



Japan's Perspective on Regulatory Reform and DDA

Towards better integration of
domestic and external economic policy

Consulting Fellow, RIETI

Nobuo TANAKA

tanaka-nobuo@rieti.go.jp

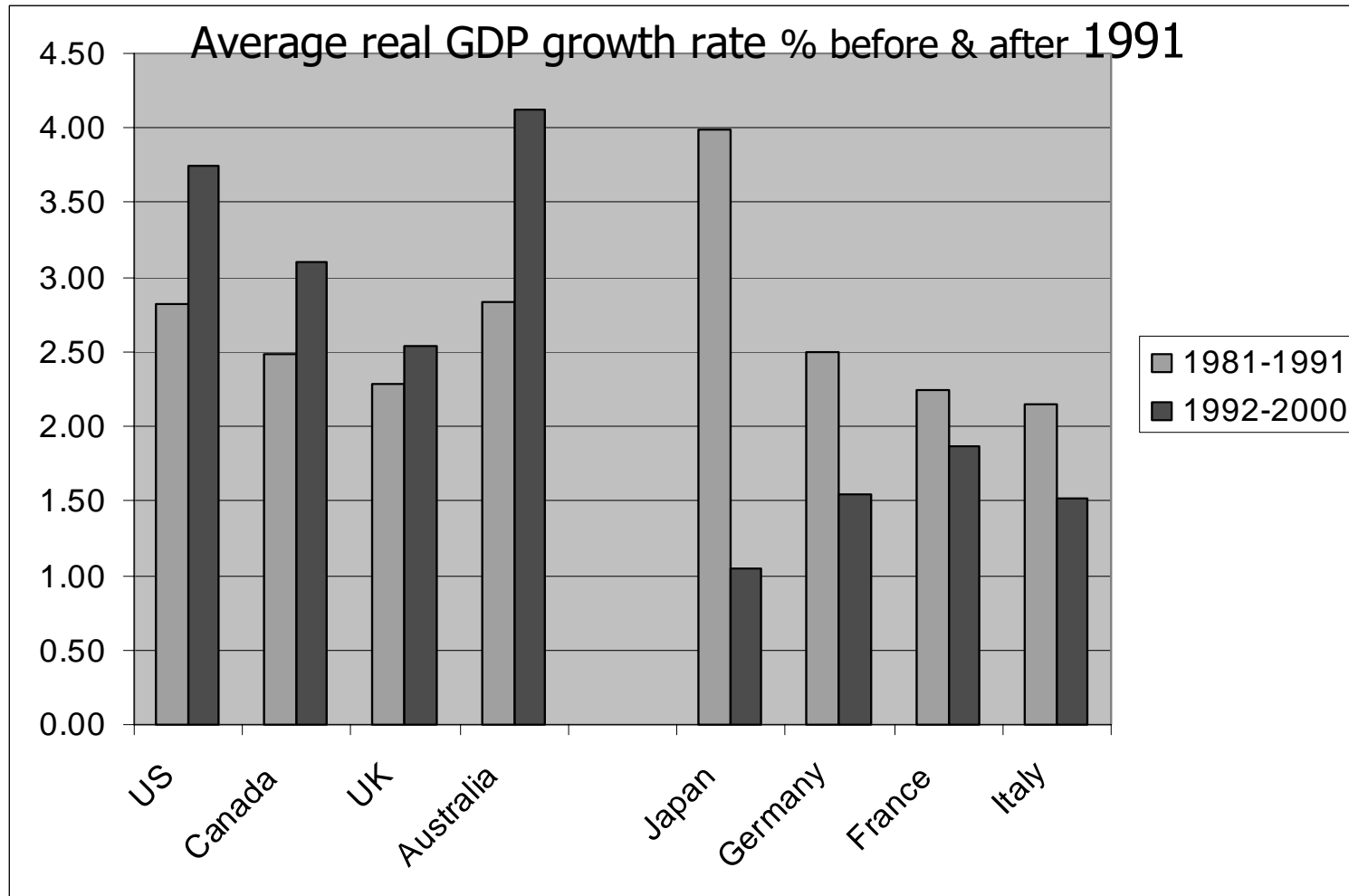
March 25th, 2003

OECD Global Forum on Governance

RIETI 
Research Institute of Economy, Trade & Industry, IAI

What's Wrong with Japan?

Winners and Losers

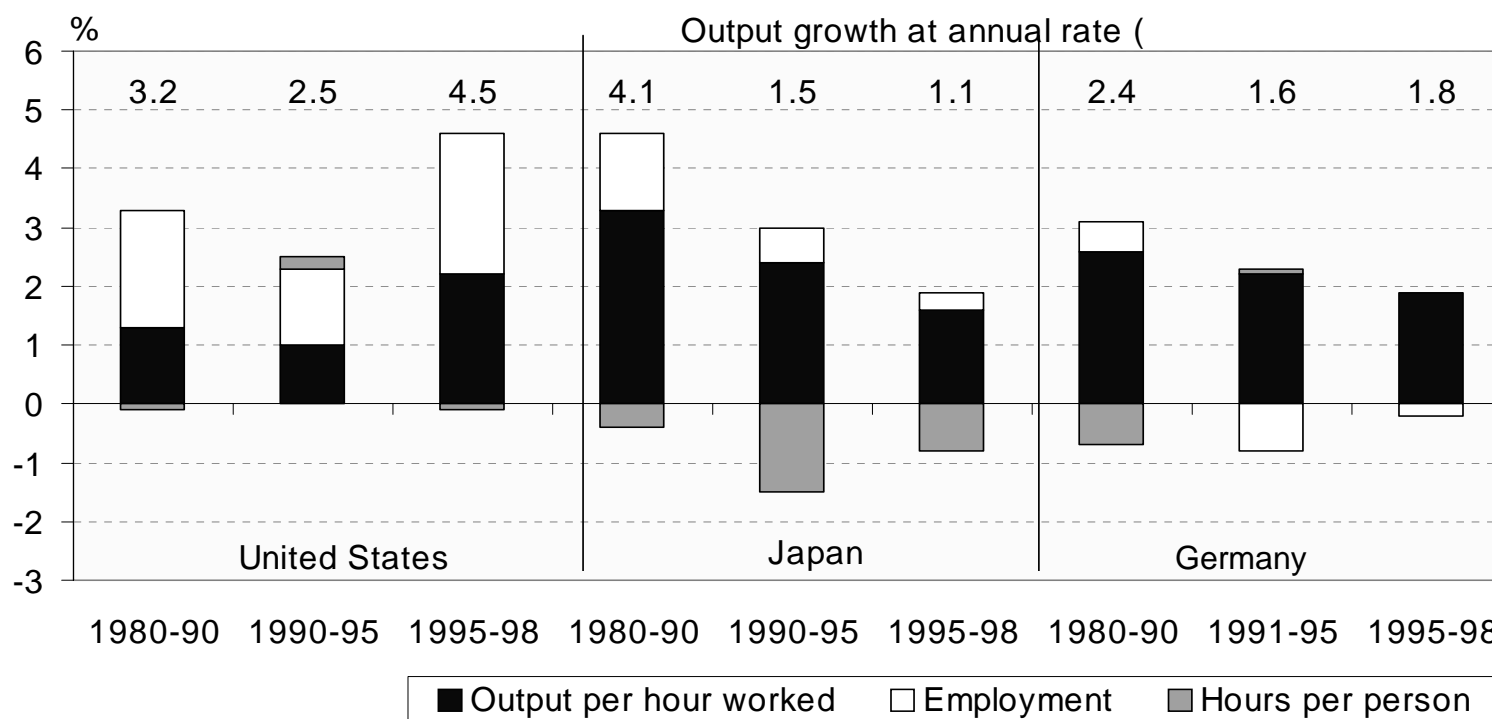


Source: OECD's Growth Report, "The New Economy: Beyond the hype". 2001

Japan and Germany lag behind U.S.

GDP and Productivity Growth in the Business Sector

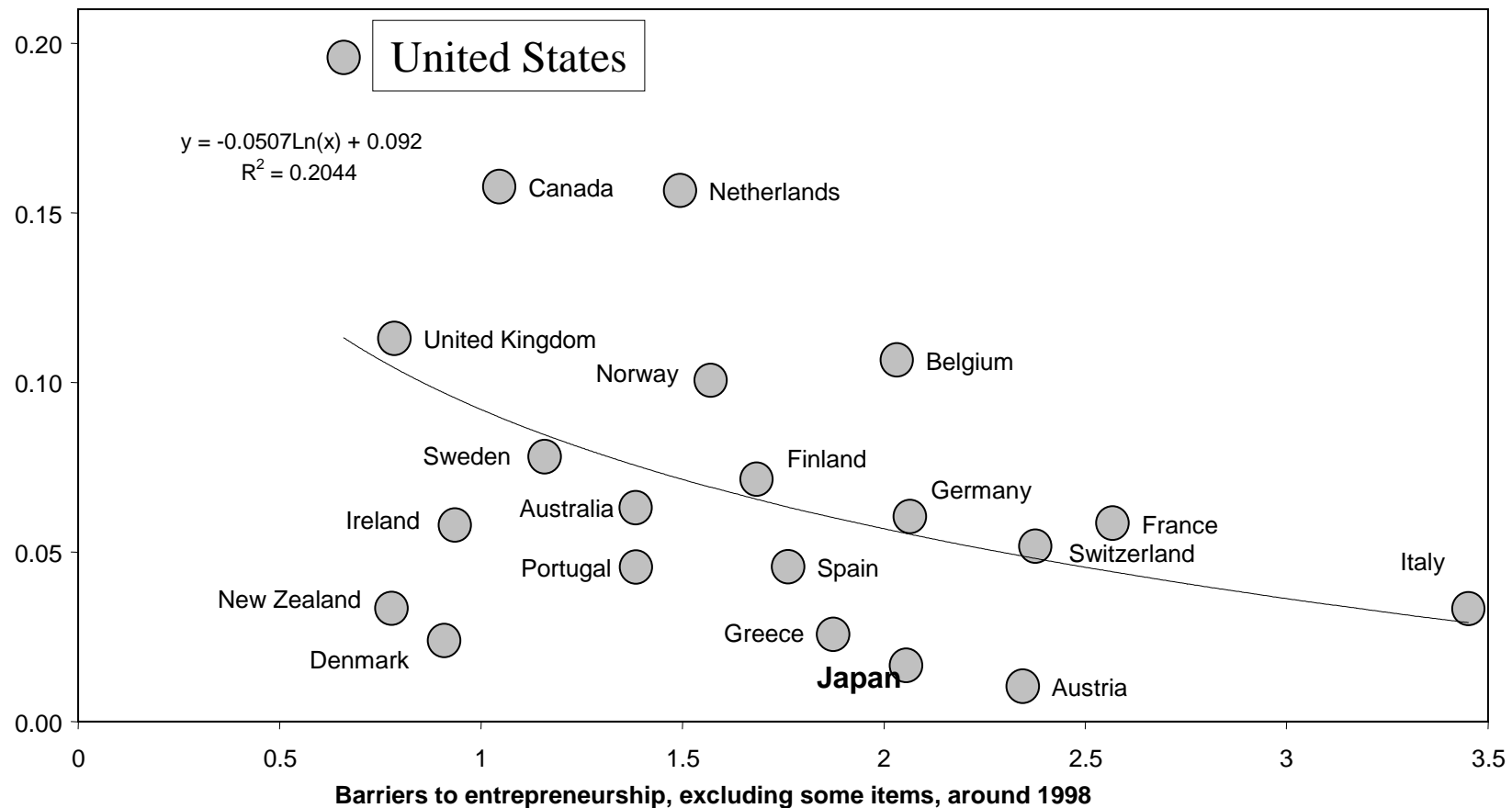
Percentage changes at annual rates



Source: Economic Outlook 66, Scarpetta et al. (2000)

