

Proposals for Post-Earthquake Reconstruction -- From the Standpoint of Financial Analysts --

Summary Version¹

On June 17, 2011, the Securities Analysts Association of Japan (SAAJ) published proposals for the recovery from the Great East Japan Earthquake. The proposals have two purposes: first, utilize the expertise of financial analysts to assess the effects of the great earthquake and policy responses for recovery, and formulate a proper common understanding about Japan's regenerating power; and second, from a viewpoint of market participants, make proposals for sustainable recovery measures that utilize the market function and private sector dynamism as well as for raising reconstruction funds.

The summaries of proposals by four financial analysts, who are also members of the SAAJ, are as below.

Macroeconomic Policy during the Reconstruction Period Sought by the Market and the Future Direction of Energy Policy

Masanobu Kaizu, CMA

Director of the SAAJ

Chief Research Officer

Financial and Economic Research Center of
Nomura Securities Co., Ltd.

It is essential for Japan to re-establish a long-term energy policy. The existing nuclear plants should be maintained and kept running upon strengthened safety measures, which were vulnerable against tsunami, while construction of new nuclear plants should be deferred. Electricity should be secured by gas turbine power and solar power. In the long term, we propose to put the innovation of magnesium power generation into practical use. As clean and fuel-saving energy can be obtained by burning magnesium

¹ This is an English summary of the proposals. The full version was issued in Japanese in June 2011 and is available on the SAAJ website (<http://www.saa.or.jp/member/news/shinsai.html>).

like coals, an abundant existing resource, the government should provide policy support toward practical use.

To financially support reconstruction contracts, proper fiscal and monetary policy is necessary. Given that Japan's economy is still in a deflationary phase, an increase in consumption tax should be avoided and reconstruction should be financed by the issuance of government bonds, thereby creating demand and aiming at overcoming deflation. Consideration on the redemption of government bonds, however, should not be deferred and a financial resource for the redemption and a redemption schedule should be determined in advance. We propose a temporary tax increase of four trillion yen per year, possibly from FY2014, for four years. Monetary policy should be more accommodative to indirect support for reconstruction.

To address the problem of the supply chain, which has been cut off due to the great earthquake disaster, it is necessary to review the inventory level according to the importance of parts and to diversify procurement sources.

Take Advantage of Post-Earthquake Disaster Reconstruction as a Chance to Rethink Japan

Daisuke Yamada, CMA

Executive Officer and General Manager

Industry Research Division

Mizuho Corporate Bank, Ltd.

What is important in recovery from the earthquake disaster is to secure the livelihood of all people including disaster-stricken ones. To that end, smooth business activity should be ensured and sustained employment should be generated, and to foster industries in the Tohoku region and to attract businesses to the region are critical. In achieving reconstruction policies, it is vital to provide policy incentives by utilizing measures such as economic zones and to form a consensus on a recovery plan that thoroughly reflect the region's initiative.

It is necessary to consider funding mechanisms for reconstruction by drawing a

distinction between these that should be financed with public funds and those that should be financed with private funds. The public sector should join hands with the private sector, such as trying to attract private funds by utilizing low interest rate funds, which are raised by public-sector financial institutions upon obtaining public credit enhancement, as a catalyst.

If the issue of whom and how the nuclear plant accident will be recompensed by is left untouched, it might create problems in power companies' funding and in stable supply of electricity. We ask for calm discussions and policy measures from a viewpoint of ensuring a stable supply of electricity, which is an indispensable infrastructure for the economy. We definitely have to avoid the onrushing overseas transfer of production stemming from an electricity shortage.

It is important to keep alert eyes on the structural factors that have covered Japan since before the crisis but instead have a viewpoint of tackling the structural problems in the post-earthquake disaster reconstruction process and rethinking how a future Japan should be.

**Deflation due to a Strong Yen, a Financial Crisis, and Political Instability:
Are Those Three Common Phenomena After the Previous Two Earthquakes
Avoidable?**

Hajime Takata, CMA

Managing Executive Officer, Chief Economist
Mizuho Research Institute Ltd.

Following the Great Kanto Earthquake of 1923 and the Great Hanshin-Awaji Earthquake of 1995, three common phenomena were identified: deflation due to a strong yen, a financial crisis, and political instability. How to avoid those is the challenge we have been faced with since the Great East Japan Earthquake. Due to the great earthquake disaster, capital stock was destroyed or damaged considerably, and the economy has been faced with the problem of how to pursue balance sheet adjustments. It is necessary to improve market and business sentiment on the economic outlook while avoiding the yen appreciation. Based on that recognition, "economic martial law"

should be declared. Under the law, the following three aims shall be pursued in a unified manner: (a) assuming private debt by public finance, (b) providing support to firms and financial institutions and thereby strengthening their capital base through securing a stable funding environment and asset purchases, and (c) ensuring stability in politics that will promote policy formulation. Japan's post-war reconstruction was a typical example of those three aims implicitly achieved.

It is important to create a public-private joint fund that will generate new capital and risk money as well as to construct a growth scenario on utilizing the fund. It is also important to prioritize resource allocation to growing industries by implementing a Heisei version of a priority production system.

