

# JAPANESE ECONOMY: OBSTACLES AND OPPORTUNITIES

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August 25, 2008

Minister of State for Financial Services and  
Administrative Reform

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## 1. The Three Challenges for Japan

### 1) Demographic Change

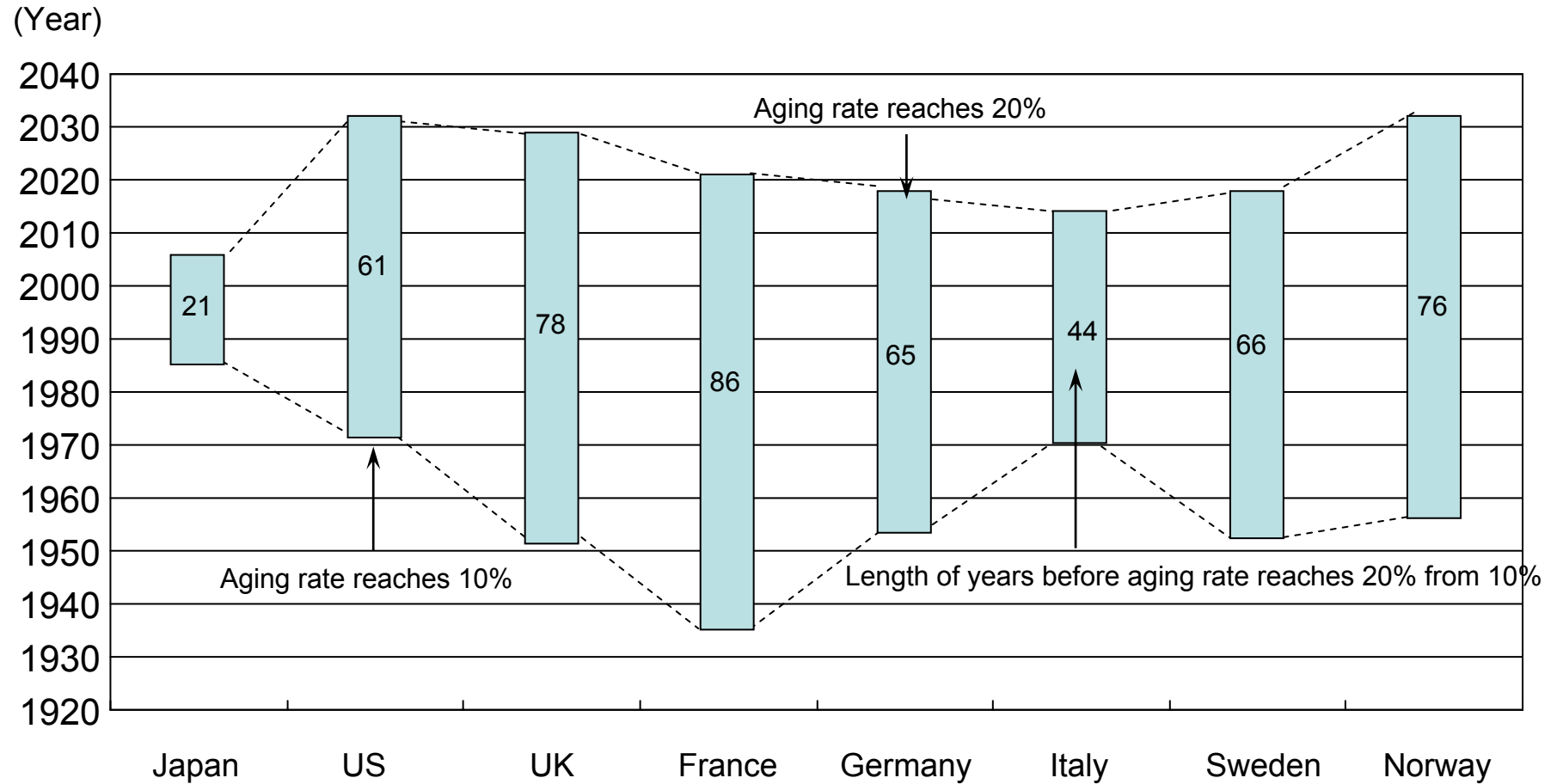
- Labor Shortage and Expanding Social Security Expenditure

### (2) Price Hike of Energy and Raw Materials

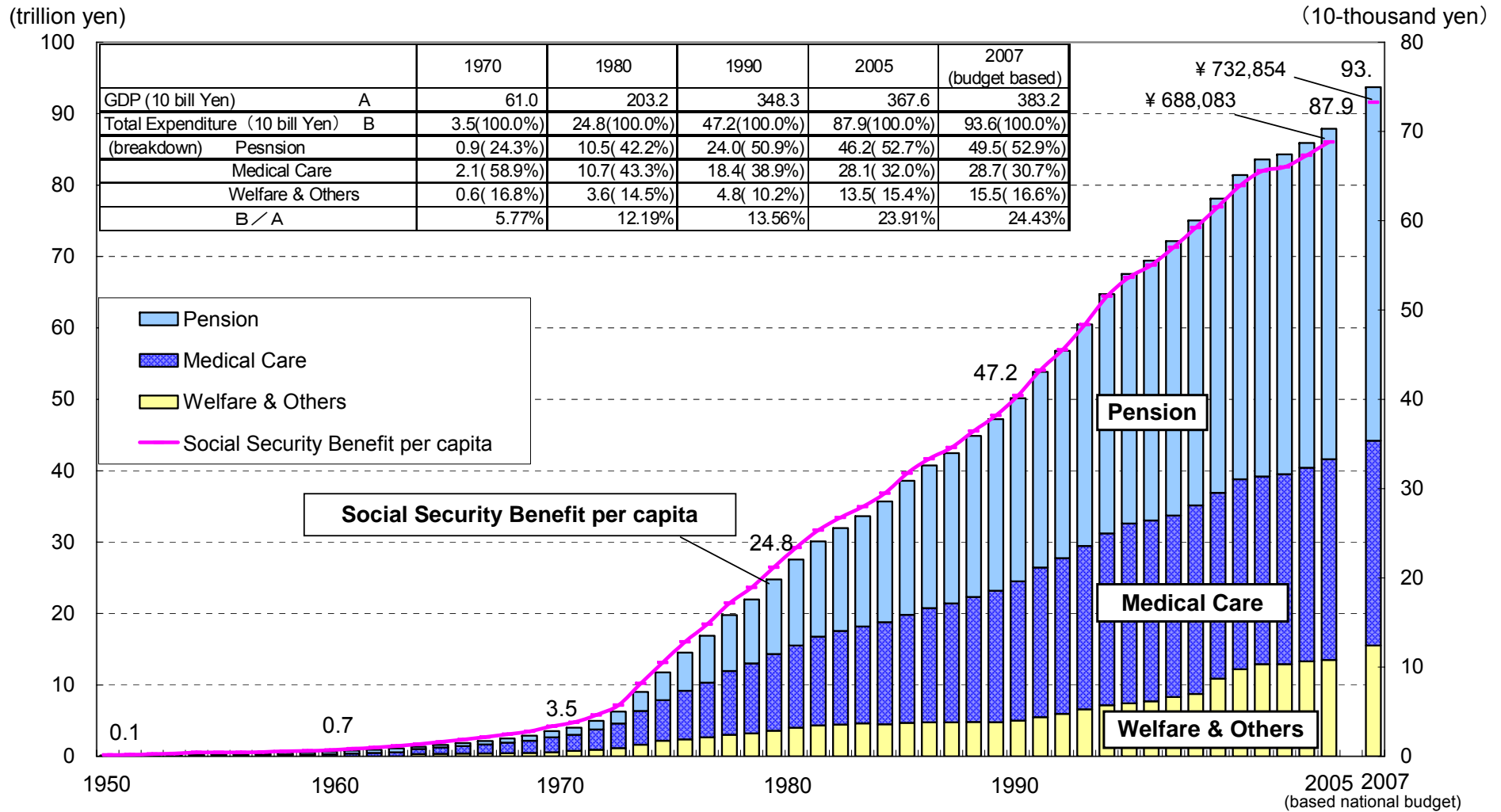
### (3) Slipping Global Competitiveness and Diminishing Attractiveness