Barriers to entrepreneurship and venture capital activity 1995-98

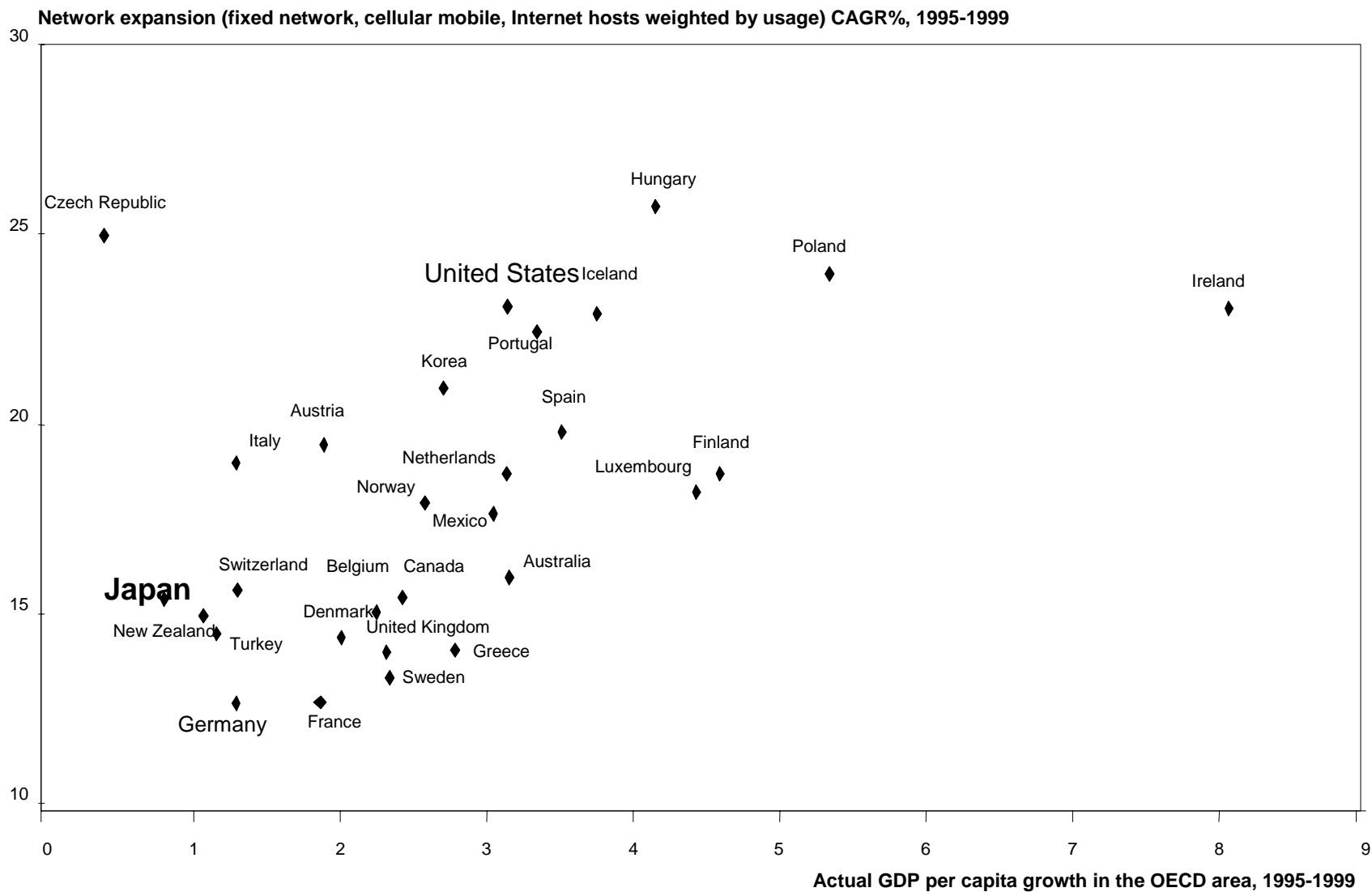
Venture capital investment in early stages and expansion as a percentage of GDP, 1995-98



Notes: Excluding "license and permit systems", "sector specific administrative burdens" (for road freight and retail distribution), and "antitrust exemptions" (for public enterprises).

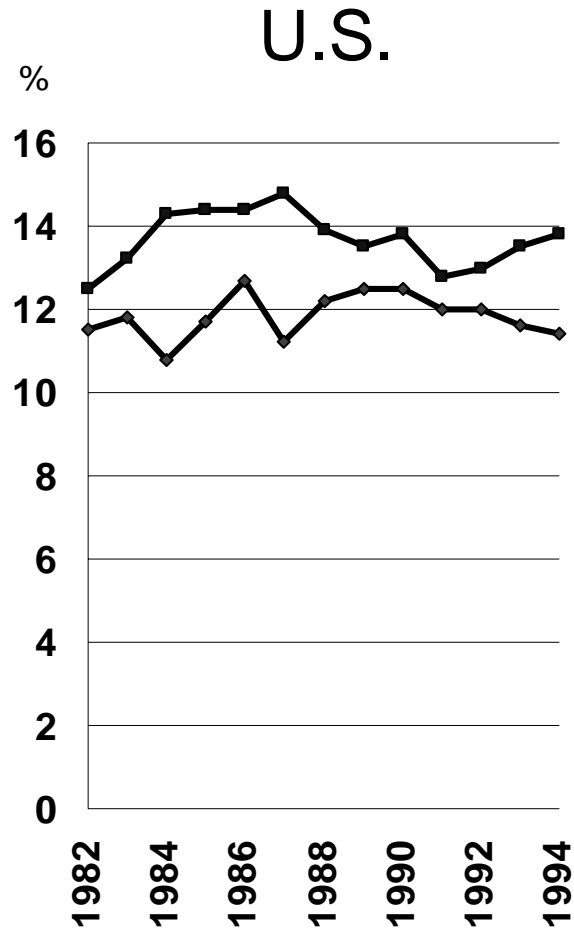
Source: OECD

Network expansion and GDP growth

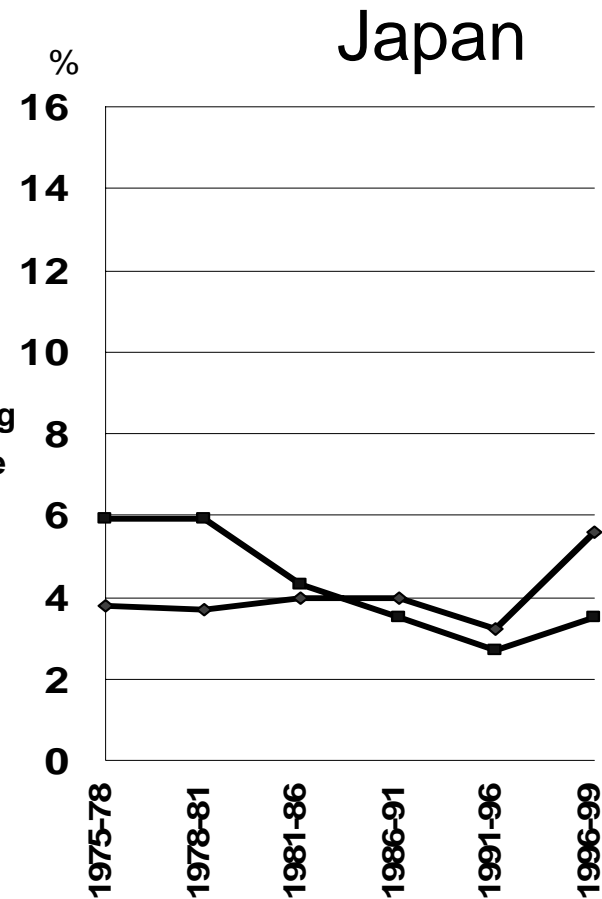


Business Start-ups and Closures in Japan and the U.S.

