



# Supporting Japan policy objectives: the OECD Contribution

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The world economy has started to recover from its deepest decline in post-war history. As bad as it was, an even more catastrophic outcome was avoided by a prompt and vigorous response by economic policy makers, including in Japan. Nevertheless, the recovery is likely to be both weak and fragile for some time to come, as projected in the OECD's *Economic Outlook*, which I will present tomorrow. And the negative economic and social consequences of the crisis will be long-lasting. Even with a return to economic growth starting in mid-2009, we expect that there will be 50 million unemployed workers in the OECD area in 2011, compared to 35 million in 2008. In short, there is a risk that the crisis will permanently lower the standard of living.

### Overcoming the crisis and the obstacles to growth

Japan is one of the countries hardest-hit by the crisis. Although it was far from the epicentre of the origins of the crisis, Japan's export-dependent economy was especially vulnerable to the collapse in world trade. We now see signs of a recovery in Japan, thanks to large-scale fiscal stimulus and accommodative measures by the Bank of Japan. But the great challenge today is to move from a policy-based recovery to self-sustained growth.

The world needs a vibrant and dynamic Japan. As the world's second-largest economy, Japan has a vital role to play in developing new technology, promoting green growth, addressing climate change and supporting economic growth in less developed nations. In short, Japan's economic health is crucial for the world as well as for the Japanese.

Japan faces some unique problems to play this role to the fullest. First, there is the rapid demographic transition. The Japanese government projects that, if the fertility rate remains at its 2005 level of 1.26, total population will fall to 95 million by mid-century. And 40 per cent of the population would be over age 65, implying a significant increase in the burden on the working-age population to pay for public spending on pensions, health and long-term care.

Second, Japan's fiscal situation creates concern, as the ratio of public debt to GDP is already the highest ever recorded in the OECD area. With a budget deficit approaching 10 per cent of GDP, public debt is on track to rise even further to over 200 per cent by 2011. A key to solving the fiscal problem is economic growth; increasing GDP, in part by ending deflation, would reduce the burden of debt.

### Japan has a number of strengths thanks to its investment in knowledge

Fortunately, Japan enjoys a number of advantages:

1. Japan is rightly famous for its emphasis on education. The proportion of young adults with tertiary education is one of the highest in the OECD area. Japan is consistently one of the top OECD countries in the PISA tests, which measures the academic abilities of 15-year-olds. And in addition to high scores, Japan has achieved an equitable access to learning opportunities, compared to other OECD countries.
2. Not coincidentally, Japan is also a world leader in R&D – spending 3.4 per cent of GDP on such investment in 2007, compared with 2.7 per cent in the United States and 1.8 per cent in the EU. Moreover, over three-quarters of Japan's R&D is in the business sector.
3. Finally, Japan has a high level of business investment compared to the OECD average, allowing it to incorporate this knowledge into its physical capital stock.

The challenge for Japan is to take full advantage of these large investments in knowledge, to translate them more fully into sustainable growth. Unlocking the human capital potential in Japan and fully utilising these resources would support a strong and dynamic Japanese economy.

At its most basic, economic growth can be explained by two variables:

- The amount of labour.
- The productivity of labour.

## Increasing labour inputs by raising female labour force participation

As for the amount of labour, we would not hope to see longer working hours for employees - working time in Japan is still above the OECD average despite a significant decline since 1990. Rather it is a question of increasing employment – *koyou*, one of the four Ks that has emerged as a priority for the new government – by including more women in the labour force. As shown on page 7 of the brochure, the proportion women between the ages of 25 and 54 who are employed in Japan – is relatively low (65%) compared to other OECD countries. Moreover, its share has hardly increased since 1994.

The opportunity cost of low female labour force participation is significant given the relatively high level of educational attainment of women in Japan. Moreover, we do not see the usual pattern of participation rising as the level of education increases. Instead, Japan is the only OECD country, along with Korea, where the labour force participation rate of women with a university education is roughly the same as for those without an upper secondary education. Moreover, many women who do work are only part-time employees. In short, Japan is underutilising the talents of its female population.

We are all familiar with factors that discourage women from employment and need to be addressed:

1. The problem of work-life balance makes it difficult for parents to combine family responsibilities with employment.
2. The rising share of non-regular workers – two-thirds of whom are women – limits the attractiveness of employment.
3. The large role of seniority and tenure in setting wages – rather than performance-based pay -- widens the gender pay gap.
4. Aspects of the tax and social security systems discourage work by secondary earners.

This morning, I would like to stress another important aspect – the lack of appropriate childcare. We share this concern with the new government, which has promised in the 9 September policy agreement that it:

“will endeavour to increase the number of childcare facilities, ensure high quality childcare, and work to eliminate waiting lists for public childcare facilities.”

