THE THIRD ARROW OF ABENOMICS

A Portrait of Evolving Change

May 2017 Report of the ACCJ

Task Force on Structural Reform in Japan

The American Chamber of Commerce in Japan

About the ACCJ

The mission of the American Chamber of Commerce in Japan (ACCJ) is to further develop commerce between the United States of America and Japan, promote the interests of US companies and members, and improve the international business environment in Japan.

Established in 1948 by representatives of 40 American firms, the ACCJ has offices in Tokyo, Osaka, and Nagoya, and represents approximately 3,500 individual members from over 1,000 companies and 40 countries. Now in its 69th year, the ACCJ has built its reputation on the strength of providing both American and Japanese members, as well as a rapidly growing international base, with unsurpassed opportunity and advantage through advocacy, information, and networking.

The ACCJ today is Japan's most influential foreign business organization, and serves as the primary forum for the foreign business community in Japan to identify and pursue shared interests and goals. More than 60 Chamber committees, subcommittees, task forces, and advisory councils cover diverse areas such as financial services, corporate social responsibility, marketing, independent business, healthcare, transportation and logistics, legal services, travel industry, and human resource management. Each committee establishes goals at the beginning of the year and meets regularly to develop ideas, discuss issues, and exchange information on topics relevant to its goals and focus.

Task Force Members

Task Force members have joined in a consensus signifying that they endorse the general thrust of this report and judgments reached by the group, but not necessarily every finding. Members participate in the Task Force in their individual, not institutional, capacities. This report does not reflect official positions of the ACCJ, the Board of Governors, or ACCJ members on any issues discussed herein.

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Report of the ACCJ Task Force on Structural Reform in Japan

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Acronyms

ACCJ	American Chamber of Commerce in Japan
FDI	Foreign Direct Investment
FSA	Financial Services Agency
GOJ	Government of Japan
KPI	Key Progress Indicator
LDP	Liberal Democratic Party
METI	Ministry of Economy, Trade and Industry
PM	Prime Minister
TPP	Trans-Pacific Partnership
OECD	Organization for Economic Co-operation and Development
2013 Strategy	Japan Revitalization Strategy (2013) www.kantei.go.jp/jp/singi/keizaisaisei/pdf/en_saikou_jpn_hon.pdf
2014 Strategy	Japan Revitalization Strategy (revised in 2014) www.kantei.go.jp/jp/singi/keizaisaisei/pdf/honbunEN.pdf
2015 Strategy	Japan Revitalization Strategy (revised in 2015) www.kantei.go.jp/jp/singi/keizaisaisei/pdf/dai1en.pdf
2016 Strategy	Japan Revitalization Strategy (revised in 2016) www.kantei.go.jp/jp/singi/keizaisaisei/pdf/hombun1_160602_en.pdf

Foreword

The Third Arrow of Abenomics: A Portrait of Evolving Change addresses the concern of many ACCJ members that the impact of the structural reforms launched by Prime Minister Shinzo Abe is not yet fully understood. Absent such appreciation, ACCJ members and their colleagues overseas lack a sound basis for long-term planning and investment in Japan. The Chamber, therefore, asked a number of its own members to form a unique Task Force to survey the Prime Minister's reform proposals and prepare an internal report to other members. This proved to be a challenging task, especially as Prime Minister Abe has periodically added new proposals, further extending the reach of an already ambitious program. Moreover, although the Task Force was assisted by a number of research assistants and professional writers over the past two years, its findings are those of business practitioners aiming to assist fellow professionals in arriving at their own conclusions. As such, it is not intended to be fully comprehensive or academically rigorous. Nor does it advocate for particular policies. However, the report does provide ACCJ members a fuller picture of the progress made on implementation of key Third Arrow policies relevant to their businesses. I believe the report highlights the significance of key structural reforms already underway as well as their potential, if they can be fully implemented, to usher in a new era of growth in Japan.

I would like to extend special thanks to Task Force Co-Chairs Arthur Mitchell and Jay Ponazecki, and to all of the Task Force members, for their work on this special Chamber project. I believe their efforts will help enable further expansion of the already substantial role that American business plays in the Japanese economy.

Sincerely,

Christopher J. LaFleur
ACCJ President

About this Report

In 2015, given the importance of the policies that have come to be known as the Third Arrow of Abenomics, a Task Force was established and charged with the responsibility of researching progress made under the Third Arrow reform initiative and providing a readout to ACCJ members. The result was this report, which was prepared for the informational benefit of ACCJ members. It is not an approved position of the ACCJ and does not reflect official positions of the ACCJ, the Board of Governors, or ACCJ members on any issues discussed herein.

The Task Force members have joined in a consensus signifying that they endorse the general thoughts of this report and judgements reached by the group, but not necessarily every finding. The Task Force has concluded that the Third Arrow is still a work in progress. For example, remarkable changes in agriculture, corporate governance, electric utility regulation, and the healthcare system have been made; however, progress toward reform of the labor system and the promotion of women in business has lagged behind the expectations created by earlier versions of the growth strategy announced by the Government of Japan (GOJ). Furthermore, following US President Donald Trump's withdrawal from the Trans-Pacific Partnership (TPP), the framework for US–Japan trade and investment relations will no doubt be reexamined. In any case, it is unlikely that the GOJ will retreat from its Third Arrow reform agenda.