% of total establishments

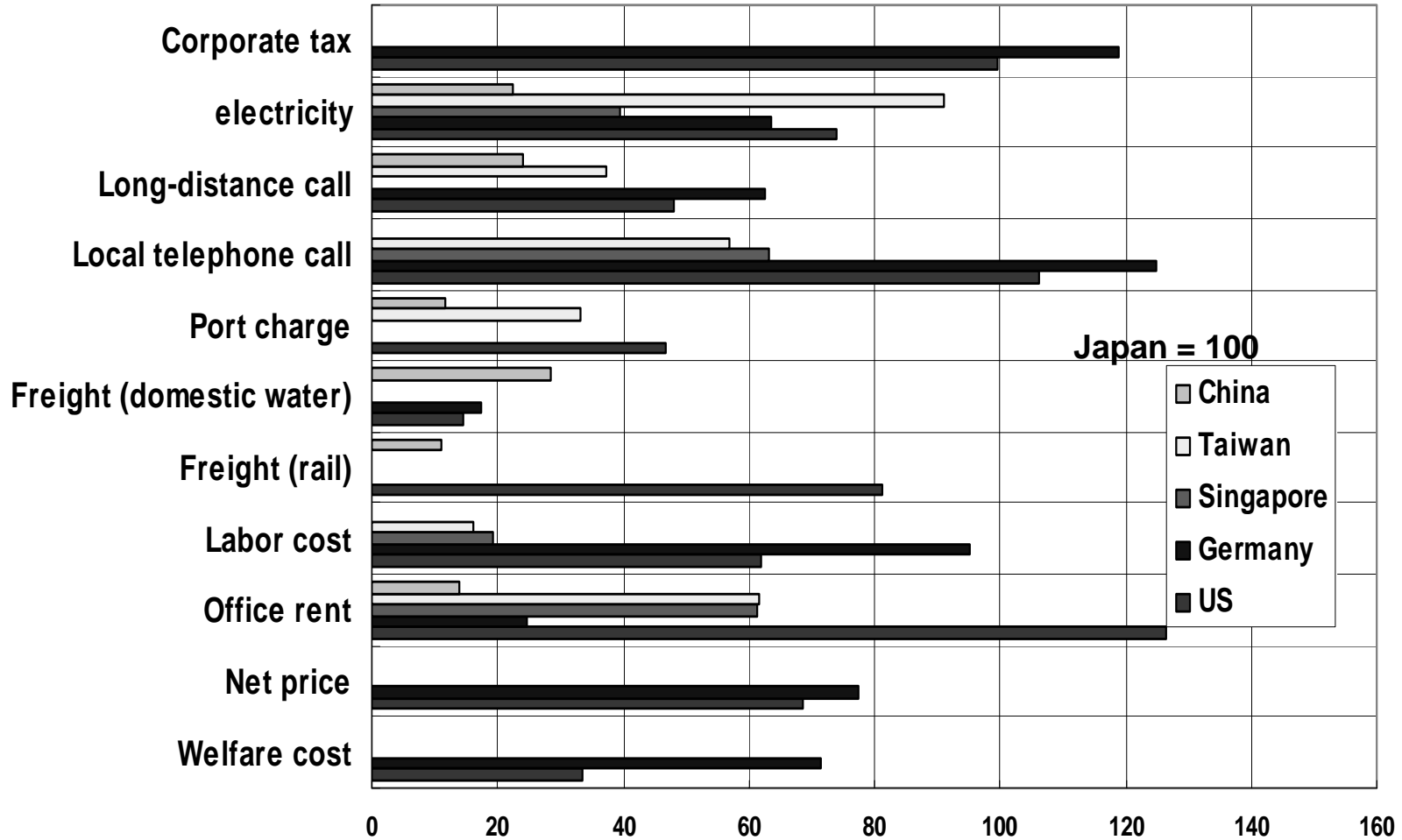


■ US Opening
◆ US Closure



■ Japan Opening
◆ Japan Closure

High Cost Structure Yr2000

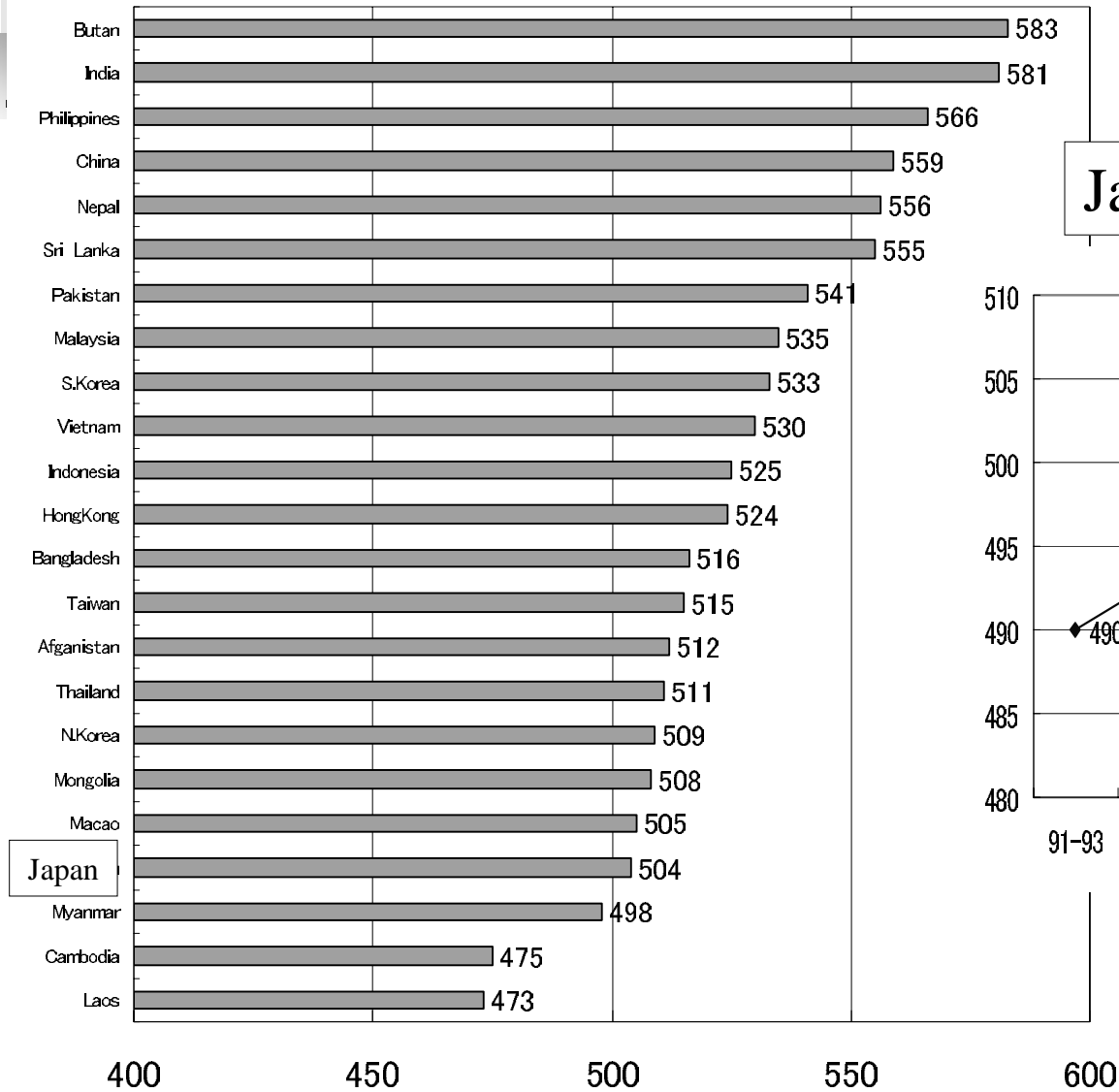


A Survey of Japan and Foreign Countries in Terms of the Cost of Industrial Intermediate Goods and Services, MITI

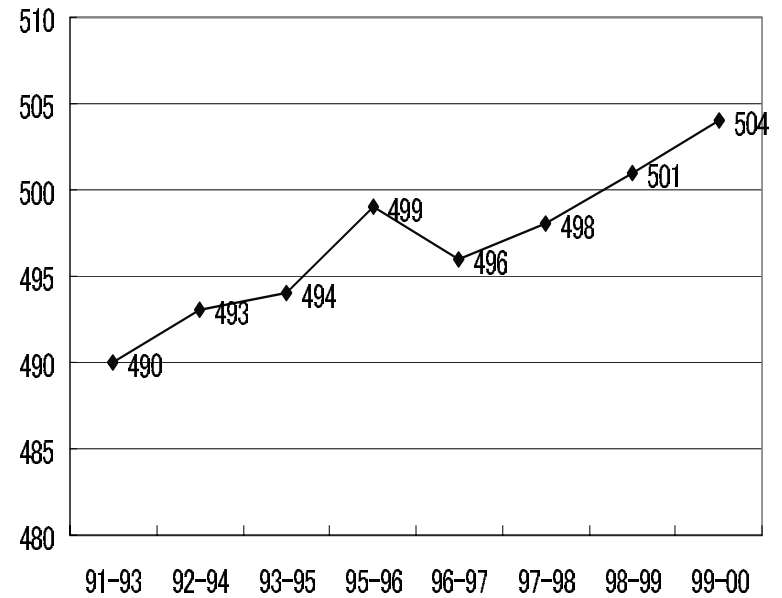
Urgent Need for Reform of Language Education

Comparison of TOEFL average scores by Country

TOEFL average scores (99-00)



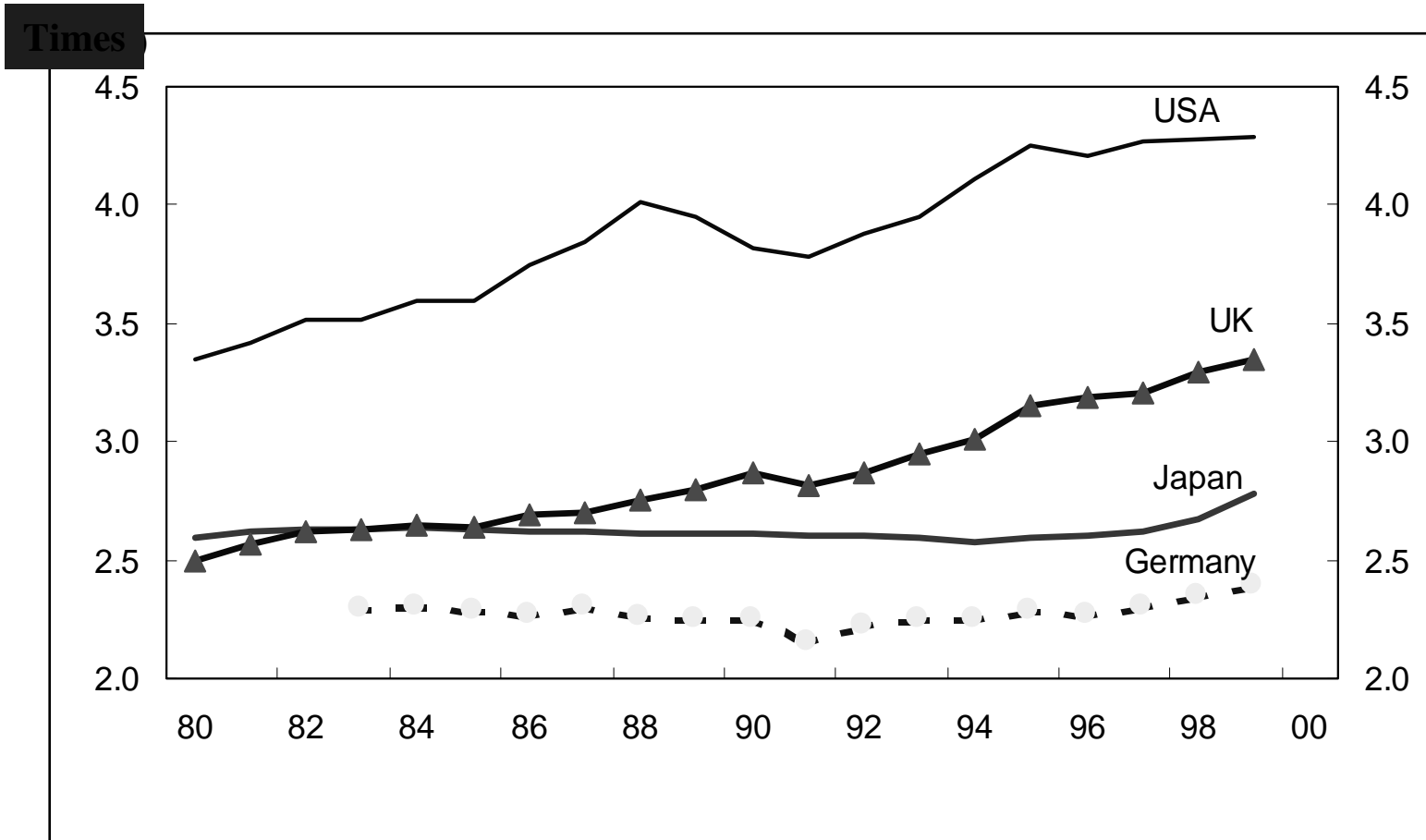
Japanese TOEFL scores



「TOEFL Test and Score Data Summaries」

The New Japan Reality: The Need For Specialists, Not “Salarymen”, Creates Rising Income Inequality

Earnings Gap - Top 10% and Bottom 10% Wage Earners



Source: OECD & ML Estimates

“Without Structural Reforms, There Can Be No Economic Recovery.”

Seven Programs of Koizumi's Reform

(“Basic Policies for Macro-Economic Management”)

1. Privatization / Regulatory reform : Maximizing use of private sector
2. The “Support Challengers” Program : A social system that encourages individual ability
3. Strengthening Welfare and Insurance : Making people feel secure and stable
4. Doubling Our Knowledge Stock : Human capital development through individual choice
5. Lifestyle Revolution : Creating an infrastructure that allows people to live and work as they like.
6. Local Independence and Revitalization : Empowering local governments to the maximum
7. Fiscal Reform : Creation of a simple, efficient government suitable for the 21st century

What is the Industrial Policy under Globalization?

Supply-Side Reform for

“Selection and Concentration.”