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# Rise in Aging Rate from 10% to 20%



# Trends in Social Security Benefit Expenditure

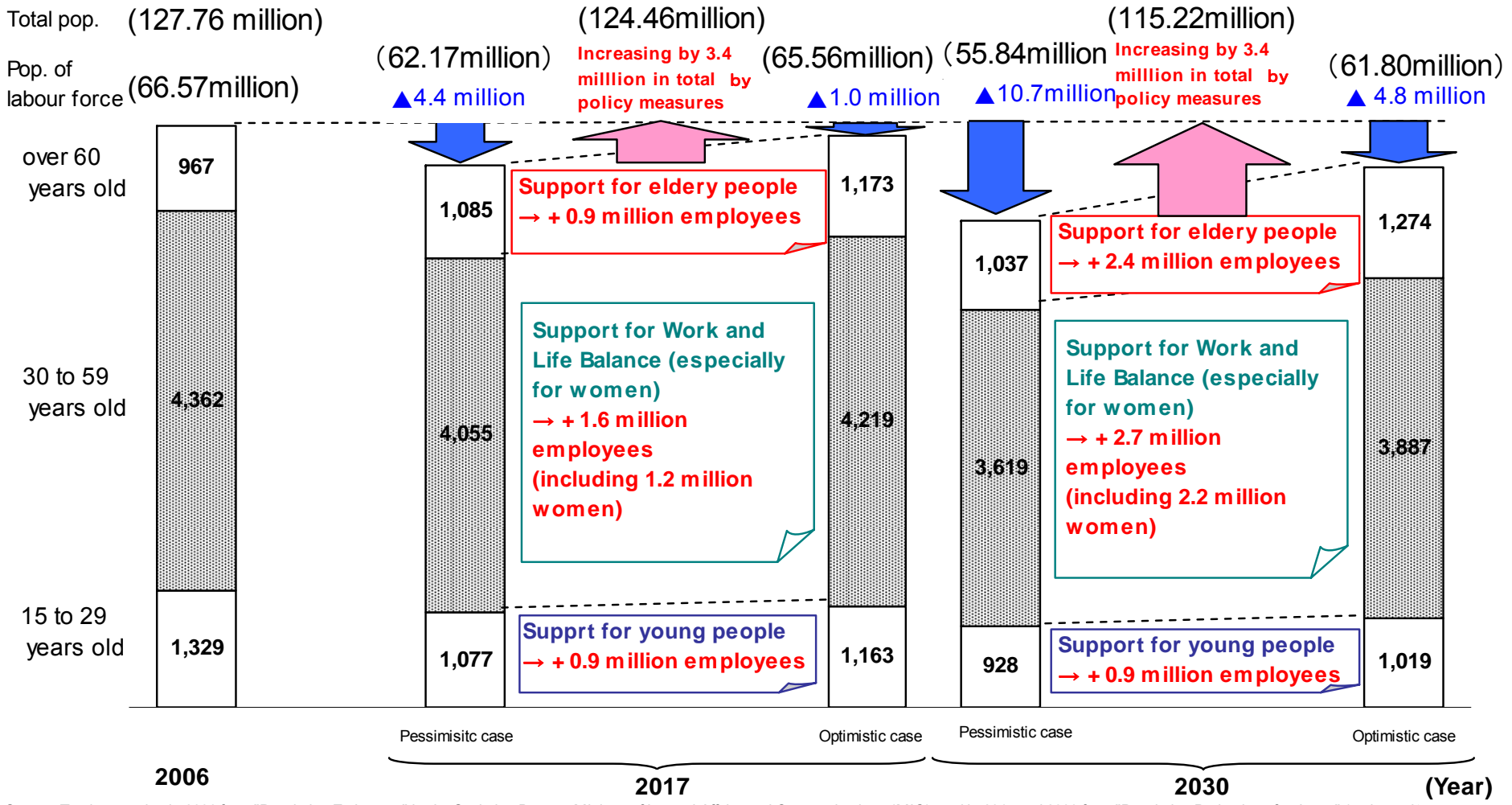


Source: National Institute of Population and Social Security Research, "The cost of Social Security in Japan" (FY2005). Estimated in FY2007(budget based) by Ministry of Health, Labour and Welfare.

Note: The values shown in the Figure are the social security benefit expenditures (unit: ¥1 trillion) for 1950,1960,1970,1980,1990, 2005 and 2007(budget based) respectively.

# Projection of the Labour Force in Japan

Faced with decline in total population, the decline in the labour force would be alleviated by creating an employment environment that encourages motivation of all workers such as the young, women, the elderly, the physically challenged. Compared with the population projection as it stands, it is estimated that the labour force could increase by 3.4 million in 2017 and by 6 million in 2030.



Source: Total population in 2006 from "Population Estimates " by the Statistics Bureau, Ministry of Internal Affairs and Communications (MIC), and in 2017 and 2030 from "Population Projections for Japan" (estimated in December 2006). Population of labour force in 2006 from "Labour Force Survey" by the Statistics Bureau, MIC, and in 2017 and 2030 from the figures which Employment Policy Study Group went through based on estimates by Study Group on Estimation of Demand and Supply in JILPT.

Note 1: "Pessimistic case" is the case where the labour rate by sex and age is estimated to stand at the same level as 2006.  
 Note 2: "Optimistic case" is the case where the young, women, and the elderly are estimated to be involved in the labour market by each policy.

## Japan's Global Competitiveness

### 1. International Institute for Management Development (IMD)

	2006	→	2007	
United States	1	→	1	(year)
Japan	16	→	24	
China	18	→	15	
Germany	25	→	16	(ranking)

### 2. World Economic Forum (WEF) 2007/2008

	Global Competitiveness	Business Competitiveness	
United States	1	1	
Germany	5	2	
Japan	8	10	
Korea	11	19	
China	34	57	(ranking)