An examination of the scope that the Task Force has undertaken could not have been accomplished by any one individual or even a small group of experts. In the course of our work, the Task Force members held sessions with GOJ officials, US diplomats, university professors, members of the various ACCJ committees, US and Japanese business executives, and other experienced observers of Japan.

The Task Force is indebted to the many contributors and commentators listed at the end of this report. We are especially indebted to our Project Director, Peter Langan, and Deputy Project Director, Yuriy Humber, who, as professional journalists and writers, helped us prepare a narrative which presents texture and context, rather than mere facts and figures. The directors of the Inter-University Center in Yokohama also strongly encouraged some of their students to prepare background papers and to perform the arduous task of checking the accuracy of the facts presented.

Executive Summary

The ACCJ formed the Japan Structural Reform Task Force in 2015 to assess and report on Japan's progress in emerging from the no-growth cycle caused by the bursting of the bubble economy in the 1990s.

This report is the result of the work by that Structural Reform Task Force. Its purpose is not to make recommendations, but rather to observe and report on the process of change taking place under a series of policies named "Abenomics," after Prime Minister Shinzo Abe.

Shortly after Abe was elected prime minister in 2012, a strategy to revitalize the economy was formulated. The strategy aimed to pull the economy out of deflation and return Japan to a period of growth by binding monetary and fiscal policies together with structural reforms, in what became known as the Three Arrows.

Much has been written about the successes and failures of the First (monetary policy) and Second (fiscal policy) Arrows, but relatively little about the Third Arrow—specifically, how policymakers analyzed the structural problems they faced, how they tackled them, what remains to be done, and what all of that may mean for Japanese as well as foreign businesses. It is our hope this report will answer some of these questions concerning the Third Arrow.

Structural reforms under the Third Arrow are constantly evolving. Articles in the Nihon Keizai Shimbun, Japan's leading business newspaper, announce regular developments and changes, creating something of a moving target in making any assessment of Third Arrow policies. Hence, this study uses the GOJ's announced strategy in 2016 as its reference point, recognizing that, by the time this report reaches readers, Japan and its Third Arrow reforms will have moved and been reshaped again.[1]

While this report will focus on the GOJ's 2016 Strategy, it is important to note that the 2016 Strategy did not appear out of a vacuum, but contains much of the content of the 2013, 2014, and 2015 Third Arrow strategies—updated, refined, reformulated and, in some cases, renamed.

For example, it was announced in 2015 that a second stage of structural reform was being implemented and items not included in earlier strategies—such as emphasis on the so-called Fourth Industrial Revolution, tourism, and sports businesses—were added to the agenda. However, Cabinet Office officials confirmed to the ACCJ Task Force that, at the same time, earlier policies and proposals have not been abandoned.

Taken as a whole, the Third Arrow structural reforms are nothing short of an ambitious attempt to make fundamental changes in the way that Japan operates; and therein lies the size and complexity of the challenge.

Regarding the First Arrow of monetary policy, the Bank of Japan can meet and change its policies with almost immediate effect and see an immediate reaction in financial markets. For the Second Arrow of fiscal policy, the Ministry of Finance can also execute relatively visible decisions that change, say, tax policy.

However, the Third Arrow involves how Japan goes about its daily business. As such, it involves:

- A multitude of ministries
- Scores of discussions in hundreds of meeting rooms
- Marshaling thousands of people in industries as diverse as hot spring resorts to pharmaceutical makers to nuclear power plants

Consequently, the Third Arrow has instead been called "A Thousand Darts," given the myriad collection of reforms it contains. This points to another key element needed for the Third Arrow results to emerge: the passage of time. The Third Arrow requires a fundamental change in behavior.

This report has been written primarily with the businessperson in mind, but it is hoped that policymakers (both in Japan and abroad) and the general public will gain insights into the latent and emerging possibilities and opportunities from Third Arrow initiatives.

This report includes references to papers and information from Japan's Cabinet Office, Ministry of Economy, Trade and Industry, the Japan Association of Corporate Directors, academics, and many, many others. Primarily, though, this report reflects the work of multiple individuals in the ACCJ and extended brainstorming by non-Japanese and Japanese businesspeople. These are people who show up for work each day in Japan while working for a foreign-capitalized company or Japanese company. As such, they are informed by daily experience.

It is widely recognized that the largest constraints to growth in Japan are the declining size of the workforce and its aging population.[2] While Japan remains one of the world's manufacturing giants, approximately 80 percent of the workforce is now employed in the service sector. Yet, according to some analyses, service sector productivity has stagnated.[3] Japan's policymakers, both politicians and bureaucrats, recognize that Japan's low rate of economic "metabolism" or resource allocation is a structural problem that has held back productivity growth for decades. The gist of a Liberal Democratic Party (LDP) policy document published on April 26, 2016, explained the goal of the Third Arrow this way:

> *To create a virtuous cycle of economic growth that will lead to distribution of the fruits of the growth to the people. Increases in productivity will lead to better working conditions and higher wages. In turn, this will give consumers and businesses more confidence about the future and, therefore, more consumption and investment will occur. This investment can be used to further improve productivity, and so the cycle continues.*

In essence, measures are needed to stimulate productivity, encourage investment activity, and improve social infrastructure. The Third Arrow reform plans are illustrated by the Venn diagram below.

The categories are somewhat artificial, as certain policies overlap. For example, providing more social infrastructure through expanded healthcare facilities will allow more women to enter the permanent workforce, thereby stimulating productivity. Similarly, there are social benefits to providing tax-advantaged savings accounts for retirement, which, in turn, can provide resources for further investment. More investment in new technologies, such as the Internet of Things (IoT), Big Data, and artificial intelligence (AI), will lead to more productivity.