In fact, children – *kodomo*, are another of the four Ks identified by the government.

Compared to other OECD countries, the Japanese government spends a relatively large amount on children who are ten years old. But it spends one of the lowest amounts on five-year olds. Shifting resources to children aged five and below, in particular by providing more childcare and early education, offers a number of benefits:

1. As mentioned, it would encourage greater female labour force participation.
2. It would improve the quality of education; research shows that the rate of return on public investment in early childhood education is greater than for later years.
3. It would promote equality by working to overcome disadvantages as early as possible.
4. Finally, it may help raise the fertility rate as the burden of childcare is one factor that discourages families from having children. Indeed, in the OECD area, there is a clear positive correlation between female labour force participation and the fertility rate.

## Raising labour productivity

The second key to a more dynamic Japanese economy is boosting labour productivity, which as shown in the chart on page four of the key issues publication, is relatively low in Japan compared to other major industrialised countries. As we all know, Japan is very productive in a number of sectors, as evidenced by its success in many manufacturing industries in the face of severe international competition. However, this is offset by weak productivity in non-manufacturing – in other words services and agriculture – which are more shielded from competition. Moreover, the gap between manufacturing and non-manufacturing has widened as the latter has experienced a deceleration in productivity. The key is to implement appropriate regulatory changes that improve the business environment and thereby encourage competition and productivity growth.

Innovation is one of the keys to accelerating recovery and putting firms on a path to sustainable and greener growth. A carefully-developed innovation plan would thus assist the business environment, or *keiki* another of the government's four Ks. The OECD is preparing an Innovation Strategy, which will be launched in spring 2010. The aim is to provide key policy principles for an effective government innovation strategy that enables businesses to innovate and flourish.

## The role of the OECD

Japan can count on the support of the OECD and its member countries in facing these challenges. The OECD is a hub for dialogue on global issues. Drawing on the experience of our 30 member countries, and through Enhanced Engagement with other major economies, such as Brazil, China, India, Russia and South Africa, our aim is to advance international economic co-operation and support the best economic options worldwide with the aim to build a stronger, fairer and cleaner economy. As is evident in the brochure we are presenting today, our aim is to support policy design with evidence-based knowledge.

## Environmental issues

Let me give one concrete example of an area where the OECD is very active: the issue of climate change and the environment or *kankyo*, the last of the government's four Ks. We certainly commend the new government for its ambitious mid-term target of cutting Japan's greenhouse gas emissions by 25 per cent by 2020. Moreover, Japan has promised to cut its emissions by 60-80 per cent by 2050.

Achieving these targets on its own will be extremely expensive for Japan, given that it is already relatively energy efficient. Japan is promoting international action on this issue. As the government pledged in its September policy agreement:

"We will call for the participation of major emitter nations in the international framework for limiting greenhouse gas emissions...and fulfill Japan's role in the international community."

Climate change is an area where the OECD is actively promoting international co-operation, which will mitigate the burden of climate change policies on Japan. OECD research shows that if Japan relied exclusively on domestic emission reductions to achieve its overall reduction targets, it would face the highest cost of abatement in the world. In other words, Japan stands to benefit more than any other country from international co-operation.

One method of such co-operation is the Kyoto Protocol mechanisms, which includes the Clean Development Mechanisms or CDM. Under the CDM, credits from projects with developing countries, which have a vast low-cost abatement potential, contribute to achieving Japan's reduction targets. OECD research has estimated that expanding the purchase of emission credits from other countries to account for 20% of Japan's overall emission cuts would reduce the cost by more than one-half. CDM requires thorough revision but it shows how international cooperation can help meeting national objectives.

A second option to increase international co-operation and alleviate the cost of reducing emissions in Japan would be to link Emissions Trading Systems -- or ETS -- across countries. This would allow Japan to meet its reduction targets in part by buying allowances in an international permit market. The first step is to create a mandatory and comprehensive cap-and-trade system in Japan. The wider the coverage of the ETS in terms of regions and industries, the greater the trading options and the cost efficiency. In practice, however, creating an international market by linking national ETSs is complicated by large cross-country differences in their systems. Governments should facilitate international linkages by harmonising the structure of their ETS, including the allocation rule for permits and future adjustment procedures. Here again, the OECD is ready to promote such international co-operation.

## Conclusion

Let me conclude by expressing the OECD's support for the Japan as strives to accomplish its objectives across a wide range of topics. As I mentioned earlier, we are well prepared to assist in the four Ks – koyou, kodomo, keiki and kankyo – as well as many other areas. The OECD, along with its member countries, can contribute to Japan's success in the years to come. At the same time, we have much to learn from Japan's long history of successfully overcoming challenges and shocks. Thanks you.