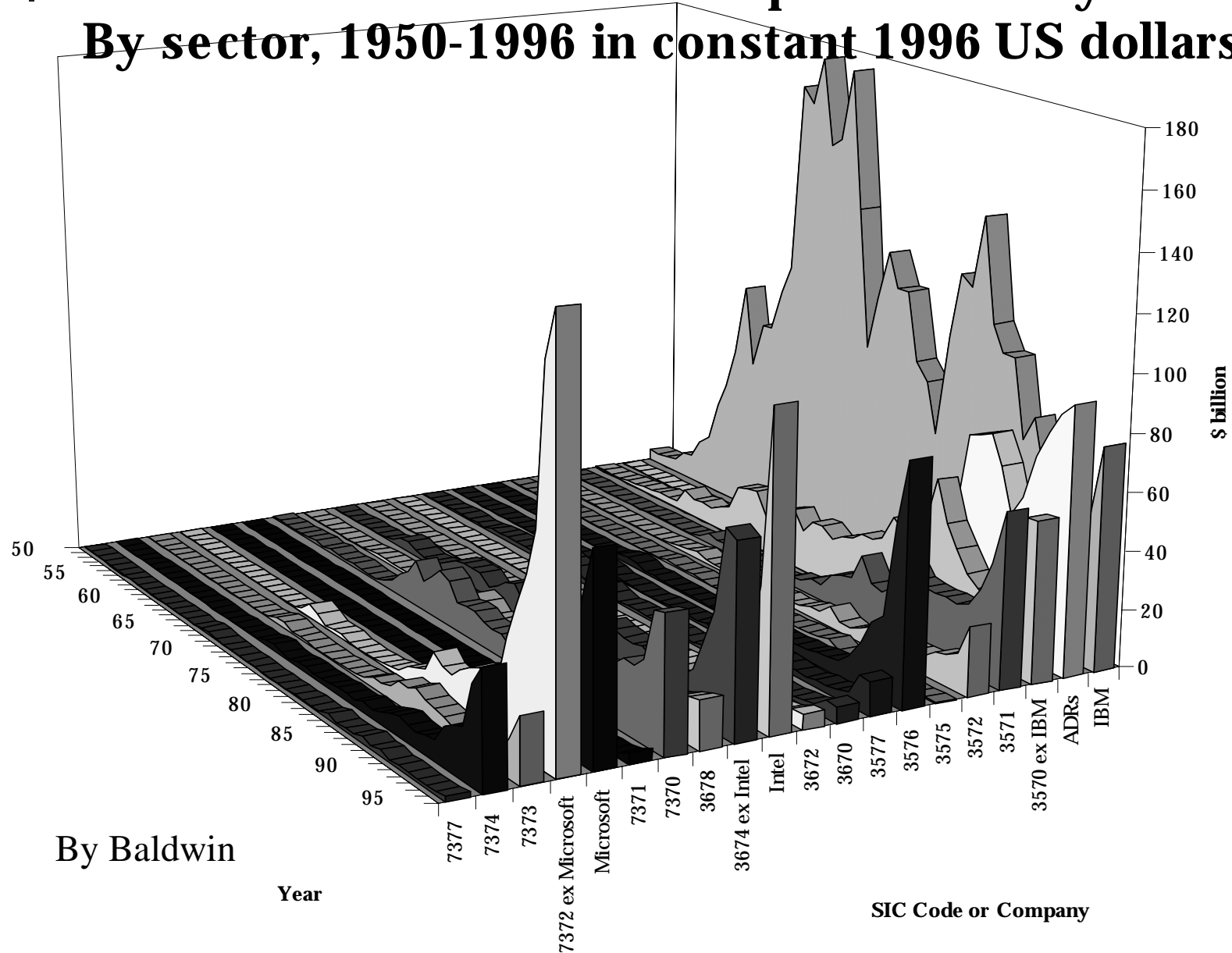
Commercial Code Revision, Bankruptcy Laws, Global Accounting Rules, etc. to provide legal and accounting tools for corporate restructuring.

Menu for Corporate Restructuring

- (1) Utilization of Holding Companies
- (2) Mergers and Acquisitions
- (3) Spin-offs and Split-offs (Corporate Divestitures)
- (4) Enactment of Industrial Revitalization Law
- (5) Enactment of Civil Rehabilitation Law : Japanese
Chapter 11, DIP finance
- (6) Stock Options
- (7) Corporate Tax Systems
- (8) Corporate Accounting Rules
- (9) Corporate Governance Rules
- (10) Pension Funds and Employment Policy: 401K
- (11) Further Reform of the Commercial Code (Outside
Directors)

Power of Modularity

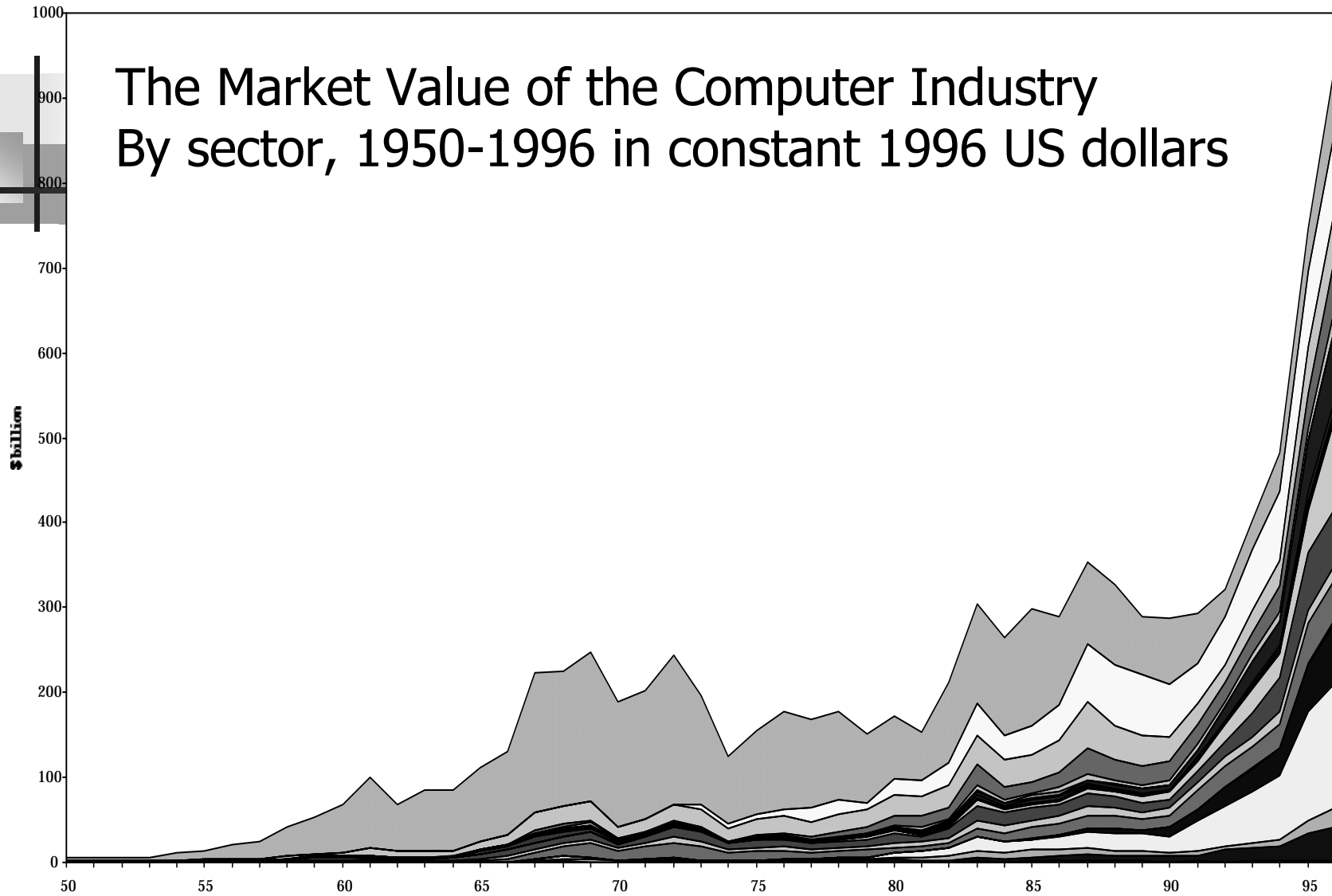
The Market Value of the Computer Industry By sector, 1950-1996 in constant 1996 US dollars



By Baldwin

Power of Modularity

The Market Value of the Computer Industry
By sector, 1950-1996 in constant 1996 US dollars



By Baldwin

Why Regulatory Reform?

Underlying ideas:

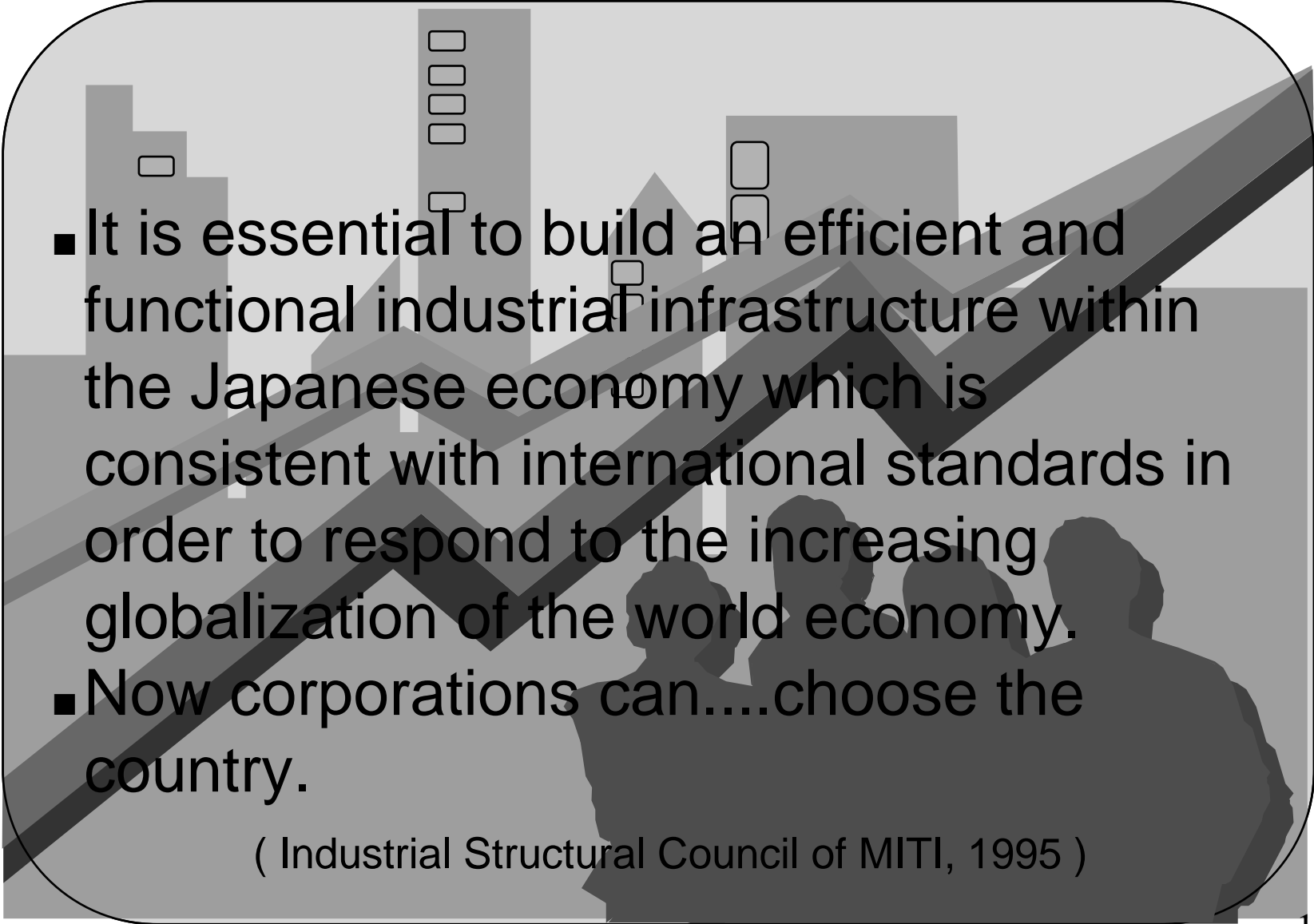
- **Stimulating competition** promotes greater management efficiency and induces dynamic innovation, which hence leads to economic growth.
- Regulations must be **competition-enhancing**.
- **Excessive regulations**, which impede the market to work efficiently, **must be eliminated**.
- **Both the developed and developing countries need continuous efforts in regulatory reform so as to keep pace with fast-evolving economic environment.**

Trade and Investment Nexus

This is increasingly important due to globalisation:

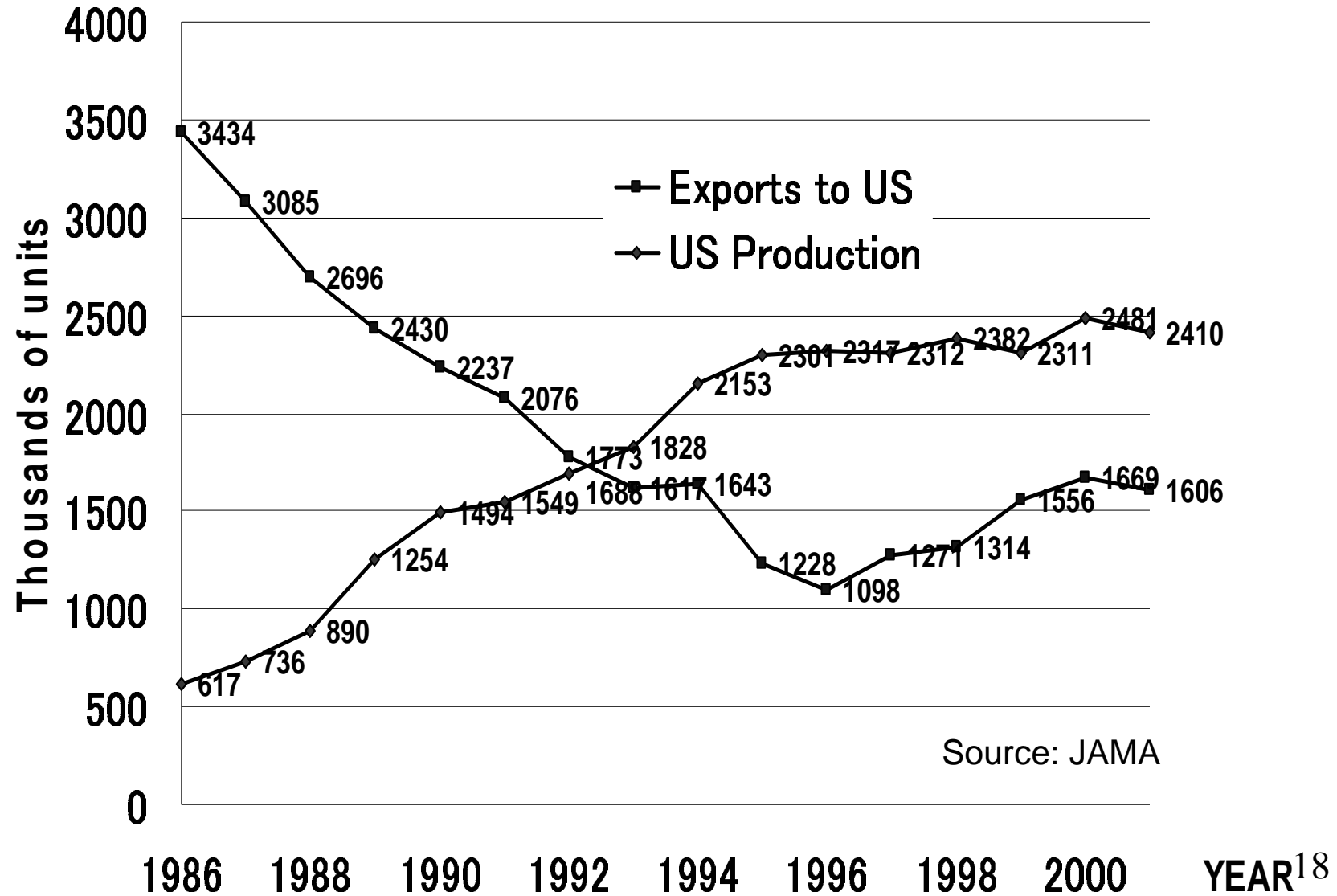
- Companies try to optimise their corporate strategy and management resource allocation from a global perspective; i.e. **a company can choose a country.**
- As globalisation evolves, active use of global resources (goods, money, people, technology, information, etc.) becomes increasingly important for economic growth.
- **Therefore countries need to ensure that their domestic regulations do not impede cross-border corporate activities.**

Globalization is the most Important Driving Force for Reform.

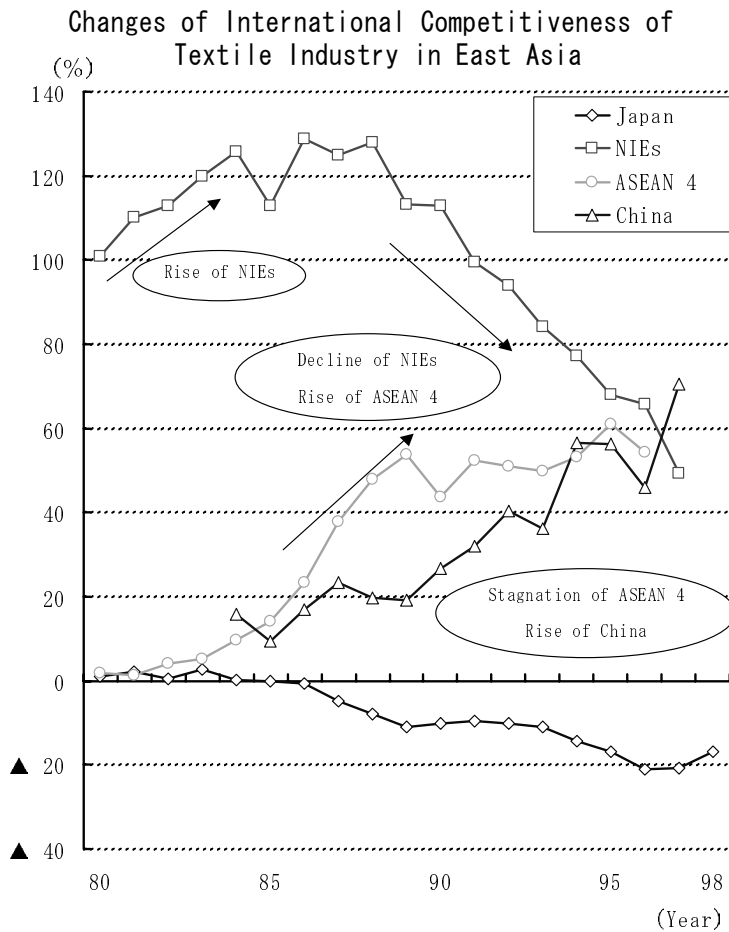
- 
- It is essential to build an efficient and functional industrial infrastructure within the Japanese economy which is consistent with international standards in order to respond to the increasing globalization of the world economy.
 - Now corporations can....choose the country.

(Industrial Structural Council of MITI, 1995)

Declining Japanese Motor Vehicle Exports to the US Coupled with Rising Production in the US



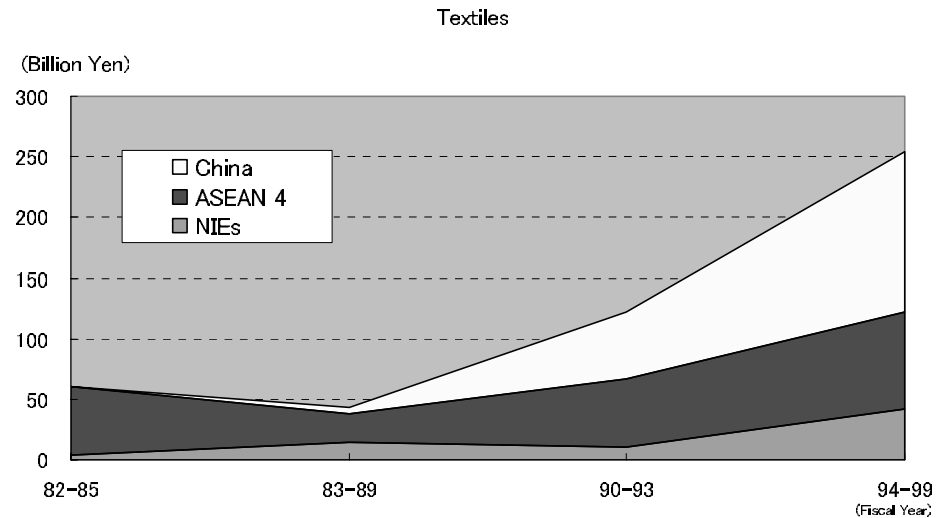
Textile Industries in East Asia



Source: Institute of Developing Economies 「AIDX」, UNIDO 「ISD」.
 Note: For explanation of ratio, see the note on chart 1.

NIEs= South Korea, Taiwan, Singapore, Hong Kong
 ASEAN4= Thailand, Philippines, Indonesia, Malaysia

Japanese Textile Industry's Direct Investment toward East Asia



2001 White Paper on International Trade, METI

“Is China a Threat or an Opportunity?”

○It is inevitable for business to take advantage of cost differences.

Labor costs in China (Japan=100)

1990 China average 2.16, Shanghai 2.95

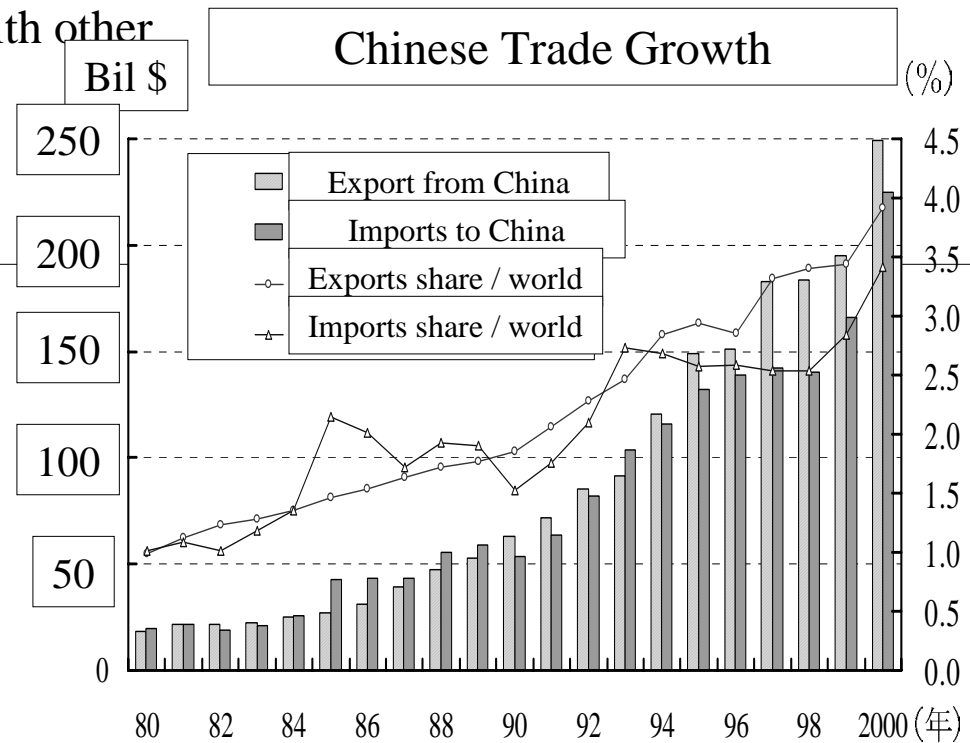
2000 China average 3.59, Shanghai 7.09

○Growing Chinese market provides new business Opportunities. Tougher competition with other foreign players.

○New Business with younger(30-40), Post-Cultural Revolution generation of Chinese businessmen

○Import Safe-guard issue: the pilot case for China-Japan trade disputes.

China can be a Driving Force of Change in Japan.



(資料) IMF「DOT」より作成

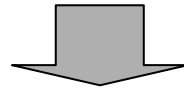
Domestic Regulators vs Trade Policy Makers

- **Thus the primal objective of domestic regulatory reform is essentially in line with that of external economic policy.**
- However, problems may arise when domestic regulators and trade policy makers are not well coordinated within the government.
- Regulators may claim that trade policy makers excessively promote unnecessary regulatory reform yielding to external pressure if they need such regulatory reform primarily for domestic reasons.
- **This is exactly what we are observing in the DDA process.**

Regulatory Issues in DDA

Widening scope of the WTO agenda under the globalisation

- Services, investment, environment, competition, etc.



