the third arrow?

(a) When Prime Minister Abe made a speech at London's Guildhall in June, he stated, "Japan's regulatory regime is like solid bedrock. I myself intend to serve as the drill bit that will break through that bedrock." Japan is determined to overcome deflation and usher in a revitalised economy.

(b) Since the Abe administration has been in power, Japanese economic policy has dramatically changed. Prime Minister Abe has launched the "three arrows" of economic revival, comprising a bold monetary policy and a dynamic public finance policy together with a growth strategy. The mood in Japan significantly changed just after the first and the second arrows were dispatched.

In this one year, the Nikkei 225 Stock Average has increased considerably: it is now 1.6 times the level of one year ago. There are also signs of improvement regarding deflation, which has long bedevilled the Japanese economy. Now growth is back as the economy has been expanding by more than 3% on an annualised basis for two consecutive quarters, one of the highest rates among the advanced economies. The outcome of Mr Abe's initial measures is already with us.

(c) But, then, what about the third arrow for sustained economic growth? Is PM Abe willing to deregulate the economy in such sensitive areas as agriculture to this end?

PM Abe declared that Japan has to be reborn. He will encourage the private sector to make capital investment for future growth through tax incentives. He also intends to open up Japanese society with the aim of having people tackle difficulties and take risks for themselves. He will address the socio-economic problems of ageing through various measures including *Womenomics* and consolidation of the financial base to take care of elderly people – one of the reasons why he has made the politically tough decision to raise the consumption tax.

Moreover, he is poised to tackle the issue of deregulation in the context of

the TPP and the Japan-EU EPA. While negotiating for these trade agreements, Japan is reforming itself in many fields; for example, even in the agricultural industry, which is politically sensitive, we are working on farmland consolidation to allow more effective production, thus making the industry more competitive.

Furthermore, PM Abe has submitted a bill to legislate the establishment of "national strategic special zones" where bold measures for reform and deregulation will be taken as catalysts to trigger drastic socio-economic changes. He aims to double the amount of foreign direct investment into Japan. It is PM Abe's goal for Japan to become the easiest country in the world in which to do business.

3. **The situation at the Fukushima Daiichi nuclear power station**

What is happening at the stricken facility? It is not an easy subject to talk about, particularly for someone like me without a scientific background, but let me try.

In brief, the nuclear power station was damaged primarily due to the breakdown of the cooling system. But through the courageous efforts of a number of people, the situation did not go as badly as it could have. Currently all three nuclear reactors are in a state of cold shutdown and the fuel storage pools are also in a stable condition thanks to the functioning of the system for recycling cooling water. It is a massive task to have to circulate about four hundred tons of water every day and clean it up for recycling. There is a long-term problem of what to do with these facilities. But with the active engagement of the Japanese Government supported by the international community, we will address this long-term task.

There is an immediate problem of the leakage of contaminated water stored in tanks as well as the control of underground water which can be contaminated when flowing into the damaged underground part of the facilities. The leakage issue is now being addressed by repairing or replacing the water storage tanks. The problem of underground water is much tougher, but the Government is trying to mobilise international

technology to block the influx of such water by setting up massive walls on the mountain side of the facilities. At any rate, the contaminated water flowing out is sifted and contained within the small bay area of 0.3 sq km adjacent to the Fukushima Daiichi facilities. The level of radioactivity outside the bay has been and remains at the normal level, with rigorous monitoring going on.

Admittedly there is a long and winding road ahead. But the Government remains committed to achieving a long-term solution with international cooperation.

4. **Political considerations**

What is the "proactive contribution to peace" which Prime Minister Abe has been talking about as the main pillar of his defence and security policy?

Let me first talk about the background to the issue. In the aftermath of the war, we accepted a drastic Constitutional change while under the Allied Occupation. It firmly established the principles of democracy and the sovereignty of the people, pacifism and respect for human rights. The principle of pacifism was embodied in Article 9, which forever renounces war and "the threat of use of force as a means of settling international disputes". It further stipulates that, "to accomplish the aim of the preceding paragraph, land, sea, and air forces, as well as other war potential, will never be maintained".