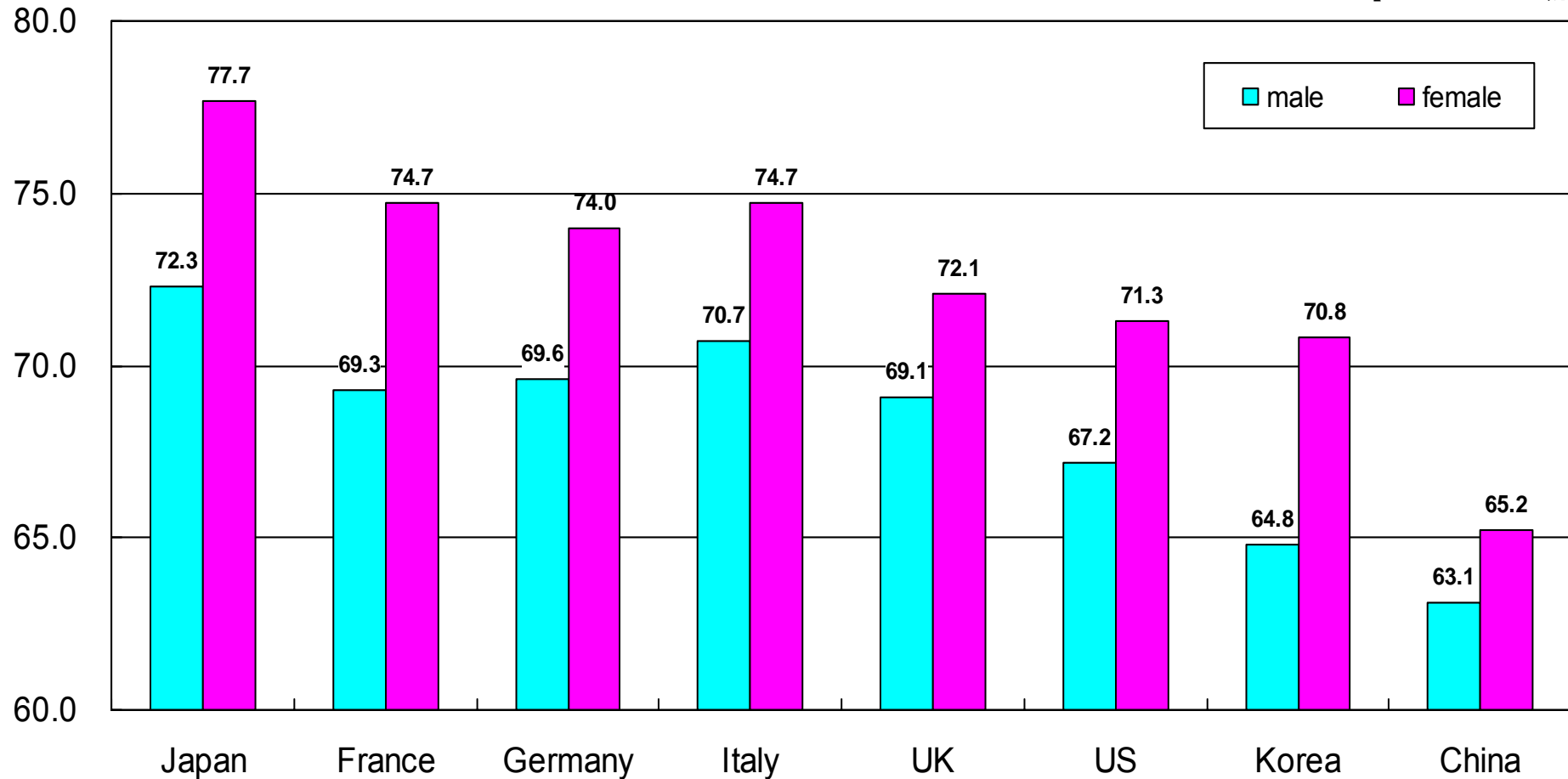
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## 2. Tackling the Demographic Change

- Fixing Labor Shortage and Controlling Medical Benefit Expenditure
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# Healthy Life Expectancy in WHO Member States

【based on HALE(※)】

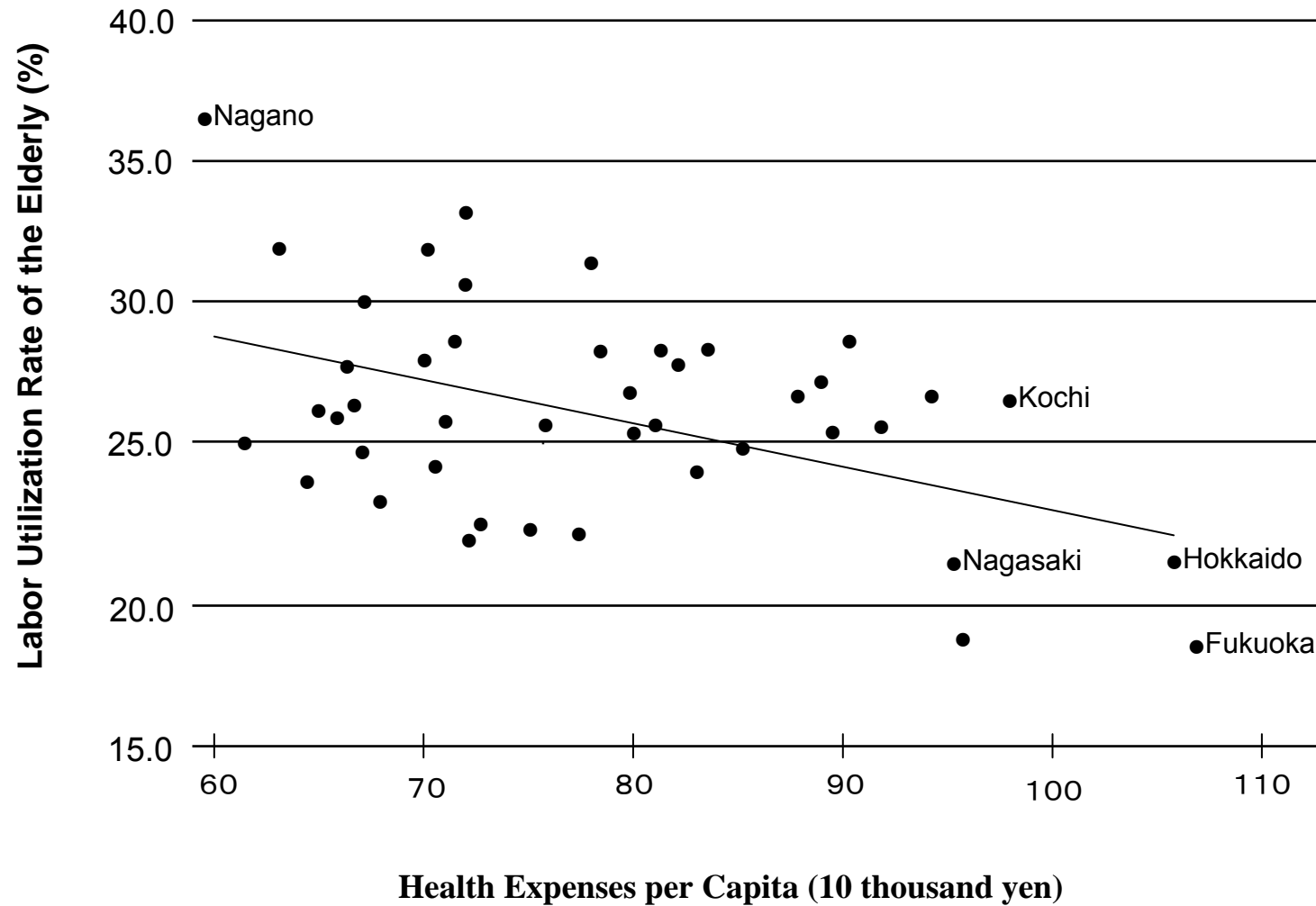


Source : WHO 「The World Health Report 2004」

※ Figures are computed by WHO based on healthy life expectancy (HALE) to ensure comparability.  
Estimates by WHO based on HALE are not revised after estimation in 2002.