2017 marks Abe's fifth consecutive year in office, a notable milestone in itself considering that Japan had five prime ministers—or on average, about one every year—in the five years preceding his tenure.

The next general election is not required until December 2018, but there is speculation of a snap election that could keep the LDP in power until 2021. And the party has made changes to its own internal rules that will allow PM Abe to run for a third term. Given this political scenario, the Abe administration has an opportunity to implement many of the changes promised by the Third Arrow over time.

Because the policies called for by the Third Arrow are multidimensional, and yet related to each other, the Abe administration gave strong coordination authority to the Cabinet Office and created a number of advisory councils, such as the Council on Economic and Fiscal

Policy, the Industrial Competitiveness Council, the Regulatory Reform Council, and the Council for Science, Technology and Innovation, to help develop a consensus among the government, business, and academia on the reform agenda.

In making its own assessment of the past and future of the Third Arrow, the 2016 Strategy states:

> *In the First Stage of the Growth Strategy, the Abe administration has cut into areas where the so-called "bed-rock" regulations remain, such as electricity, agriculture and healthcare, which have been considered taboo. It has carried out reforms that have been thought to be impossible, such as a drastic reduction of the effective tax rates, signing the TPP (Trans-Pacific Partnership) agreement, and enhancement of corporate governance. (Note: Many of the references to the TPP were made before U.S. President Donald Trump pulled the United States out of the agreement but still provide useful background).*

It goes on to say that, in the Second Stage of the Growth Strategy, Japan has adopted the paradigm of the "fourth industrial revolution" in big data, artificial intelligence and robotics to lead the future revolution in productivity.

Given the vast scope of the Third Arrow reforms, it has been impossible for the Task Force to research each and every policy proposal and track its trajectory; nor do we intend to merely repeat the promises made by the GOJ. Nevertheless, some readers may believe that we have not given credit where credit is due. Others may argue that our views are too optimistic. Our only aim is to provide a balanced, consensus view based on our experience.

Despite the research and foregoing caveats, it is undeniable that certain reforms have taken place so we will try to provide a broad overview as to what has been accomplished in such areas as productivity enhancement, investment promotion, social infrastructure improvements, and others (which are summarized in this Executive Summary), provide a rough estimate concerning where matters stand as of December 31, 2016, and take a deeper dive into some of the more important areas.

As one might expect, the results in many of the areas are mixed. There are some clear successes where reforms have been enacted and progress is evident, others where changes have been made but not yet had a clear impact, others which are short of concrete detail, and cases where the reforms could be significant but have not been fully implemented.

In summary: the Third Arrow is a work in progress.

It is clear that the government's role is to deregulate where necessary (as in healthcare or electric power) or, in other cases, to create new regulations (as in cybersecurity and the digital economy). According to some accounts, national government approvals are required by 14,908 regulations, and there are over 40,000 business-related rules (tsutatsu)—not to mention prefectural and local rules and regulations.[4]

Today, the key is for the government to create an environment that is conducive to business development while protecting the public interest.

However, it is important to recognize that the responsibility for transforming Japan does not rest solely with the government. Business and opinion leaders must seize the opportunities presented and push for concrete results, recognizing that the government no longer tries, as it once may have done, to be the dominant force guiding the economy.

Productivity Enhancement

Many observers have pointed out that a country can expand the size of its workforce and/or the total number of hours worked, increase the amount of capital invested, and/or use research, innovation, and creativity to increase the productivity of labor and capital inputs.

In other words, increases in "total factor productivity" are essential. Parts of our analysis reveal, for example, that the government aims to reorganize the agricultural industry through reducing the role of JA-Zenchu and encouraging farming as a business. Other clear goals are to: revitalize local areas where the population is in serious decline, revamp labor laws to reduce the differences between regular and part-time workers, and promote the inclusion of more women in the workforce. TPP was seen as a way of giving a form of international commitment to the reforms, which would encourage farmers and SMEs to participate in export markets.

Investment Promotion

Abe's government saw that it had to boost the lifeblood flowing through Japan's financial sector. The goal was set for Tokyo to claim the mantle as the leading Asian financial hub. "My administration has the objective of turning Tokyo into a financial city, a hub of Asia. So, we would like to grapple with various reforms to that end," Abe told the Council on Foreign Relations in New York in 2014.[5]

These various reforms approach the issue on multiple fronts. The first made use of a Special Zones initiative to designate Tokyo as a zone focused on improvements in the banking and finance sectors. Other reforms, discussed in separate chapters in this report, look at how to improve Japan Inc.'s corporate governance and how to attract overseas financial professionals through improvements in immigration procedures and better access to education and health services for foreign families.

Social Infrastructure Improvements

Much of the progress that has actually been made involves social infrastructure, by which we mean the so-called "soft" institutions that encourage connections between people, improve health, welfare and education, and govern social and business interactions in society.

The corporate governance reforms contained in the Stewardship Code for institutional investors and fund managers, as well as the Governance Code applicable to listed companies, promise to focus corporate management on better economic performance and reasonable risk taking.

Reform of the electric power industry will introduce new levels of competition in the retail market, leading to the development of new business models and potentially better service at lower prices.

Comprehensive reform of the pension system and social safety net has yet to take shape, but developments in financial services and products (as well as a diversity of pension schemes) and reform of the Government Pension Investment Fund bode well for savers and investors over the long run.