Japan is in a position to show a "Japanese Model" that will set the strictest standards on energy problems and meet those standards. Japan should take advantage of the position for its growth.

Let Us Establish a Japanese Model that will Lead the World through East Japan Reconstruction

Ryoji Musha, CMA

President

Musha Research Co., Ltd.

Reconstruction from the great earthquake disaster could be an opportunity for Japan to promote reform and acquire Global Citizenship in the Global Commonwealth, which will be a future vision of the world. One model to reform Japan is to build a structure of multilayer division of labor, and that will also be the key to the reconstruction of East Japan. The multilayer division of labor is, with one region both achieving status in the global division of labor and playing a role in the domestic division of labor, to obtain income from abroad and establish a self-support economy in the region. To that end, it is necessary to build foundations for industry and employment by promoting infrastructure improvement in the disaster-stricken areas as a national project, and to create local governments with full authority to slash away all sorts of vested interests and regulations and pursue strict economic rationality. We need to have a perspective of

creating a region that can be linked with the rest of the world.

As for energy, Japan should adopt a distributed renewable energy system in the long term. The introduction of market competition is inevitable in electricity reform.

As the output gap narrows due to post-earthquake disaster reconstruction policies and momentum gathers for reflationary policy, the yen might depreciate and create a macroeconomic environment toward overcoming deflation, which leads to a rise in wages and asset prices. Those can be a resource for reconstruction.

Mr. Yukio Suzuki, CMA, former Chairman of the SAAJ, CEO Chief Analyst, Belle Investment Research of Japan Inc., summed up the proposals and pointed out that the following points should be given priority during the reconstruction from the earthquake disaster.

1. Above all, offer disaster victims places to live. In a longer time-span, secure employment. In order to do so, industrial development is critical. Employment will not be secured for long under supplementary support. It is necessary to map out a growth strategy and accumulate industries. To bring out the vitality of private firms, it is necessary to create infrastructure and provide incentives to the private sector.
2. Heads of government and firms should take the lead, improve organizational capabilities, and carry out prioritized measures. It is necessary to select a leader who has an experience of running an organization and getting the job done, and overcome the current crisis.
3. Re-establish the management system of nuclear energy. While the accident has occurred due to an unprecedented natural disaster, there have been many elements of man-made disaster in terms of ex-post responses. It is not clear yet why the safety of the nuclear plant was not secured, but governance seems not to have been so effective in the system to promote the nation's nuclear power policy and Tokyo Electric Power Company's operation of nuclear plants. Preparations for a natural disaster were insufficient, and risk management did not function properly. While it

is essential to review Japan's energy policy, it is not realistic to make paradoxical decisions, including abolition of nuclear power and adoption of solar power. It is necessary to establish a solid risk management strategy for nuclear power while promoting a new energy policy. Investment cannot be attracted to a nation where electricity is not supplied sufficiently. Guidelines for a new energy policy, which will strike a balance between energy cost and supply capacity, should be promptly established.

4. Don't shy away from difficult tasks and immediate inconveniences but resolve them. It is critical not only to do things that can be done immediately or tentatively but also to establish a mechanism for managing risks from a long-term perspective. The damage from the great earthquake disaster is estimated to be well over 20 trillion yen, which is enormous. The absence of proper political and financial responses will induce a secondary disaster in the social system. Since there is a solution, we should use our wisdom and take action.
5. How the reconstruction should be financed? If fiscal spending and tax increases are done at the same time for the reconstruction, the economic stimulus through fiscal spending will wane. If fiscal spending is made without any supporting fiscal resource and reimbursement is considered once the economy becomes sound, it might just end up accumulating debt. It is thus necessary to make clear about the fiscal resource.

As for reconstruction funds, not only public funds but also private funds should be utilized. To that end, a funding scheme, which is incentive compatible and harmonized with the market mechanism, should be established.

A natural disaster might also occur in the future, and thus a rehabilitation scheme that is valid for future natural disasters should be established.

6. Investors' role. Investors have a major role to play in the reconstruction from the great earthquake disaster. Investors are required to invest from a long-term perspective beyond immediate gains and losses. Japan's reconstruction depends on the spirit of investors that want to revive Japan through their investments. It is the

innovation of a mechanism which creates new value, that investors will invest in. Firms, non-profit organizations, and the government should show their institutional capabilities to create new value concerning Japan's reconstruction and win the understanding of investors.

7. A growth strategy is necessary for reconstruction. Before the earthquake disaster, there were substantial challenges to be addressed. For example, Japan's population will decrease by 30 million by 2050. The current size of the economy cannot be maintained by domestic demand only. It is inevitable to tap external demand, and thus necessary to accept skilled workers as immigrants and pursue regulation easing to attract investment. Globalization of human resource management at firms is also required. In tapping external demand, the key to differentiation will be Japanese taste.

The SAAJ strongly believes that the proposals made here will serve as reference to the efforts toward reconstruction by the nation, municipalities, businesses in the disaster-stricken regions, and the residents.