## Labor Utilization Rate of the Elderly and Health Expenses for the Elderly per Capita by Prefecture



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### 3. Japan's attractiveness and Underutilized Money: Two Examples - Utilizing Household Financial Assets and Overseas Retained Profits

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## Assessment of the Tokyo Market as a Global Financial Center

### ○ Comparison with New York and London

	Item	Point (※)
	Safety and security in communities	44
	Amounts of household financial assets	29
	Stability in economic environment	17
	Political stability	13
	Highly developed infrastructure of communication and information	10
	Costs of operation including office rent, wage, cost of equipment	▲ 11
	Regulation over financial institutions	▲ 14
	Corporate tax rate	▲ 18
	Lofty fire wall	▲ 21
	Availability of talented people in global finance	▲ 27

### ○ Comparison with Hong Kong and Singapore

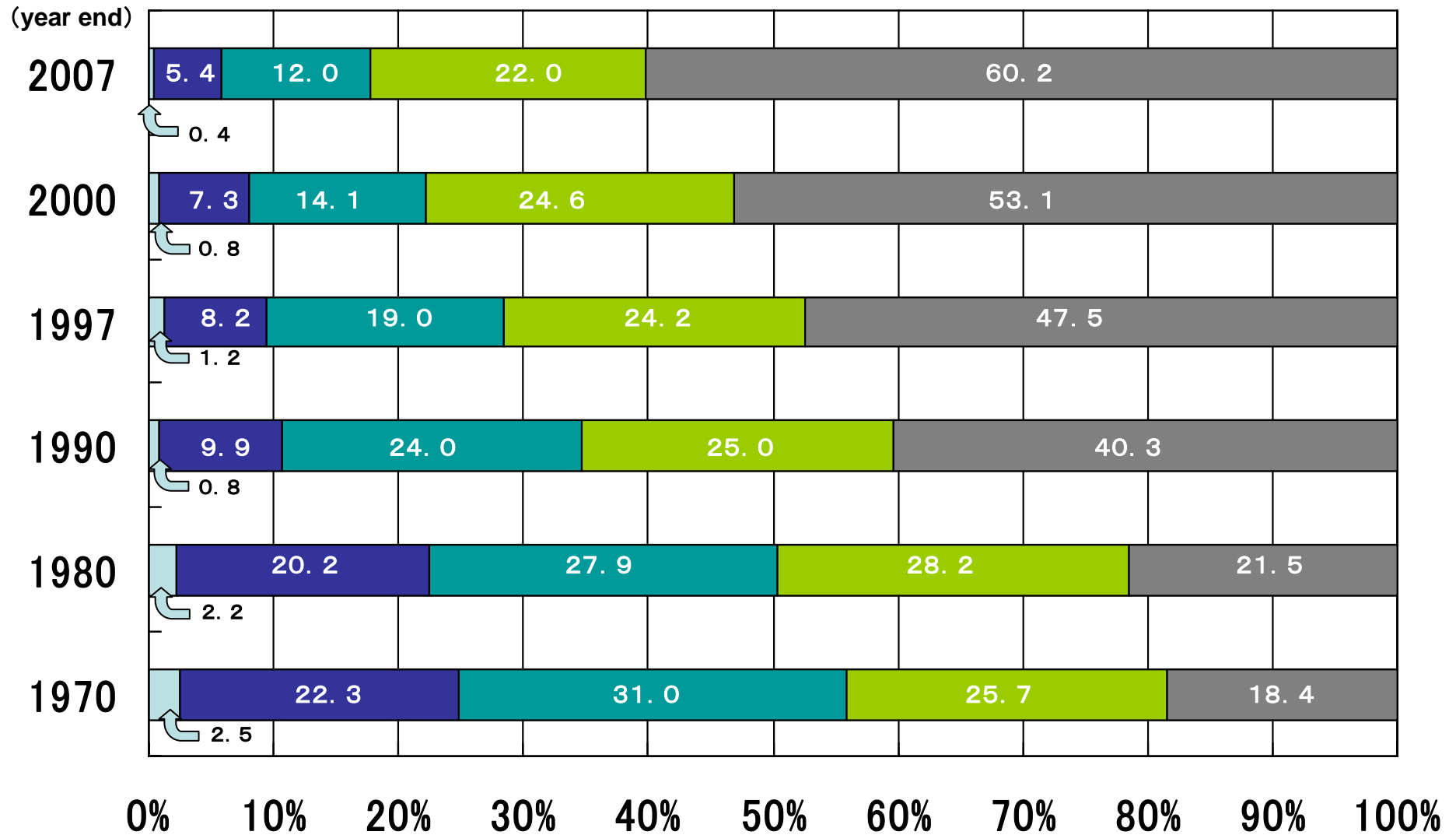
	Item	Point (※)
	Amounts of household financial assets	34
	Safety and security in a community	28
	Political stability	25
	Stability as a capital importing or exporting country	18
	Stability in economic environment	16
	Costs of operation including office rent, wage, cost of equipment	▲ 15
	Living environment for foreign workers( including those on private life and income tax)	▲ 15
	Regulation over financial institutions	▲ 16
	Availability of talented people in global finance	▲ 16
	Lofty fire wall	▲ 18
	Lower corporate tax rate	▲ 29

Note: A point is the difference between the number of corporations which think the Tokyo market is of more advantage than other markets and those which don't think so.

Source: This is a result of the inquiry survey conducted by Japan Center for International Finance (JCIF). JCIF sent out questionnaires in June to July 2007 to 120 of foreign banks and securities corporations, and received responses from 49 corporations by end of July including 36 of foreign banks, 12 of foreign securities corporations, and 1 of other financial institution (response rate: 41%).

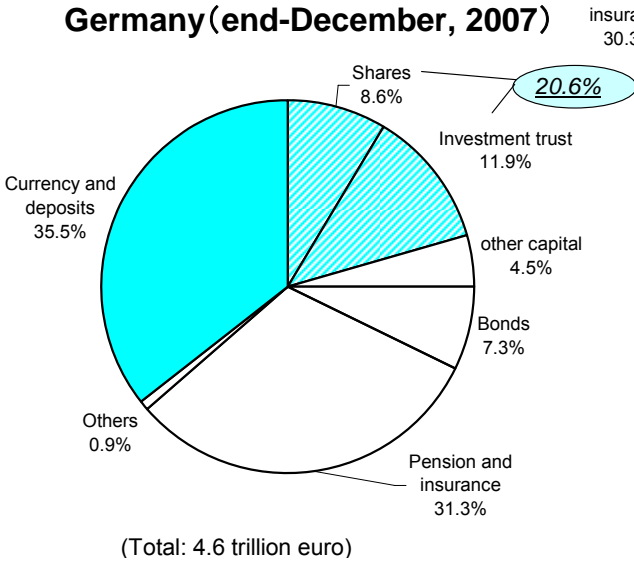
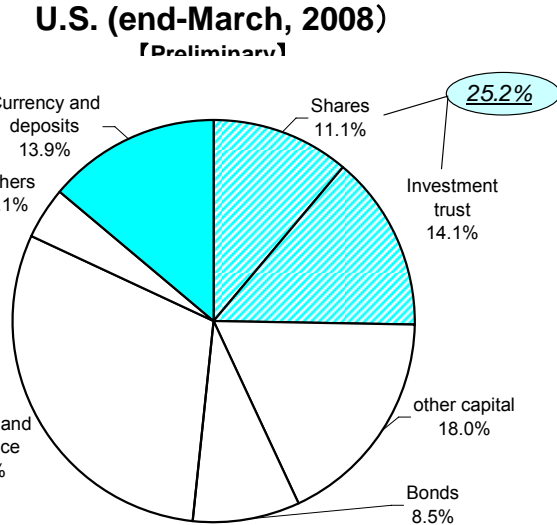
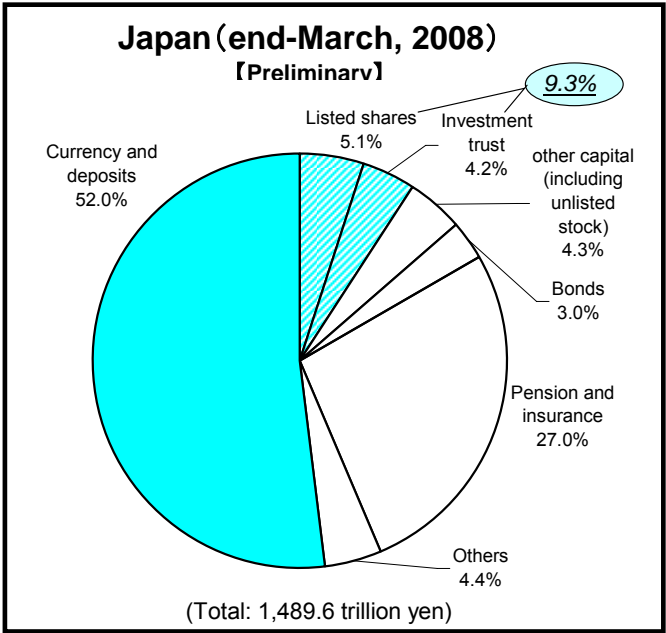
# Households Financial Asset Holdings Age Group