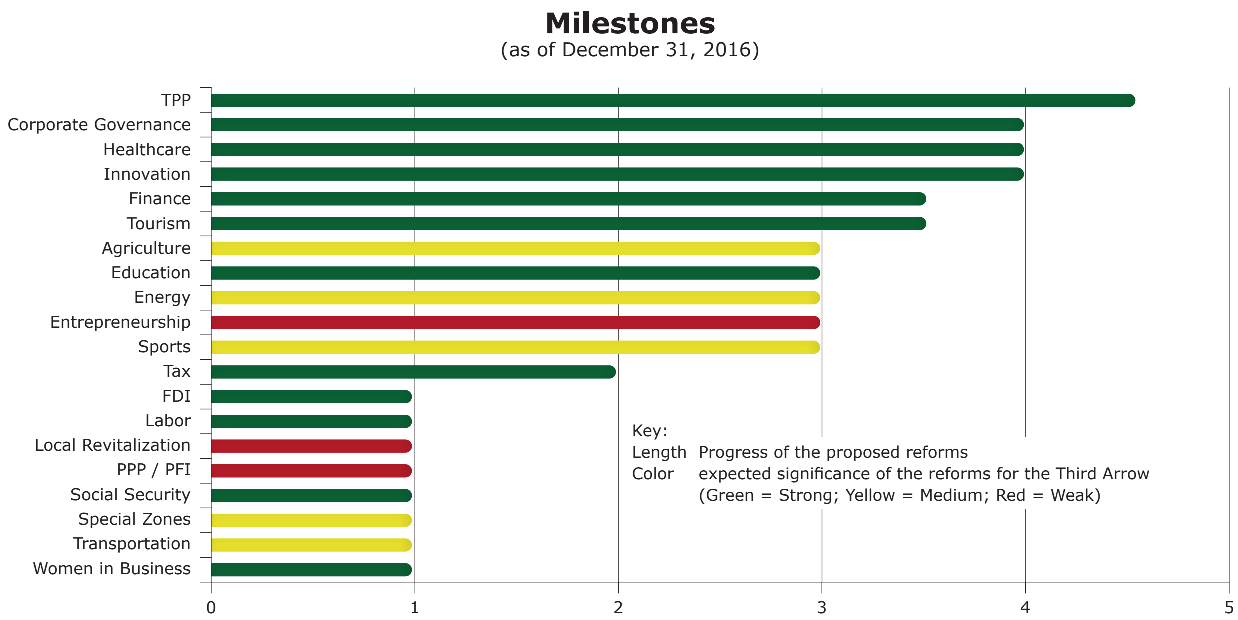
Tourism and Integrated Resorts

The opportunities in tourism and integrated resorts came relatively late in Third Arrow planning, though the evidence is fairly clear that the tourism industry holds significant promise for Japan. The country's climate and geography allow for world-class snow sports in Hokkaido and through the Japan Alps, and tropical reefs and beaches at the other end of the archipelago in Okinawa. In 2016, visitors to Japan reached record highs of more than 24 million, and they spent an estimated US $33 billion. The goal is to boost visitor numbers to 40 million by 2020, the same year as the Tokyo 2020 Olympic and Paralympic Games.

As the Japan Travel Bureau Foundation's goal is to attract more long-stay tourists by developing cultural experience programs in rural areas, this could be a lifeline of sorts for rural areas facing population decline by generating tourist industries in regions of scenic natural beauty.

The government also passed legislation in December 2016 to legalize gambling, which creates opportunities for the development of integrated resorts including casinos. While the plan has opponents, some estimates say integrated resorts could bring in even more tourists and US $30 billion in yearly revenue.

The chart on the following page represents the consensus estimate of the ACCJ Task Force concerning the progress that has been made as of December 31, 2016, in achieving certain milestones, and where progress is lacking (or may have limited impact) in terms of achieving the announced goals of the Third Arrow. The bars in the graph are color-coded to indicate the significance of the reform toward advancing the goals of the Third Arrow (e.g. green, yellow, and red). The degrees (1–5) are a rough estimation of how much has been achieved through our reference dates (from inception until December 31, 2016).



The foregoing chart is not the result of a scientific or academic inquiry. It is an attempt to give a picture of where things stand as of December 31, 2016, while recognizing that the goals of the Third Arrow are a moving target as different policy changes manifest themselves and take hold in the economy.

The following chapters seek to shed more light onto each selected topic and illustrate a "state of play" for each and how it measures up against the goals of the Third Arrow.

Tangible developments arising from reform in some of the target industries and practices, such as corporate governance and restructuring of the electric power industry, will unfold over many years. What is significant is that the reforms have begun and they are moving in a direction likely to produce results and opportunities under an LDP leader who looks set for several more years in power.

Having said that, it is unclear whether these reforms are recognized by the public. Ever since the bursting of the bubble economy, Japanese policymakers have poured significant energy into many and various measures to try to get the economy back on track. In the 2006 book *Japan Remodeled*, Professor Steven K. Vogel, while commenting on the early reform proposals put forward by the Koizumi regime, observed that:

> *"Despite popular perceptions to the contrary, Japanese government and industry translated this collective reform frenzy into action. The government lowered interest rates, increased and decreased public spending, lowered and raised taxes, coddled and cracked down on ailing banks, liberalized financial flows, eased labor standards, revised corporate law, lifted the ban on holding companies, privatized special public corporations and revised the pension system. Just for good measure, the government also reorganized itself."*

Perhaps the "popular perceptions to the contrary" in Vogel's book allude to what was discussed earlier about the passage of time. Specifically, in the slow passing of time, structural change sometimes is not easily seen—it is certainly not a headline grabber in the way that global financial markets react overnight to a shift in interest rates.