- “Behind-the-border” measures become increasingly relevant to the trade and investment liberalisation
- But the regulators are not always able to fully take into account the trade and investment implication of domestic regulations

External Economic Policy Challenges

- Promotion of Free Trade and Cross-border Systemic Harmonization -

□ No. of regional trade agreements notified to WTO/GATT

1958 EEC launched	2	1950s	2nd-5th tariff negotiations	Industrial tariffs (21,000 products)					
			Kennedy Round (1964-67)	Industrial tariffs (30,300 products)		AD			
1966 Australia-NZ FTA launched 1967 EC established 1968 Tariffs eliminated within EC	3	1960s	Tokyo Round (99 countries; 1973-79)	Industrial tariffs (33,000 products)		AD, TBT, government procurement, subsidies, etc.			
	18	1970s	Uruguay Round (124 countries) (1986-94)	Agriculture, services Industrial tariffs (305,000 products)	GATT 1994	AD, TBT, government procurement, subsidies, etc.	TRIPS, textiles, rules of origin, trade-related investment measures, (TRIMs)		
			WTO launched (1995)						
	6	1980s							
	93	1990s	New Round (2001-)	Agriculture, Services Industrial Tariffs	Regional Trade Agreement	Anti-Dumping(AD), Subsidy	Intellectual Property Rights (TRIPS)	Investment*, Competition*, Trade Facilitation*, Transparency in Government Procurement*, e-Commerce,	Environment
1993 EU launched; APEC Seattle meeting 1994 NAFTA launched 1995 MERCOSUR launched 2005 FTAA (planned)									

Notes:

1(*). Preparatory work for negotiation.

2. A simple comparison of the number of products on which tariffs have been reduced cannot be made because the way of classification differs at each round.

Source: 「White Paper on International Trade, Japan (2000)_ etc.

Towards Integration of *domestic* and *external* economic policy

Real challenge is how to realise the integration of domestic and external economic policy.

- Rationale of regulatory reform and trade/investment implication of domestic regulations should be well-understood both by domestic regulators and trade policy makers.
- But this may not be easy.
- **China is using WTO as a tool for domestic economic reform.**
- Japan's recent experience may give us some ideas for this challenge.

Japan's Case

- The economic malaise of the 1990s has revealed fundamental structural problems of the Japanese economy and the need for regulatory reform.
- Since then Regulatory Reform has been prominent on Japan's political agenda.

<Examples>

Financial Services: Comprehensive reform package known as the “Big Bang” initiated in 1996

Electric Power: Enabled Independent producers (IPPs) to supply the electricity in 1995

Retail Distribution: Eliminated the commercial adjustment provision in regard to market participation in 1998

Japan's Regulatory Reform and WTO Negotiation

Telecommunications:

- Barriers between domestic and international operations (I.e., between NTT and KDD) eliminated during 1997 and 98
- Demand/Supply adjustment in regard to market participation eliminated in 1997
- Number of telecom carriers increased from 3,260 (FY1995) to 9,349 (FY2000)

Telecom (1993 - 1997)

Uruguay Round service negotiation

Finance (1994 - 1997)

Current negotiation (2000-)

Finance:

- Comprehensive reform package known as the "Big Bang" initiated in 1996.
- Complete implementation in 2000 achieved a wide range of deregulation of controls of entry, pricing, commissions and the creation of new products.
- Banks, insurance companies, securities firms became able to enter into each other's line of business.

Education

Energy

maritime

Courier

Environment

Japan's Case

- The challenge today is to deepen and speed-up the regulatory reform underway.
- Stronger initiative is required as regulatory reform targets more complicated issues.
 - With the current Administration's slogan "Structural Reform without Exception", in addition to the major sectors such as financial services and telecommunications, **current focus is also on the public service sectors including medical and health services and educational services.**
 - Those sectors are considered to have been **over-protected in the name of social policy** and therefore have much room for innovation-enhancing regulatory reform.
- The Japanese Government is pursuing this objective by top-down approach with some trans-ministerial initiatives.

Japan's Case

Some “devices” to promote regulatory reform include;

Council for Regulatory Reform (established in 2001)

- An independent advisory body for Prime Minister
- Comprehensively investigating the existing regulations and drafting *Three-Year Program for Promoting Regulatory Reform*, which sets a specific target for each Minister to promote regulatory reform

Structural Reform “Special Zone” (introduced in 2002)

- “Path-finder” approach by introducing experimental deregulation in a certain geographical area
- Local governments, private companies etc. can make proposals directly to an independent authorising body under Prime Minister, not to each Minister responsible for relevant regulations

Illustrative Image of *Structural Reform “Special Zone”*

“Special Zone” for Education

- where private entities including profit-making companies are allowed to establish and run formal educational institutions, while only non-profit specially-permitted-juridical-persons are currently allowed in other regions.

“Special Zone” for Medical Services

- where private entities including profit-making companies are allowed to establish and run hospitals to give medical services of a certain kind, while only non-profit specially-permitted-juridical-persons are currently allowed in other regions.

“Special Zone” for International Integration

- where foreign engineers, tourists, students can obtain visas more easily and/or longer than in other regions.
eg. IT engineers’ can stay for 5 years instead of 3 years.
eg. The limit for the number of foreign workers whom each company can employ for the training purpose is eased.

Agriculture

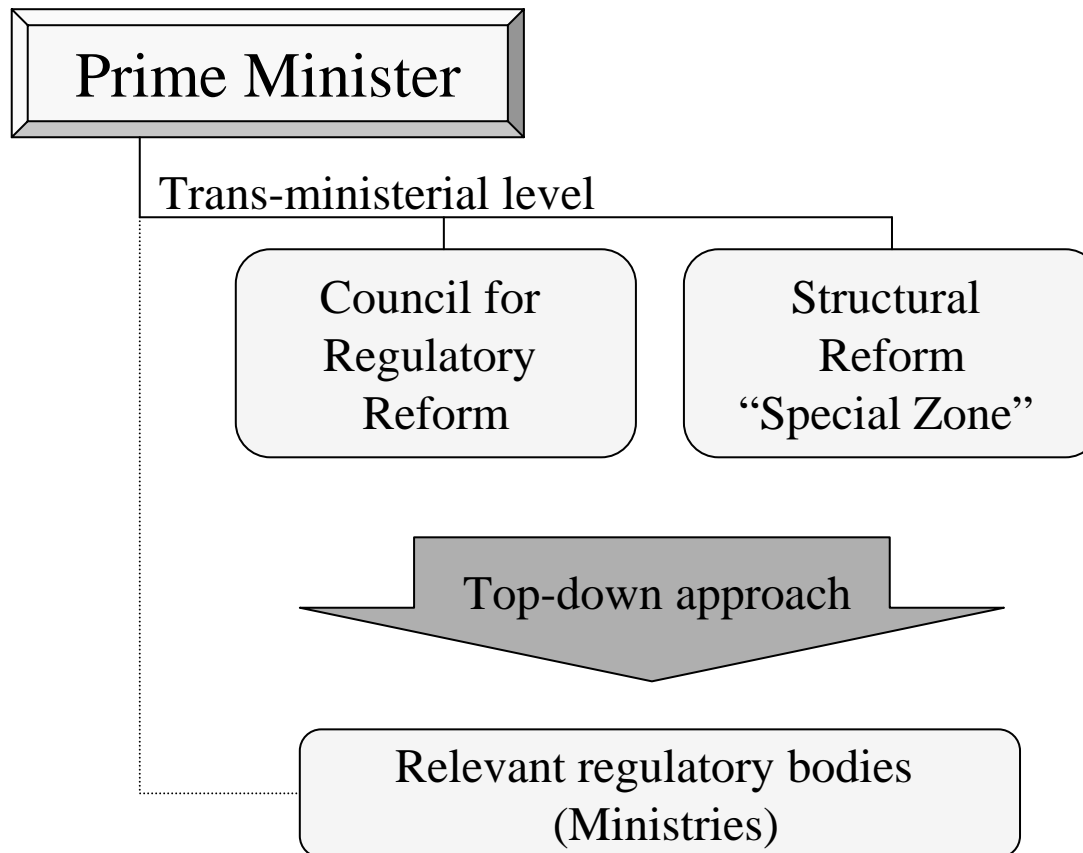
International Transportation

Welfare

Local Government Restructuring

New Energy Source and Recycling

Japan's Case



Japan's Case

- Moreover, integration of domestic regulatory reform and external economic policy is promoted through:

Investment Council (re-started in 2002)

- An independent council led by Prime Minister to consider how to promote foreign inward investment to Japan including the promotion of relevant regulatory reform.
- The target is set to double the current balance of foreign investment within 5 years.
- METI, responsible both for domestic regulatory reform and external economic policy, is mandated to support the Council.

Japan's Case

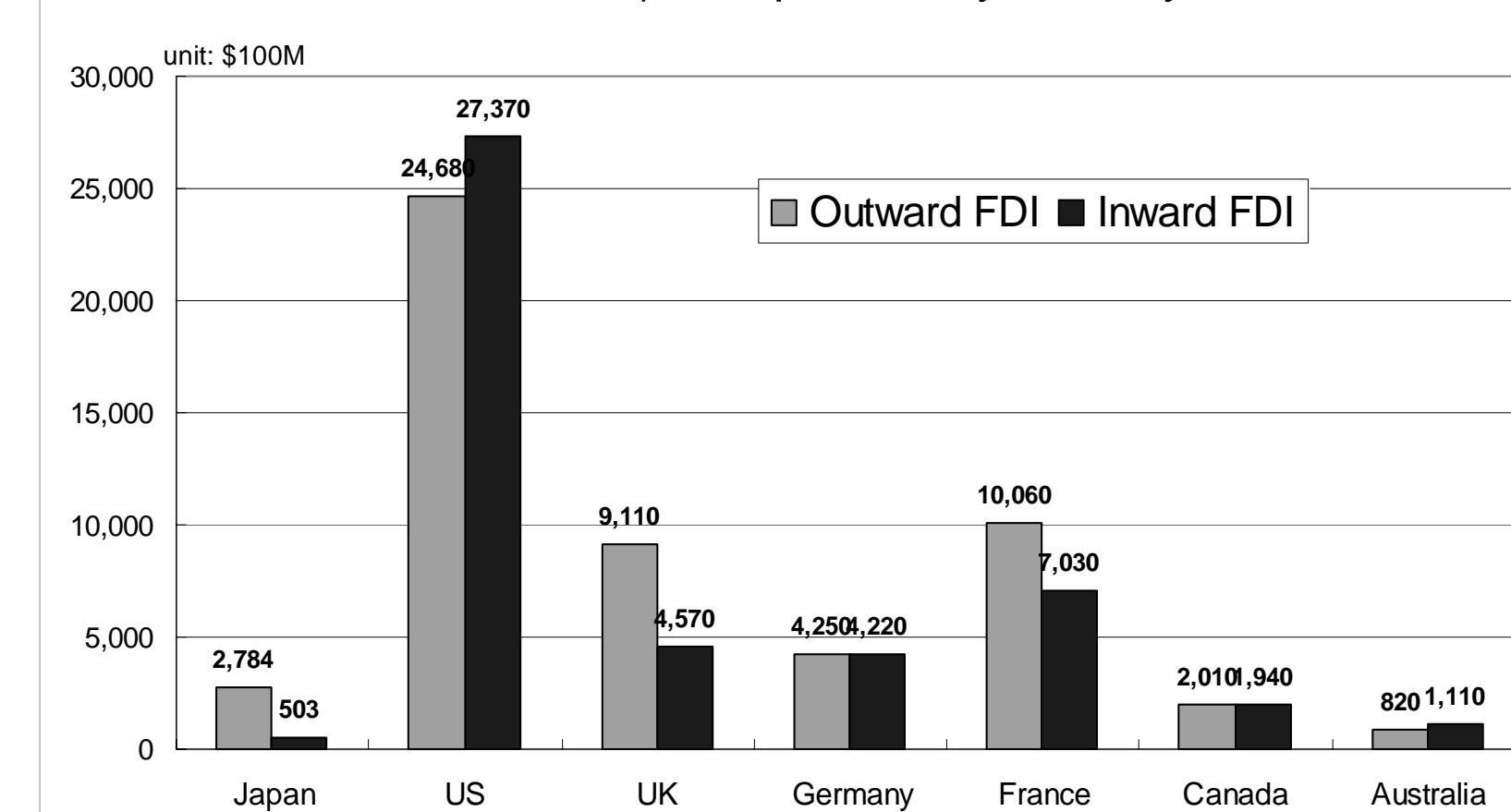
Plus:

Special Working Group for Promoting International Economic Integration (established in March 2003)

- Established under the Council for Regulatory Reform, aiming to promote WTO and other trade policy agendas including FTAs.
- This means that regulatory reform will be considered primarily in the context of WTO and FTAs.
- The regulations to be considered may include those relating to “movement of natural persons”.