■ under 30 
 ■ 30~39 years old 
 ■ 40~49 years old 
 ■ 50~59 years old 
 ■ more than 60



# Composition of Household Financial Assets (Japan, German, U.S.)

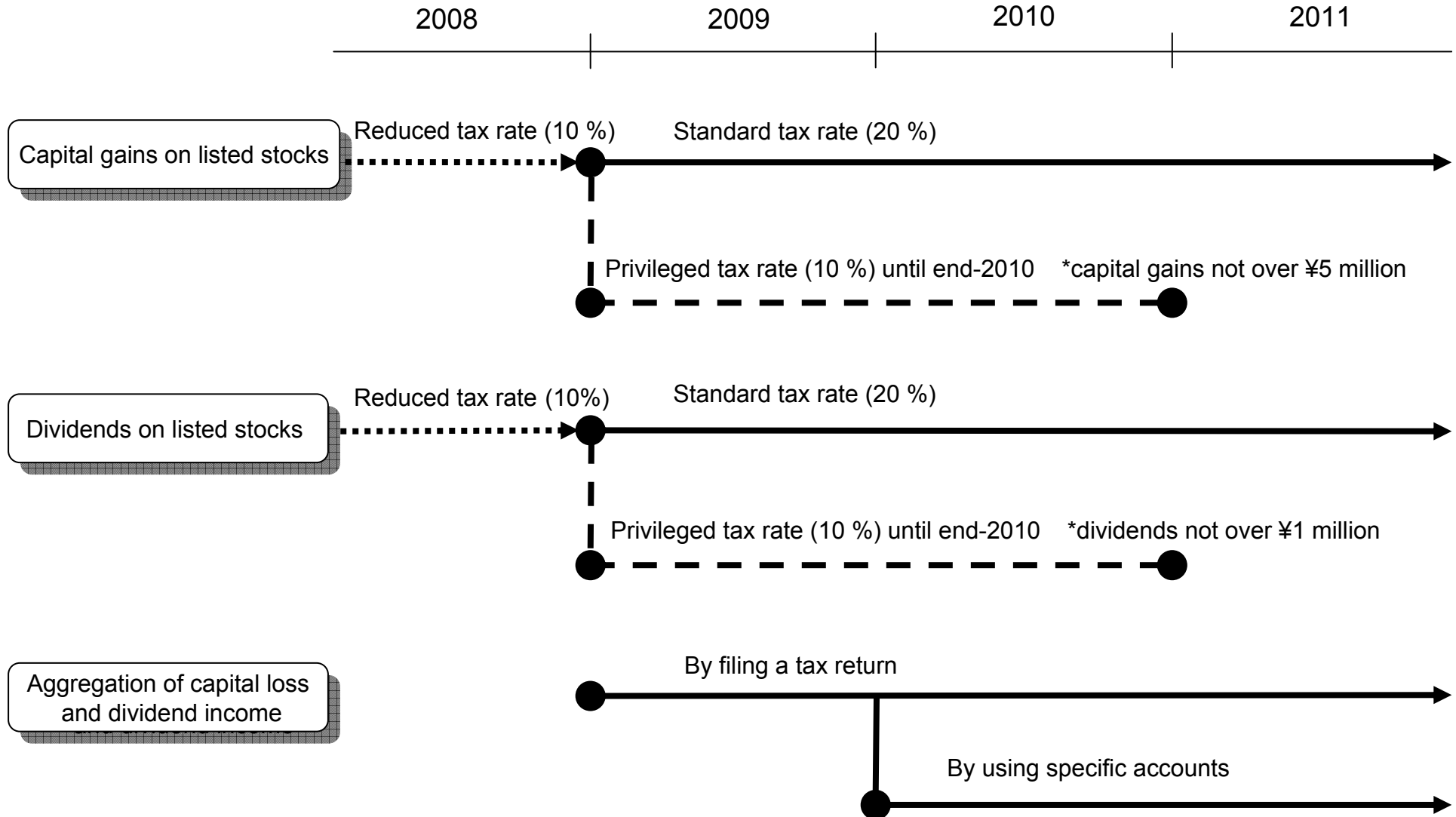
Cash and Deposits Account for Half of Household Financial Assets in Japan higher than other countries.



Note: Japan's figures include only "household". Those of U.S. and Germany include both "household" and "nonprofit organizations".  
 Source: Japan: Bank of Japan, "Flow of Funds Accounts", United States: Federal Reserve Board "Flow of Funds Accounts", Germany: Deutsche Bundesbank "Monthly Report May 2008"