This is a very explicit statement of pacifism. But it has never been understood to imply the renunciation of the right to self-defence. That is the reason why we have maintained the Self-Defence Forces and relied on the JSDF and the alliance with the United States for our national security. This arrangement has worked very well as we have enjoyed a relatively peaceful environment and prospered within the global free trade system under the leadership of the United States. In fact, for the past 68 years since the end of the War, Japan has not engaged in any armed conflict even involving its territorial claims or maritime boundaries. But as Japan's economic power has grown, there has been criticism, particularly in the US,

that Japan was taking a free ride on the back of the US security guarantee.

In the first Gulf War in 1991 there was a heated debate about the role Japan should play; at that time it was argued that the JSDF should not be deployed abroad even for UN missions, as that would go beyond the Constitutional limit of self-defense, and, consequently, the Japanese Government decided to make a huge monetary contribution of US$13.5 billion to the US and other UN sanctioned multinational forces – something which even required the introduction of a new tax to raise the money. After the liberation of Kuwait, however, it turned out that our monetary contribution was not much appreciated by the Kuwaitis, certainly not as much as the contribution from those who had helped with military force.

It brought home to us Japanese that Japan should no longer shy away from international efforts to maintain and restore peace in other parts of the world. In the next decade, Japan gradually modified its position and started participating in UN peacekeeping operations. Since the historic dispatch of an engineering unit to Cambodia, we have sent altogether 9,000 personnel to many disaster relief or post-conflict peacekeeping and reconstruction missions.

However, there has been lingering debate about the limits of what the JSDF can do in such missions. For instance, JSDF personnel in such missions can defend themselves when attacked by guerrilla forces or other armed groups, but are not allowed to go and defend friendly UN forces as that would go beyond the right to self-defence. Some people have felt it is too strict an interpretation for a country which should be contributing to peace.

There has arisen further debate about what the JSDF could and should do in cases where Japan itself has not been attacked to support or protect the US forces which are tasked to defend Japan in order to maintain or restore peace in the region. Those are moot points that have long and repeatedly been debated over the years.

That is the background to Prime Minister Abe’s approach to defence and security.

He believes that Japan should make a more proactive contribution to world peace and that there should be debate about the necessary preparations, legal and logistical. Moreover, institutionally he is setting up a National Security Council to produce a National Security Strategy under the Prime Minister's leadership.

Some people assert that it is a nationalistic response to the rise of China. But, as is clear from the background, this is primarily about a debate which had been going on long before people started talking about the rise of China. It is based on the recognition that Japan's peace and prosperity have been and remain inseparable from world peace. Until the 1990s, Japan was concerned only about its own defence while relying on a restricted interpretation of self-defence under the Constitution, but gradually Japan has started playing a limited international role in peacekeeping, and now wants to contribute even more proactively to global peace and security like other countries.

In short, under PM Abe's defence and security policy Japan is not becoming "nationalistic" as some people have suggested but is in fact becoming more "internationalist".

5. Japan-UK relations

Finally, as Japanese Ambassador to the UK I would like to address the importance of Japan-UK relations.

(1) This year Japan and the UK have commemorated two anniversaries for which a series of events have been conducted.

One is under the initiative of *Japan 400*, which marks the passage of exactly four centuries since England and Japan embarked upon a trade relationship following the arrival in Japan in 1613 of an English merchant ship dispatched by King James I.

The other is the 150th anniversary of the arrival of five future leaders from

the Choshu clan, who travelled secretly in defiance of the prohibition on foreign travel in order to study this country's advanced technology so as to help modernise Japan. Unfortunately those five young samurai, being non-Christian Orientals, were not allowed to study at Cambridge at that time.

However, they went to UCL, thereby opening the way for the extremely successful UK-Japan academic exchange which has continued up to today. Moreover, within seven years of their arrival, a Japanese student named Kencho Suematsu, who later became an Education Minister and President of both Tokyo and Kyoto Imperial Universities, was already reading Maths and Physics and graduated *summa cum laude* from St John's College here.