Inward FDI / Outward FDI

(Cumulative investment balance) Comparison by Country 1999-2000



	Japan	US	UK	Germany	France	Canada	Australia
Outward/Inward	5.5	0.9	2.0	1.0	1.4	1.0	0.7

Notes: Used 2000 year end currency rate of 114.9yen/\$ for Japan. Others IMF.

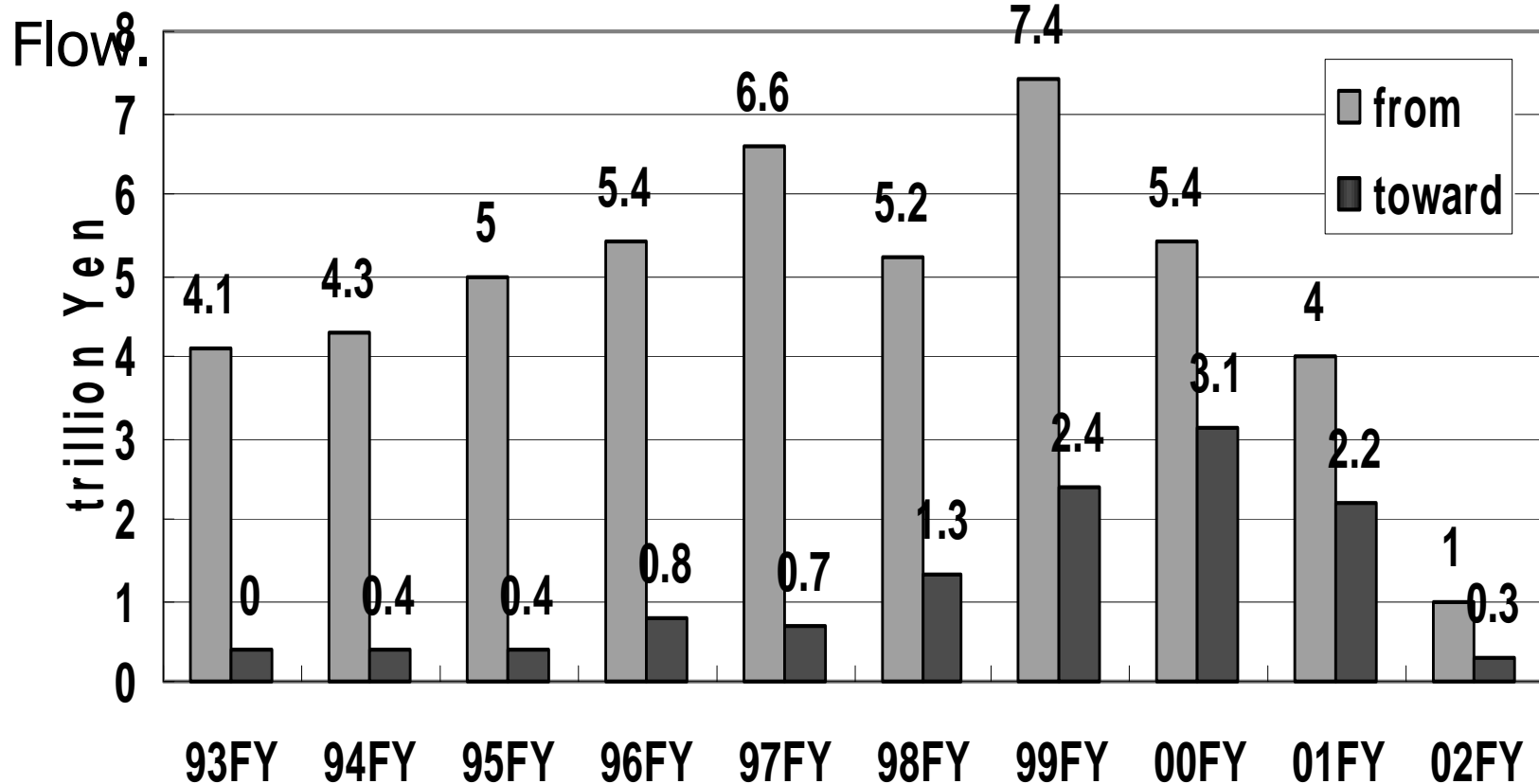
Japan, UK 2000CY, Others 99CY.

Source: Japan - Statement of balance of payments (2000CY)

Others - International Financial Statistics (IMF)

Foreign Direct Investment into & from Japan

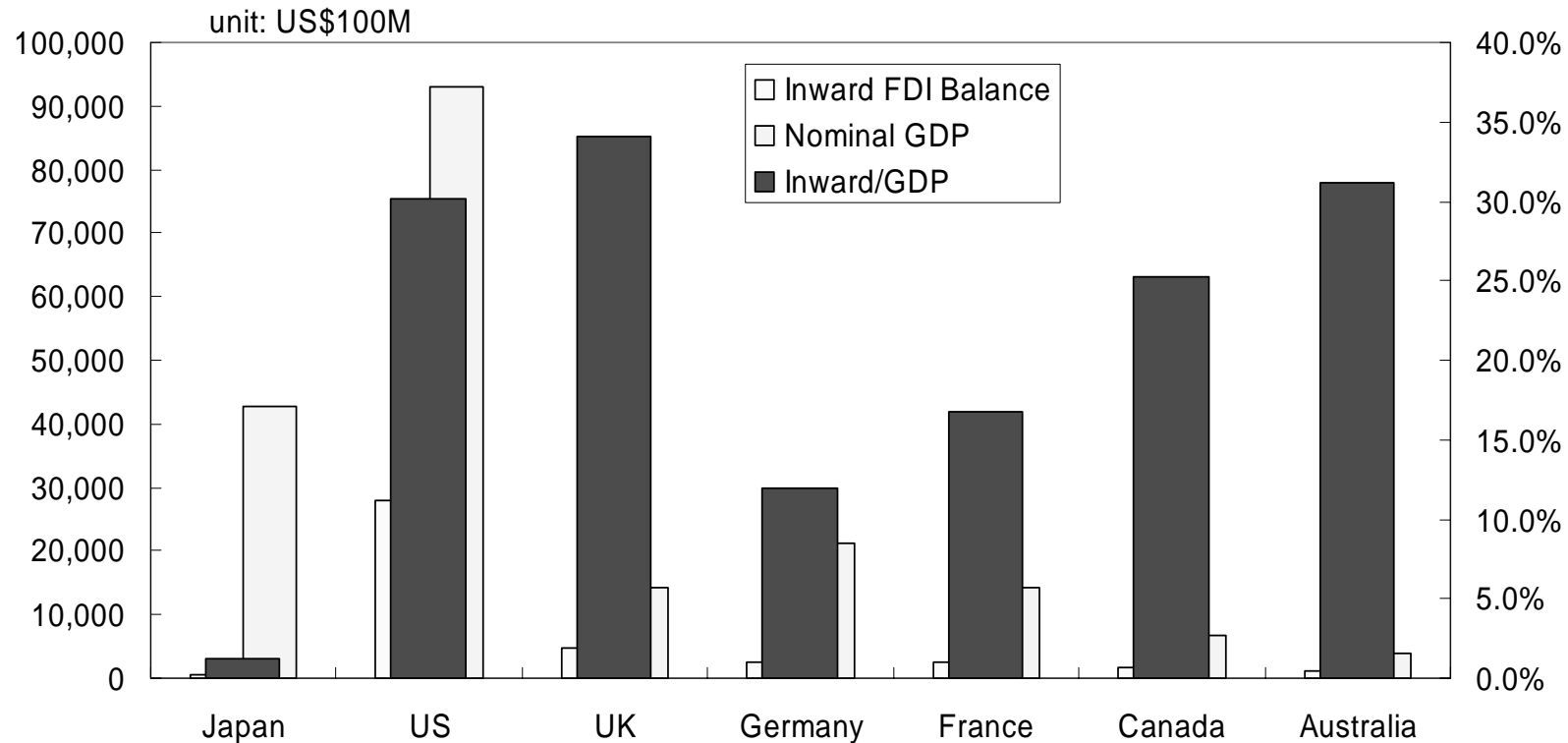
Substantive increase in Inward FDI relative to Outward



Out : In = **10:1** **11:1** **13:1** **7:1** **9:1** **4:1** **3:1** **1.7:1** **1.8:1** **4-6**

Inward FDI by country

(Cumulative investment balance / Nominal GDP 1999-2000)



Notes: Used 2000 year end currency rate of 114.9yen/\$ for Japan. Others IMF.
Japan,UK 2000CY, Others 99CY.

Source: Japan - Inward FDI Balance: Statement of balance of payments.

Nominal GDP: Economic Planning Agency, SNA related data.

Others - Inward FDI Balance: International Financial Statistics (IMF)

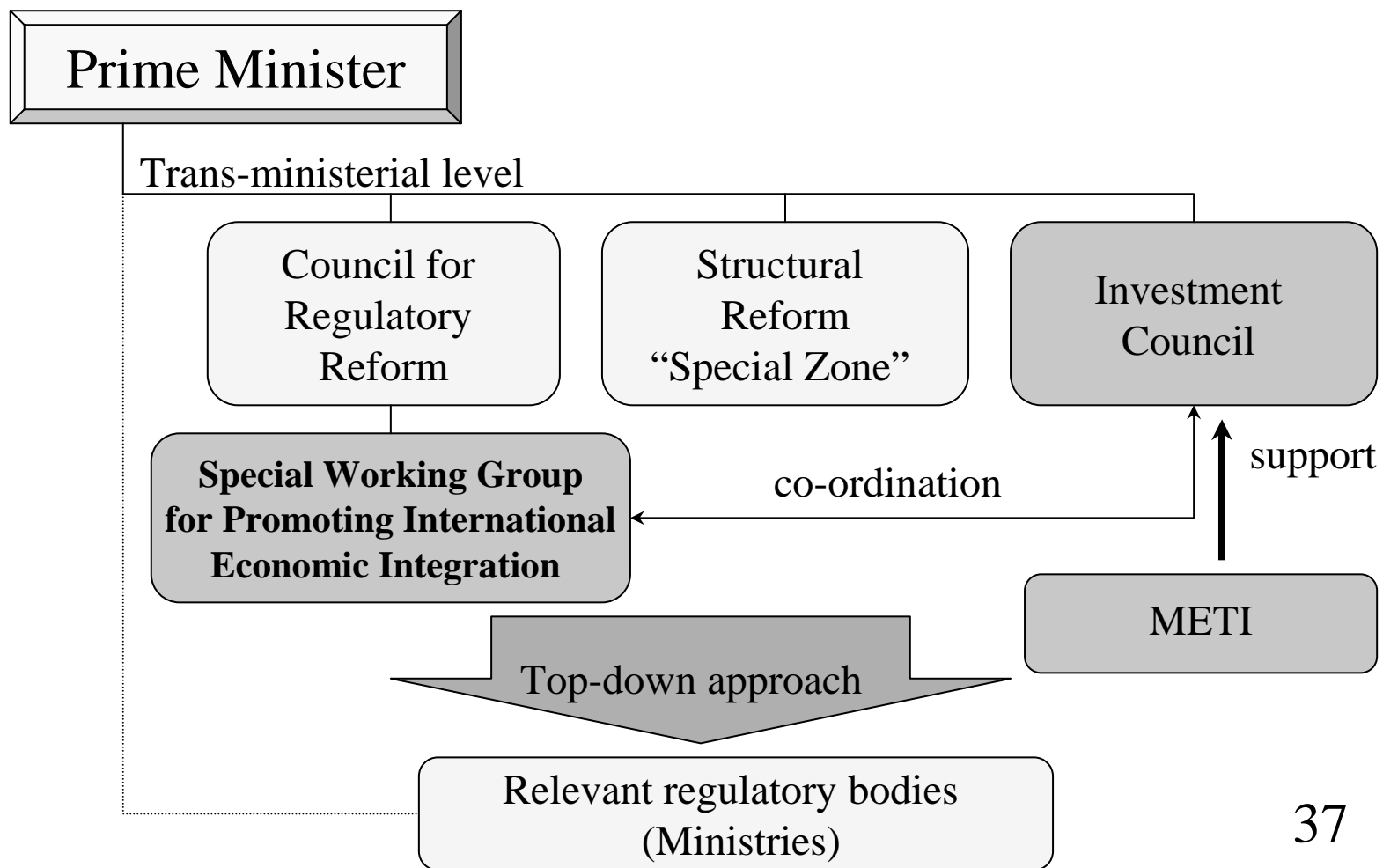
Nominal GDP: Economic Planning Agency, National Economic Accounting

Japan's Case


‘Rebirth of Japanese Charm’ in the General Policy
Speech by the Prime Minister Koizumi on January 31, 2002

“Foreign direct investment in Japan will bring new technology and innovative management methods, and will also lead to greater employment opportunities. Rather than seeing foreign investment as a threat, we will take measures to present Japan as an attractive destination for foreign firms in the aim of doubling the cumulative amount of investment in five years.”