# Reform Schedule of Taxation on Financial Products

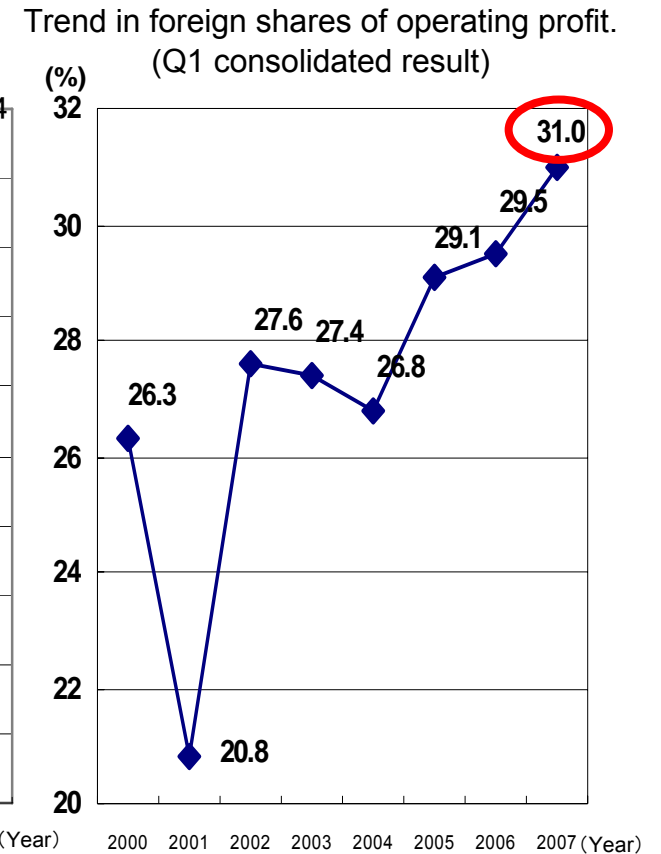
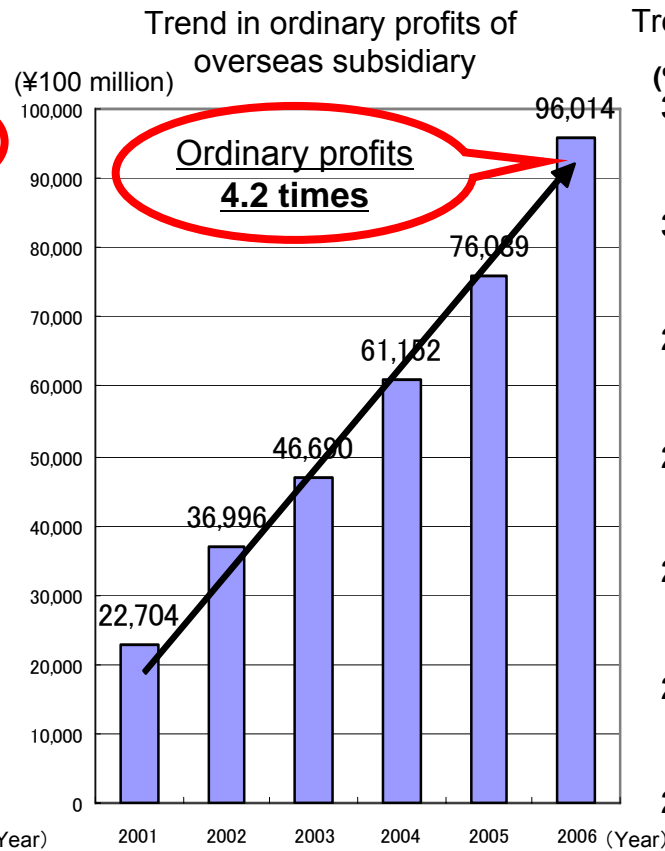
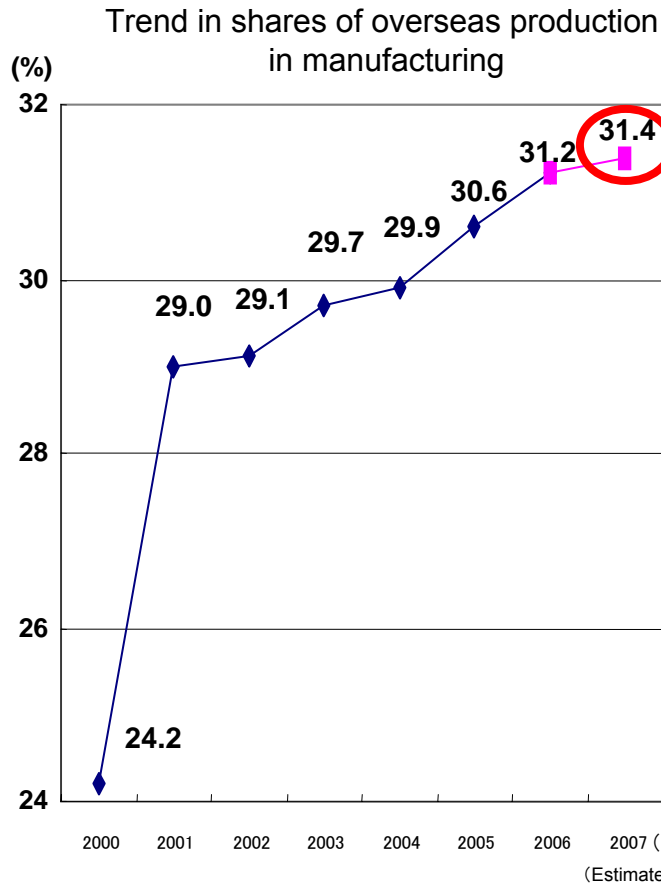
(after FY2008 Tax Reform)



# International Taxation for encouraging repatriation of profits to Japan

## 【Fact】

- Share of overseas production by Japanese corporations has risen up to over 30%.
- Ordinary profits earned overseas substantially increased, so did ratio of operating profits from overseas.



Note: Based on figures of corporations operating overseas  
Source: Ministry of Economy, Trade and Industry (METI), "Basic Survey of Overseas Business Activities"

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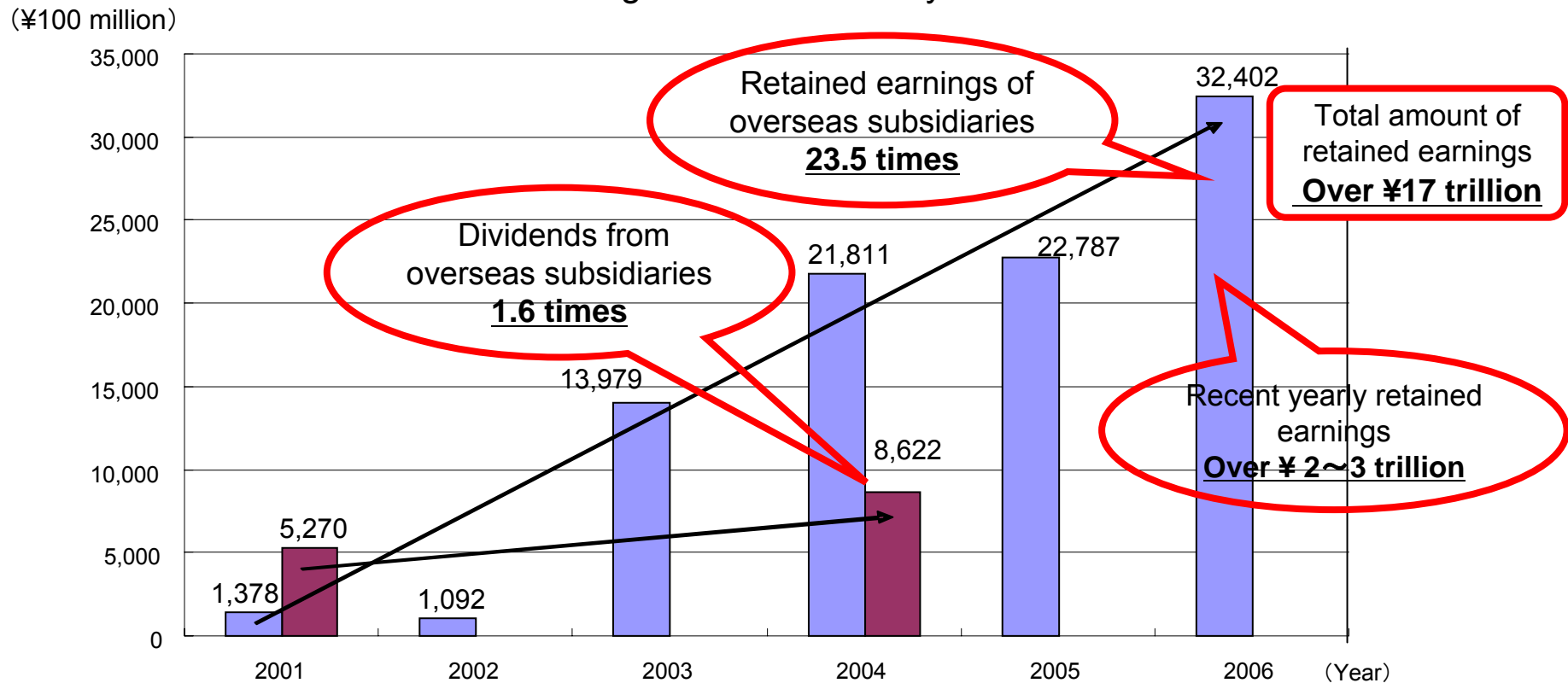
Source: Nihon Keizai Shinbun