In this sense, this report is a portrait that seeks to reveal something about the changing character of its subject; it is not a snapshot of details frozen in time. We hope that the following chapters will help to develop a more nuanced conversation on where Japan's economy is, where it is heading, and what opportunities are likely to emerge under the Third Arrow.

Notes

1 We will not attempt to recount in detail the history of economic reform initiatives in Japan, but it is useful to note that such strategies (10 by one count) have been adopted during the tenure of various other prime ministers, including the LDP's Junichiro Koizumi, Yasuo Fukuda, and Taro Aso, as well as the Democratic Party's Yukio Hatoyama, Naoto Kan, and Yoshihiko Noda.
2 www.stlouisfed.org/on-the-economy/2015/november/japans-aging-workforce-lessons
3 www.rieti.go.jp/jp/publications/pdp/10p007.pdf
4 Address of Akio Mimura, Chairman of the Japan Chamber of Commerce and Industry, to the Yomiuri International Economic Symposium, November 21, 2016
5 www.cfr.org/asia-and-pacific/conversation-shinzo-abe/p33494

1 Agriculture Reform

Agriculture is one of Japan's oldest industries and, according to some critics, beyond reform due to a byzantine administrative structure consisting of cooperatives and subsidies. It may be a surprise to hear, then, that it is in this industry that the government has achieved possibly the most radical progress.

Prime Minister Shinzo Abe's government passed an act in 2015 that encouraged entrepreneurs to venture into farming, and several large retail and industrial corporates have taken up the opportunity as requirements on farmland ownership have been relaxed.

The result: a record ¥745 billion in agriculture, forestry, and fishing exports in 2015—up 22 percent from the previous year.

Context

While contributing less than 1 percent to Japan's GDP,[1] the agriculture sector wields outsized political weight—in part due to voting boundaries (skewed in favor of the rural population) and its top organ of administration, the Japan Agriculture Group, also known as JA-Zenchu. The organization oversees the countrywide network of 700 farming cooperatives, which allows it to control prices at which farmers sell produce and, in turn buy fuel, fertilizer, and other materials, as well as distribution.

JA-Zenchu dominates Japan's corn and rice trade, and its operations extend to a bank (the country's fifth largest with US $532 billion in customer deposits[2]), an insurance firm, asset management, and farming materials trading.

The organization, which obliges members to sell their farm produce at set prices, counts 10 million members, or about 8 percent of the population.[3] Its influence was seen in the first half of this decade, when members turned out to protest in Tokyo streets against moves by the Japanese government to negotiate the Trans-Pacific Partnership (TPP) free-trade pact with the United States and other nations.

JA-Zenchu has argued, via its Norinchukin Research Institute, that, if countries such as Australia, the United States, and New Zealand gain full access to Japan's 127 million consumers, more than 25 percent of local rice output would cease. JA-Zenchu says agriculture cannot be viewed only in economic terms. Rice, for example, is not only the nation's staple, but is also part of the country's cultural tapestry. Just a few generations ago, rice was the basis of Japan's currency and payment system. Japan's narrow islands are no match for the breadth of Australian and US plains, and hence its food trade requires a ring fence.

Norinchukin has warned that, if Japan's US $48 billion worth of agricultural products protected by high import duties were open to all foreign farmers, 99 percent of wheat, almost all sugar, and most beef production would not be competitive. Government data show that Japan already imports half its pork and beef, two-thirds of its sugar, and almost 90 percent of its wheat.

The reasons JA-Zenchu enjoys such power are: (1) its historical alliance with the LDP, the main party of governance since World War II; and (2) the aging, part-time and fragmented nature of the country's agricultural industry, where the average farmer is 67 years old.[4]

At the end of the war, US occupation authorities broke up large landholdings and forced owners to sell parcels of pasture to farm workers at low prices. As a result, Japan's farm size averages one to two hectares, among the smallest in the world, according to University of Tokyo research. This means it can be cultivated on a part-time basis, even on weekends only, for most of the year.

In fact, of Japan's 2.53 million farmers, only a fraction work full time.[5] For the rest, farming provides about ¥1 million a year, or less than 15 percent of their income, University of Tokyo professor Masayoshi Honma said in a 2012 interview with Bloomberg News.[6] In 2012, that was ¥1 million (US $12,800) in annual sales from farming.

Backers of this system paint an idyllic picture of what is known as *sanchan nogyo*, agriculture based on the labor of *ojii-chan*, *obaa-chan*, and *okaa-chan*—the grandpa, the grandma, and mom. They say that keeping farms small sustains rural communities, and that land mergers are not possible in many cases due to Japan's mountainous terrain.

Third Arrow Concept

The emphasis of Third Arrow reforms has been to move from the kind of agriculture concept eulogized by JA-Zenchu to a modern, business-driven farm that considers market economics, costs, and scale when making decisions. Abe's government realized that Japan's farming would be hit significantly once it joined TPP (discussed in another chapter).