(2) Japan has come a long way since it began to industrialise with help from the UK. It is now around three decades since a Japanese company started producing automobiles in this country, and now three UK-based Japanese car companies alone manufacture more than half of British-made cars. As the British auto industry is worth around £17 billion and more than 80% of its output is exported, it can be estimated that Japanese auto firms produce around £7 billion of export earnings. Moreover, Japanese companies are investing and bringing their latest technology here in such other sectors as railways. During London 2012 some of you must have experienced a fast and smooth ride from St Pancras to Stratford on one of the Javelin trains, which are built and maintained by the Japanese firm Hitachi.

(3) We share common values in our adherence to democracy and the rule of law. In terms of foreign policy, Japan is committed to the rule of international law as opposed to rule by power. Asia is enjoying the benefits of rapid economic growth but, at the same time, is facing challenges such as a more severe security environment with the risk of instability caused by the rapidly changing economic and geopolitical picture and by the marked diversity of the region.

I believe that there is room for Japan and the UK to cooperate even more closely in contributing to the enhancement of the rule of law as well as

rulemaking in Asia so as to alleviate such risks in accordance with international law.

(4) Since Japan is extremely poor in natural resources, it stands to reason that we are committed to the global free trade system. It is important that free trade be embraced not only by a limited number of countries but by all the leading economies, including the EU and Japan.

Spurred by this philosophy, Japan is keen to promote the WTO negotiations, but as a supplementary measure is ready to step up its preparations for the EPA negotiations with the EU as well as the TPP negotiations with the US and Asia-Pacific countries. Incidentally, the UK has been the staunchest supporter of a Japan-EU EPA.

Japan aims to double the amount of all foreign direct investment into Japan to £220 billion (¥35 trillion), which equals the sum total of the current market capitalisation of BP, Tesco, Barclays and Royal Bank of Scotland. The UK has invested more than £8 billion in Japan so far, while Japan has invested more than £29.6 billion in the UK. Business relations based on such investment flows as well as trade provide the solid foundation for our bilateral relationship as a whole. We would certainly welcome a much bigger influx of British investment into Japan.

(5) In the middle of October, Foreign Secretary William Hague visited Tokyo to hold the second strategic dialogue with the Japanese Foreign Minister, Fumio Kishida.

Mr Hague and Mr Kishida discussed global issues of concern to both Japan and the UK, including security, economic growth and our shared values. They also addressed the situations in Syria and East Asia in detail.

The Japanese Minister explained to the British Foreign Secretary about Japan's policy involving a "Proactive Contribution to Peace". Mr Hague strongly supported the idea of Japan making a more active contribution to global peace. We deeply appreciate his unequivocal support in this regard.

This indeed is the reflection of the extent to which we share common international perspectives. That is the reason why PM Abe described the UK as Japan's 'a priori' partner. I look forward to the UK and Japan cooperating much, much more in many important areas, including the economy and foreign policy as well as defence and security.

(6) To promote Japan-UK relations on a long-term basis, we put importance on human exchange between our countries, especially among youngsters. The Japanese Government offers two programmes in this regard. One is the JET programme, a Japanese Government initiative that brings English-speaking university graduates, including many from the UK, to Japan as Assistant Language Teachers in Japanese schools or as International Coordinators in local governments for two to three years. More than 10,000 Britons have joined the programme so far. The other is the MEXT Scholarship. On this scheme, one can choose virtually any field of study taught at Japanese universities, and now more of them are offering courses in English.

I sincerely hope that many of you will join our programmes as I believe that the experience will help you forge successful careers. For further information, please visit the Embassy's or the Government's website, or ask my assistant for a leaflet.

In the essay I quoted in the beginning, Bertrand Russell said, "All great books contain boring portions, and all great lives have contained uninteresting stretches." I do hope my speech has contained something other than boring portions and provided you with some interesting stretches for your student life.

Thank you very much.