## International Taxation for encouraging repatriation of profits to Japan

### 【Fact】

- Japanese corporations tend to retain most profits abroad without repatriating them, thereby increasing the amount of retained earnings held overseas.
- On the other hand, dividends from overseas subsidiaries register a modest increase.

Trends in retained earnings and dividends by overseas subsidiaries



Source: METI, "Basic Survey of Overseas Business Activities"

\*A similar reform in U.S. succeeded in increasing dividends from overseas subsidiaries from 5.8 trillion yen (2004) to 28 trillion yen (2005).



## International Taxation for encouraging repatriation of profits to Japan

○ There are mainly two ways to avoid double taxation on income earned overseas by corporations.

### 1. Foreign Source Income Exemption System [France, Germany, Canada etc. 21 out of 30 OECD member countries]

→ Limit taxable corporate profits to domestic source income:  
➡ not tax dividends and other income from overseas subsidiaries

### 2. Worldwide Income Tax System [Japan, U.S, UK etc. 9 out of 30 OECD member countries]

→ Tax all income (both domestic and overseas) earned by Japanese corporations at the domestic corporate tax rate. However,

- ① Income earned by foreign subsidiaries is taxed only after being repatriated to parent companies (tax deferring).
- ② Tax paid abroad is deducted from domestic corporate tax (Foreign tax credit system).

➡ Repatriated dividends are subject to domestic corporate tax in Japan to the extent that there is tax rate differential over the source state's tax rate (corporate tax and withholding tax on dividends).

Note: Switch from worldwide income tax system to territorial tax system is under consideration in U.S. and UK.

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#### 4. Positive or Negative? Impact of Soaring Energy and Raw Material Prices

- Realizing Japan's Potential in Efficiency-Related Technology

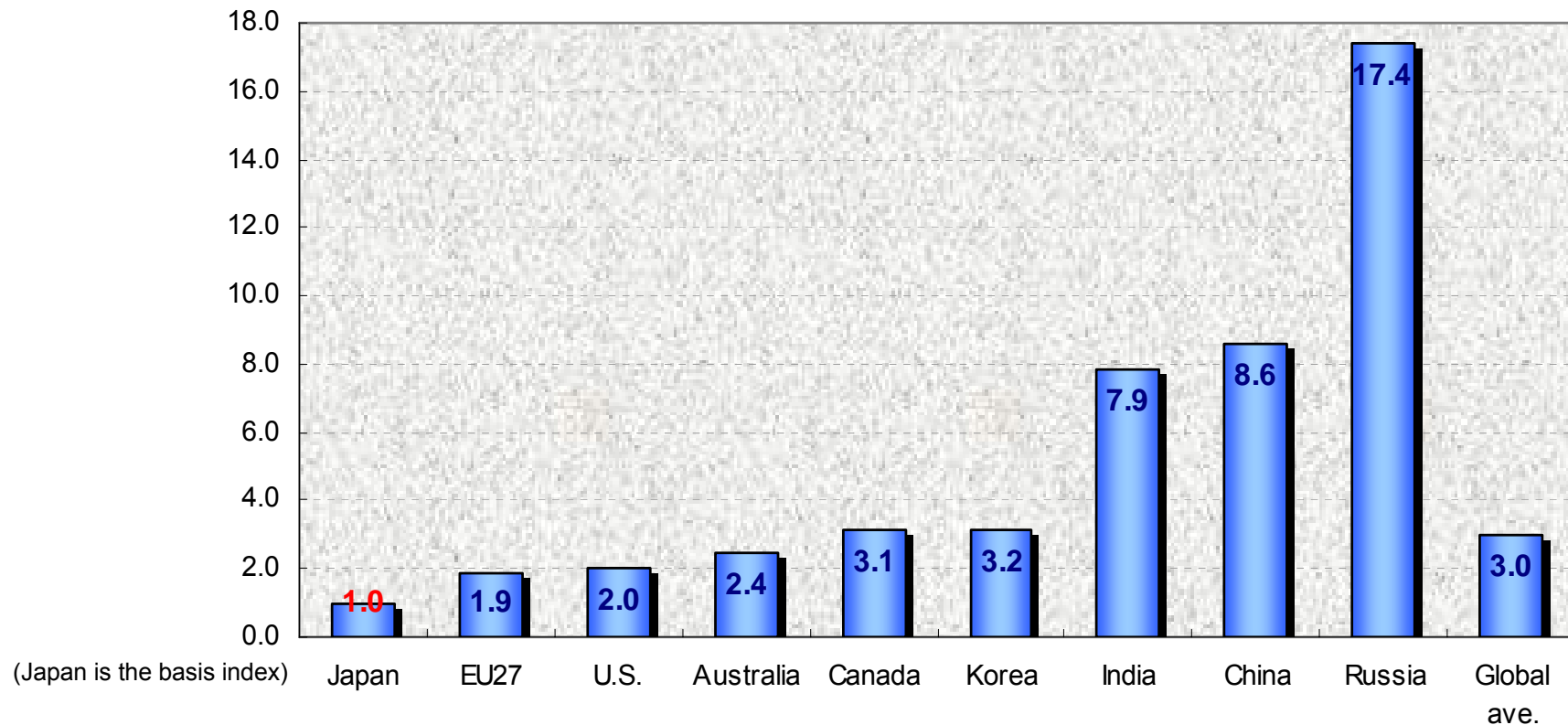
#### 5. New Perspective for Enhancing Global Competitiveness

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## Energy Efficiency —Taking Advantage of Efficiency-Related Technologies is Japan's strength

Energy input per GDP of Japan is outstanding: 1/2 of that of U.S. and EU, 1/9 of China, 1/17 of Russia.