However, rather than seeking to protect the farming industry further, the government has done the opposite: it has asked the sector to toughen up and look for exports as its salvation. The term the government uses for such business-minded farmers is *ninaite*, those who can earn a full-time income from the profession.[7]

“Agriculture is the most difficult sector to reform,” PM Abe told Bloomberg in a December 2013 interview. Introducing new measures such as land banks means farmland will “be consolidated and taken over by those who are really motivated,” Abe said.

Of course, no reform would be possible without JA-Zenchu at least acquiescing. Still, the group had signaled a gradual acceptance that TPP would indeed take place, and that the model for the industry it had helped construct to date would need to change.

As such the government’s reforms sought to lay the basis for an alternative system where business-minded farmers can expand operations, the current administrative system overseen by JA-Zenchu is disbanded, exports become an important part of the industry’s thinking, and new high-level technology is introduced. The latter has, inevitably, been dubbed “smart farming.”

The Third Arrow set a target of raising the export value of agricultural, forestry, and fisheries products and food to ¥1 trillion by 2020 and ¥5 trillion by 2030, from about half a trillion yen in 2013. The government also said it expected the market for the so-called “Sixth Industry,” which refers to the processing, direct sales, export and urban-rural exchanges in agricultural produce, to reach ¥10 trillion in 2020.

Adjacent to that was a target for the business-minded, efficient *ninaite* farmers to control 80 percent of farmland by 2023. As of March 2015, that number was 50.3 percent, up from 48.7 percent a year earlier, according to government data.

The Third Arrow in Action: Size and Scale

There is no way for a farm of one or two hectares to be globally competitive. Thus, Abe’s government has pursued a means to make farmland consolidation a reality. This was done first by passing legislation in 2014 to scrap the *gentan* system that sets annual rice production figures for each prefecture to shore up prices. The subsidies that come with the *gentan* system are due to be phased out completely in fiscal year 2018, making rice-growing entirely price-competitive.

“I expect more deregulation to follow that is consistent with changing agriculture into an industry,” then-Economy Minister Akira Amari told reporters in November 2013.

The move should put emphasis on farmers and local agricultural cooperatives to compete. It is expected to cut rice production costs by 40 percent through 2023 via means such as stimulating farmers to secure multi-year contracts for sale of produce, opportunities to trade rice on a spot market, more demand-driven production, and a focus on exports.[8] Meanwhile, the government targets doubling the productivity of rice for feed by 2025, compared with 2013 levels, through the halving of production costs at ninaite farmers.[9]

Even more importantly, the *gentan* system change is expected to help bulk up the size of farms as farmers and cooperatives pool land. Bigger farms can afford to use machinery to cut costs and consider adding processing facilities to manufacture, say, jam instead of just plums, to extract higher margins, and to target markets abroad as well. The potential for bigger land plots can also attract business that needs scale to invest.

To tackle this issue, the government set up a Farmland Intermediary Management Institution in each prefecture to work on the transfer and consolidation of farmland. These so-called Farmland Banks seek to broker mergers of agricultural spaces or purchase land for consolidation and resale. This includes uncultivated farmland in Japan—which almost doubled in the past two decades, reaching 420,000 hectares in 2015—as farmers retired, data from the agriculture ministry show.

To stimulate these organizations to be productive, the government plans to publicize the results of their work and rank them. Already, an online information system for farmland started in April 2015. Prefectures with the most effective Farmland Banks are due from fiscal year 2015 to receive more favorable treatment via budget allocation and so on.

In addition, staff at the Farmland Banks are encouraged to think of their operation as a business that is similar to private real estate development. The government is still looking at ways to pass on profits from the Farmland Banks to local agriculture.

Outside of land mergers, the government aims to bring a similar consolidation approach to livestock and dairy farming to build-up scale. Proposed so far are "livestock clusters" that could consist of cattle-breeding stations, integrated areas for breeding and fattening of beef cattle, and rationalized systems for distribution of raw milk. The idea is that once there is a bigger and more integrated operation, businesses would be lured to provide the investments that farmers need to scale up.

The KPIs set by the government include increasing the number of dairy farms that also engage in processing and other related activities to 500 farms by 2020 (up from 236 farms in 2013). So far, there has been a small uptick in farm numbers. Most of the investments in farms that seek to integrate primary, secondary, and tertiary processes have been small and in state-designated Special Zones. For agriculture, these are the Yabu and Niigata zones.

One area of concern is how entrepreneurial agricultural projects underway in the Yabu and Niigata zones will fair outside those territories and whether they can be replicated elsewhere in the country.

Administrative Changes

The changes above have only become possible since the Abe administration, riding on the wave of popular support nationwide from the 2012 election the victory, took on the influence and power of JA-Zenchu. In 2015 and 2016, the government managed to pass the Agricultural Cooperatives Law, the Agricultural Committee Law, and the Farmland Law.

In addition to the farmland reforms mentioned earlier, these legislations force JA-Zenchu to transform by the end of September 2019 (from a "special private corporation" that enjoys extraordinary, semipublic powers protected by law into a "general incorporated association" without regulatory functions and subject to ordinary taxation).

The organization will give up its power to audit and guide local cooperatives and its auditing arm will be spun off into a certified public accounting company and forced to compete with other auditors. JA-Zenchu's profitable wholesale division will be similarly converted into a publicly held company.

With its legal status changed, JA-Zenchu will face restrictions on its political activities and lose privileged access to Ministry of Agriculture, Forestry and Fisheries officials. Instead, from late 2019, JA-Zenchu will be required to undergo external audits by certified public accountants as well as to work on instilling a culture of business management in its organization.