Japan's Case



What are New METI's Missions?



M.I.T.I. was restructured into the Ministry of Economy, Trade and Industry as of January 6, 2001.

New mission is Economic Reform /Restructuring

Three Basic Principles to Re-allocate Resources

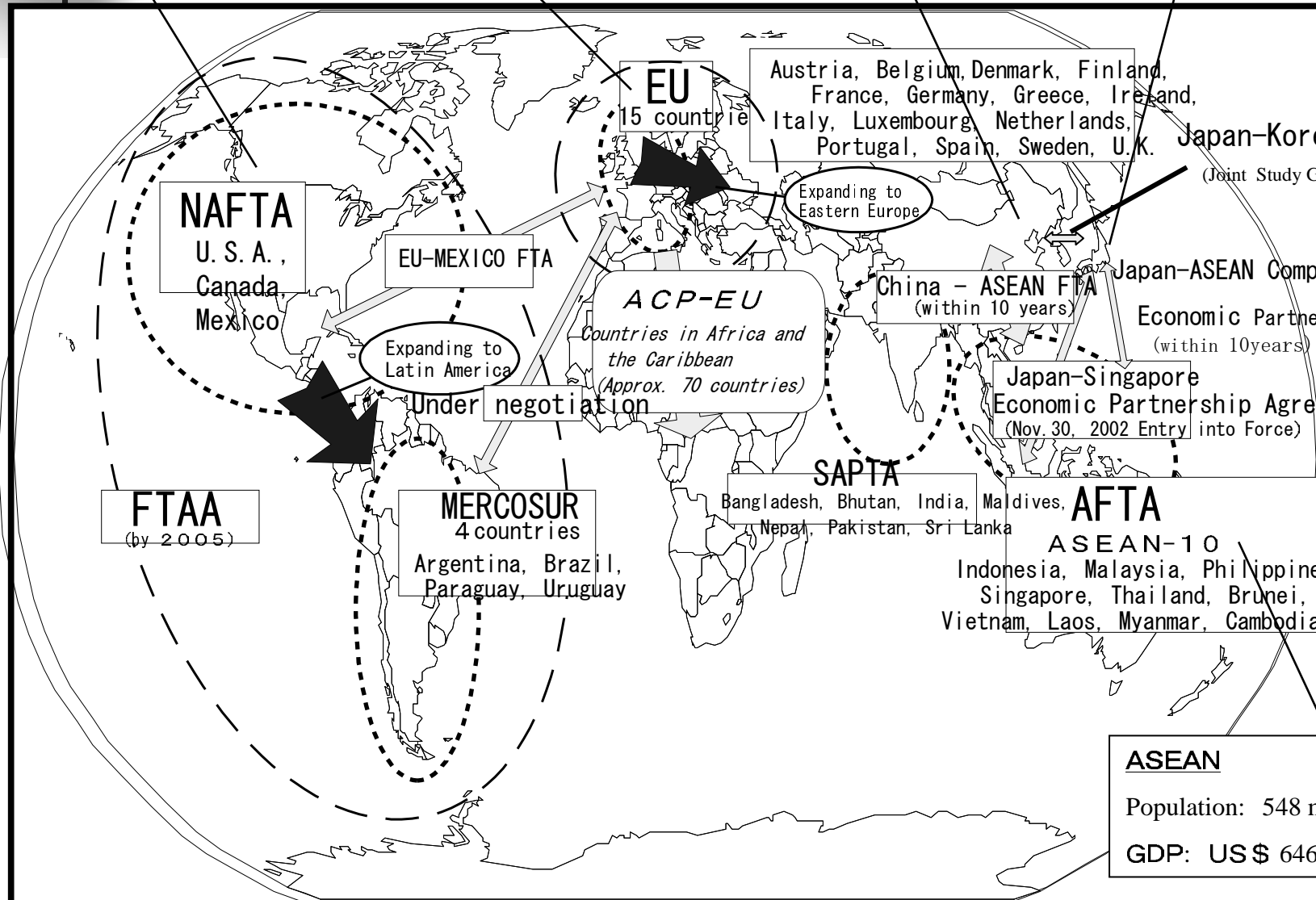
- 1) from Public to Private
- 2) from Regulation to Liberalization &
- 3) from Monopoly to Competition.

Creating an External Driving Force for Reform

Aiming at the Revitalization of Japan's Economy.

< Main Regional Groupings >

<p>NAFTA</p> <p>Population: 411 million</p> <p>GDP: US\$ 11,100 billion</p>	<p>EU</p> <p>population: 376 million</p> <p>GDP: US\$ 7,837 billion</p>	<p>CHINA</p> <p>Population: 1,266 million</p> <p>GDP: US\$ 1,080 billion</p>	<p>JAPAN</p> <p>Population: 126 million</p> <p>GDP: US\$ 4,760 billion</p>
--	--	---	---



NAFTA
U.S.A.,
Canada,
Mexico

EU-MEXICO FTA

Expanding to
Latin America

Under negotiation

FTAA
(by 2005)

MERCOSUR
4 countries
Argentina, Brazil,
Paraguay, Uruguay

ACP-EU
Countries in Africa and
the Caribbean
(Approx. 70 countries)

EU
15 countries

Austria, Belgium, Denmark, Finland,
France, Germany, Greece, Ireland,
Italy, Luxembourg, Netherlands,
Portugal, Spain, Sweden, U.K.

Expanding to
Eastern Europe

SAPTA

Bangladesh, Bhutan, India, Maldives,
Nepal, Pakistan, Sri Lanka

China - ASEAN FTA
(within 10 years)

AFTA
ASEAN-10
Indonesia, Malaysia, Philippines,
Singapore, Thailand, Brunei,
Vietnam, Laos, Myanmar, Cambodia

Japan-Korea FTA
(Joint Study Group)

Japan-ASEAN Comprehensive
Economic Partnership
(within 10years)

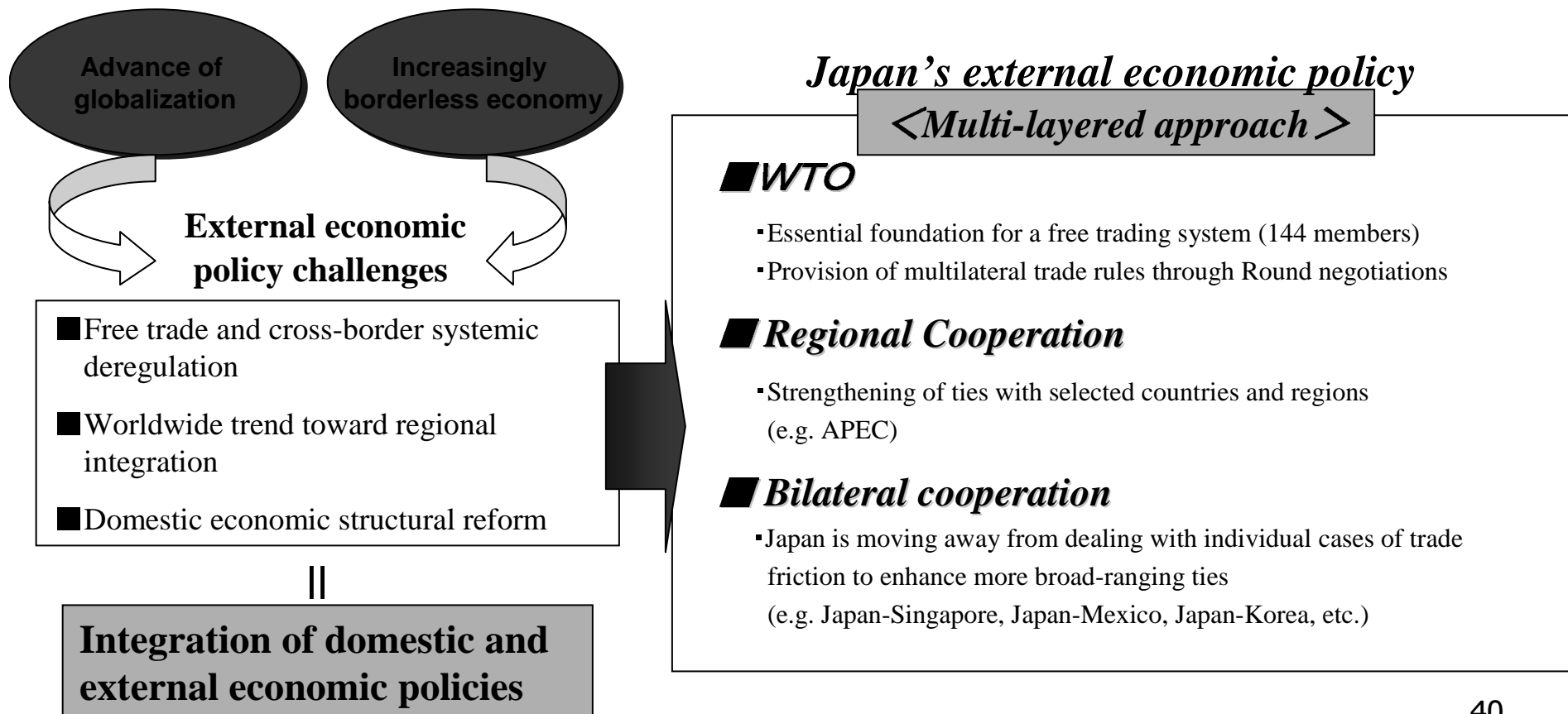
Japan-Singapore
Economic Partnership Agreement
(Nov. 30, 2002 Entry into Force)

ASEAN
Population: 548 million
GDP: US\$ 646 billion

Basic Structure of Japan's External Economic Policy

Multi-layered approach

Japan is promoting EPAs with closely related countries and regions in the economic sense, as well as working toward the WTO new round for establishing global rules.



Key ideas

- Regulatory Reform faces a lot of challenges : it may be better pursued by top-down approach with leader's strong initiative rather than bottom-up approach.
- Integration between domestic and external economic policy may be better promoted with some organisational devices.
- Inward-investment promotion can be a good driving force to integrate domestic and external economic policy.

Restructuring or Boneyard

: the Need for Speed

While restructuring our Company in the 1980s, we spent much of our time talking about the accelerating pace of change: in world politics, in technology, in product introduction and in the increasing demands of customers. We don't have to do that anymore. Change is in the air. Newspapers and networks hammer it home daily. GE people today understand that pace of change, the need for speed, and the absolute necessity of moving more quickly in everything we do, from inventory turnover, to product development cycles, to a faster response to customer needs. They understand that slow-and-steady is a ticket to the boneyard in the 1990s.

“To Our Share Owners” (1990 Annual Report) of GE