【Supply of primary energy per GDP (2005)】

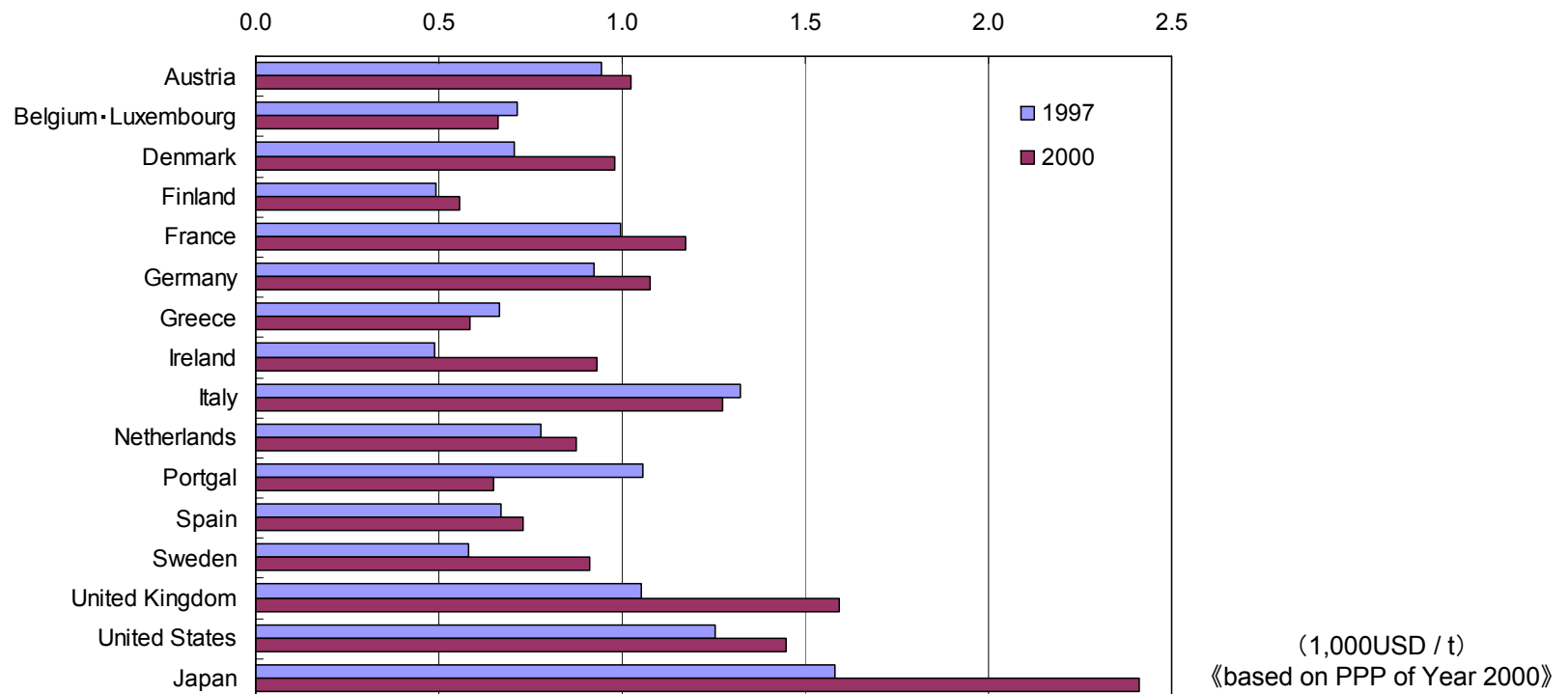


※Calculated from IEA “Key World Statistics 2007”. Indices on calculation based on total primary energy supply (TPES) divided by GDP for each country and Japan is the basis index.

## Energy Efficiency —Taking Advantage of Efficiency-Related Technologies is Japan's strength

- Resource efficiency of Japan is 2 - 3 times as high as U.S. and EU countries, and highest in the world.
- Furthermore, Japan improved its efficiency at a remarkable rate during 1997-2000.

### 【Comparison of resource efficiency\* for 1997 and 2000】



\* Resource efficiency: GDP divided by Natural Resources Input

Source: (EU) EUROSTAT "Material use in the EU 1980-2000: indicators and analysis",2002.

(US) WRI "Material Flow Accounts: A Tool For Making Environmental Policy",2005

(Japan) Estimates by Ministry of Environment

(GDP) OECD "OECD in Figures 2001 Edition."

\*\*U.S. Figure in 1997 is substituted by that in 1994.

# Top 20 Countries in GDP per capita ( 1980 ~ 2006 )

## Top 20 Countries in GDP per capita ( 1980 ~ 2006 )

1980年	1985	1990	1995	2000	2006	Population (2006)
1 Qatar	1 UAE	1 Switzerland	1 Luxembueg	1 Luxemburg	1 Luxemburg	46
2 UAE	2 Qatar	2 Luxemburg	2 Switzerland	2 Norway	2 Norway	464
3 Kuwait	3 United States	3 Sweden	3 Japan	3 Japan	3 Qatar	84
4 Luxemburg	4 Norway	4 Finland	4 Denmark	4 Switzerland	4 Switzerland	729
5 Saudi Arabia	5 Switzerland	5 Norway	5 Norway	5 United States	5 Iceland	31
6 Switzerland	6 Canada	6 Denmark	6 Germany	6 Iceland	6 Ireland	424
7 Sweden	7 Sweden	7 Iceland	7 Austria	7 Denmark	7 Denmark	543
8 Norway	8 Kuwait	8 Japan	8 Sweden	8 Qatar	8 United States	29,972
9 Iceland	9 Luxemburg	9 United States	9 United States	9 Sweden	9 Sweden	911
10 Denmark	10 Iceland	10 France	10 Belgium	10 Ireland	10 Netherlands	1,635
11 France	11 Denmark	11 Austria	11 Netherlands	11 Hong Kong	11 Finland	525
12 Netherlands	12 Finland	12 Canada	12 France	12 United Kingdom	12 United Kingdom	6,053
13 Belgium	13 Japan	13 Italy	13 Iceland	13 Austria	13 Austria	826
14 United States	14 Australia	14 Belgium	14 Finland	14 Netherlands	14 Canada	3,258
15 Libya	15 France	15 Netherlands	15 Singapore	15 Canada	15 UAE	423
16 Finland	16 Bahamas	16 Germany	16 Hong Kong	16 Finland	16 Belgium	
17 Canada	17 Netherlands	17 UAE	17 Australia	17 UAE	17 France	6,135
18 Australia	18 Austria	18 Australia	18 Canada	18 Germany	18 Australia	2,065
19 Germany	19 Bahrain	19 United Kingdom	19 Italy	19 Singapore	19 Germany	8,229
20 Austria	20 Saudi Arabia	20 Qatar	20 United Kingdom	20 Belgium	20 Japan	12,775
∴						
22 Japan						

(unit: 10 thousand)

• High Oil Prices (\$29) pushed oil states high up on the list.

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• Switzerland and Luxemburg, strong in banking business, moved high on the list.

• Japan moved up due to the bubble economy.

• Low oil prices (\$25) pushed oil states down in the ranking.

• Yen appreciating yen (\$1=¥94) pushed Japan up to the list.

• UK emerged in 20th after Thatcher's reform in 1980s.

• Weak oil prices (\$18) drove Middle Eastern countries out of the list.

• U.S. jumped up due to rapid progress of IT revolution.

• Recovered oil prices (\$30) pulled back Middle Eastern countries on the ranking.

• German unification in 1990s pushed Germany down.

• EU countries universally moved up due to Euro appreciation against Yen and U.S. dollar. U.S. and Japan moved down.

• Rising oil prices (\$66) pushed up Middle Eastern and other oil countries.

<Major industry of top 20 countries in 2006>

Luxemburg (Finance), Norway (Oil), Qatar (Oil, Natural gas), Switzerland (Finance), Iceland (Fishery), Ireland (IT), Denmark (Agriculture and Livestock), United States (Finance, IT), Sweden (IT), Netherland (Oil, Natural Gas), Finland (IT), United Kingdom (Finance), Austria (Finance), Canada (Finance), UAE (Oil), Belgium (Finance), France (Manufacturing), Australia (Coal, Steel), Germany (Manufacturing), Japan (Manufacturing)