The reforms require more than half of the board of directors of local JA-Zenchu branches to be certified farmers and experts in sales/marketing or management of agricultural products. Meanwhile, local JA-Zenchu branches that do not conduct banking or insurance services will be able to transform from cooperatives into joint stock companies. The medical arm of JA-Zenchu, which is the JA Welfare Federation, is expected to become a medical corporation in its own right.

The government said it plans to monitor the business activities of local JA-Zenchu businesses for five years before making a decision on whether these should be open to non-members of JA-Zenchu. Potentially, this could prevent JA-Zenchu from offering its banking, insurance, and trading services to the general public. As JA-Zenchu profits from intermediation between the farmers and government, critics say the organization's other businesses gain an unfair advantage.

In addition, the government reformed the Agricultural Affairs Committee system for the first time in 60 years. This was an attempt to introduce new, business-minded perspectives into local farming decision-making bodies that would be better allies in the government's reforms as opposed to staunch JA-Zenchu backers. The reform requires that municipal committee members will no longer be voted on by local farmers, but instead will be decided by the mayor, based on the criteria that the person is a "certified farmer" or *ninaite*. Committees are also expected to appoint members to promote optimization of farmland.

To eliminate some of the bureaucracy, national and prefectural agricultural committees are being abolished. Instead the Ministry of Agriculture, Forestry and Fisheries will take over the appointments for the national-level Agricultural Committee Network Organization.

Business Enters Farming

Limitations on corporations to own farmland were eased in 2015, allowing companies to own up to half (increased from "up to one-quarter") of a farming enterprise. Inside the National Strategic Special Zones (discussed in Chapter 8), establishment of agricultural corporations that produce and process agricultural products is already allowed.

"The government will promote partnership between companies and farmers, expansion of the business scale, innovation of management and technologies, and increases in added value," the Japan External Trade Organization said in a 2016 presentation.[10]

So far, there have been notable moves by food retail businesses into farming, while some of the large industrial companies (Nippon Steel and Toyota, for example) have taken advantage of the heat and electricity their manufacturing facilities already generate to set up low-cost vegetable factories, often based on hydroponics.

The development of technology to grow produce indoors has led to a mini-boom in indoor spaces being converted to grow leafy vegetables, as well as tomatoes and peppers, in Japan. A former Sony semiconductor factory in Japan was converted in 2013 into the world's largest indoor farm. For the project, young Japanese company Mirai Co. partnered with GE Japan to make efficient use of water, space, and LED lights to produce 10,000 heads of lettuce per day.[11]

This so-called "vegetable factory" technology is already becoming an export category for Japan, with trading house Marubeni, electricity specialist Showa Denko, and engineering firm Chiyoda winning interest from the Middle East.[12]

In 2016, Showa Denko, Marubeni, and Chiyoda signed a contract with Al Ghurair Group, one of the largest conglomerates in the United Arab Emirates, to introduce a demonstration plant in Dubai in January 2017. These Japanese partners hope to secure sales and installation of the technology in a number of Middle East countries—and potentially water- or sun-deficient areas like Africa and Siberia—in the future, according to Showa Denko.[13]

The results are not just in volume. Take 400-year-old trading firm Mitsui & Co.'s venture into onion marketing in Hokkaido. The northern island is Japan's top area for growing onions, but does not produce any well-known brands of the vegetable.

In late 2014, Mitsui tied up with local seed company Okamoto Plant Breeding to start producing a new onion variety called Sarasara Gold. The onion is characterized by a higher-than-normal content of quercetin, which is a compound said to help prevent lifestyle-related diseases, according to the *Nikkei*. By emphasizing the health benefits of this variety, Mitsui told the newspaper that it plans to cultivate new sales outlets such as department stores, to grow yields from 100 tons to 5,000 tons "as soon as possible."

Mitsui, which mainly deals in mining and energy commodities, in 2014 also bought a 49-percent stake in a new company to produce and sell tomatoes at a specialized, 10-hectare farm west of Tokyo. These were Mitsui's first ventures into agriculture in Japan, showing the appeal of the sector for business once reforms were enacted.

Government data show that the number of farming corporations rose by 1,732 to 13,561 in the three years after rules were relaxed in December 2009 to allow companies to take bigger stakes in agricultural ventures from less than 10 percent previously. At the last count in 2010, companies held stakes in 7 percent of farmland in Japan, according to the agriculture ministry.[14]

If projects like Mitsui's show the value of branding in agriculture, for convenience store operators like 7-11 and Lawson—as well as Japan's biggest supermarket chain Aeon—investing in domestic agriculture is a chance to secure supply amid shortages of fresh groceries and control over product selection. These companies are even training young staff to work the fields.

Lawson started its farming ventures in 2010, even before the arrival of Abenomics policies, but has scaled up its agricultural program significantly since then. By 2014, Lawson had 12 farming joint ventures and planned 28 more, because the government reforms of land was making consolidation of small holdings into large tracts easier, the company explained to Bloomberg.

"Farm output will keep falling unless we take action," said Yayoi Sugihara, a spokesman for Lawson in Tokyo. "We want to bring on young farmers to become professional producers."

Aeon became the country's biggest vegetable grower in less than five years. The supermarket chain had 14 farming ventures covering 230 hectares in 2014, and planned to more than double this by early 2016, according to Bloomberg.[15] These ventures grow mostly cabbage and spinach, and account for just 1 percent of the fresh produce sold by Aeon, leaving much room for expansion, the company told the news agency.

Changing Focus to Exports

Previous governments have focused on the idyll of Japan needing to become a fully self-sufficient food producer. This led to a number of inefficiencies and a mindset of retaining production at all costs. At the same time, Japan's ratio of 60 percent imports in food produce has hardly wavered in the last decade.

The drive of the Third Arrow has been to abandon the idea that Japan has to be self-sufficient in food at all costs. Instead, farmers should aim to produce internationally competitive, high-quality agricultural, forest, and fishery products. The farmers themselves should pick the crops and methods that make the most business sense.
As an extension of this change in policy, the Abe administration has encouraged exports to capitalize on the growing wealth in Asian countries and the reputation for high quality in Japan's agricultural produce.

In terms of the headline numbers, the Third Arrow has already seen progress. As mentioned earlier, there is a ¥1 trillion export target by 2020 for agricultural, forest and fishery products. So far, the government has overseen an 11 percent jump in these products to ¥669 billion in 2014 and a 22 percent year-on-year jump in 2015 to a record ¥745 billion.

Government plans call for the development of an export organization for each type of product. It is difficult to see progress on this front so far or to measure how useful it will be. One idea is to promote Japanese food and alcohol products during the 2020 Tokyo Olympic and Paralympic Games, which seems an obvious time to parade the best the country has to offer. Otherwise, most of the work the government plans to do in terms of promotion is described as help in establishing food safety and certification standards for exports. A tangle of international standards in each food produce category is seen as one barrier to boosting exports further.

Smart Farming

The new frontier in Japan's farming is robotics. About 65 percent of those tilling the land are over the retirement age of 65, and there are not enough young people willing to toil in the countryside, government data show. Some industry experts estimate that Japan would need to double the number of people under 40 engaging in farming before 2025 to maintain current levels of agricultural production.

The arrival of robots on Japanese farms is both a matter of solving this demographic issue and part of the broader push by the government to introduce a robot-driven industrial economy for an aging society.

Leading the advance are tractor-manufacturers Kubota, Yanmar, and Iseki, all of which are developing self-driving agricultural machinery that can be used in rice paddies and other fields. Kubota has already developed its first prototype autonomous tractor that follows routes using GPS positioning.

The advent of self-driving industrial vehicles, already introduced in mining in Australia among other countries, will affect all industries within five years. Japan plans to introduce self-driving on highways by 2020, as well as drone delivery networks around the same period, according to the 2016 Strategy. The use of this same technology in farming fits well with the staff shortages in the industry.

Taking the technology further, the goals of Abenomics include drone management of fields, where the devices could be used to measure atmospheric and soil conditions. A company called Farm Note is in charge of this development, according to the 2016 Strategy.

The same company is also working on wearable tracking devices for cows—and potentially other herd animals—to monitor their progress, helping to make sure herds return from pastures intact and on schedule.

New exoskeleton devices, also known as wearable robotics, are being developed by Kubota and a score of other Japanese industrials, such as Panasonic, Honda, and Toyota, to help support human bones and muscles and increase their power. The technology is expected to help farmers with heavy-duty carrying tasks and harvesting.

Such measures could help revive the image of agriculture from old-people's *sanchan nogyo* to high-tech, Takaki Shigemoto, an analyst at Tokyo-based JSC Corp., told Bloomberg.[16]

"Applying new technologies to farming will boost the appeal of agriculture to younger people and help increase their participation in the sector," Shigemoto said.

Notes

1. www.gfmag.com/global-data/country-data/japan-gdp-country-report#axzz2kmA1XTXk
2. www.relbanks.com/rankings/largest-japanese-banks
3. www.zenchu-ja.or.jp/about/organization (Japanese)
4. www.bloomberg.com/news/articles/2016-04-23/robots-replacing-japan-s-farmers-seen-preserving-food-security
5. Exact numbers vary depending on publication. Bloomberg News in 2012 cited a number below 1 million, while *Japan Today* put it at 1.7 million in 2014: www.japantoday.com/category/technology/view/japans-agri-tech-farming-revolution;
6. www.bilaterals.org/?japan-s-free-trade-nemesis-built&lang=fr
7. According to The Tokyo Foundation's Yuko Banno, the word *ninaite* has a very specific meaning in the context of agricultural policy. It does not refer to all farmers, but only those currently operating "effective and stable farm management," as described in the 1999 Basic Law on Food, Agriculture, and Rural Areas, and others who might be expected to achieve such standards in the future. "Efficient and stable farm management" means farming on a level capable of bringing in a lifetime income comparable to that obtainable in other industries by working a similar number of hours. www.tokyofoundation.org/en/articles/2014/japanese-agricultural-policy
8. According to the key performance indicators outlined in the Abe administration's Growth Strategy, 2015 Revision.
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2 Banking and Finance

“We’re never going to get a revival of the economy unless we get a more vibrant financial sector,” Robert Feldman, chief economist at Morgan Stanley MUFG in Tokyo at the time, told the *Financial Times* in 2012. The truth is, in the last 15 years, Tokyo—and with it Japan—had already lost its title as the financial capital of Asia.

At the start of this decade, in lockstep with the weakening of the overall economy, Japan saw foreign banks such as Standard Chartered and HSBC wind down their retail businesses in the country, global investment banks cut local jobs, and its own domestic firms struggle to develop into international forces. Nomura Group’s takeover of the remnants of Lehman Brothers is a case in point.

The Tokyo Stock Exchange still listed the largest market capitalization of stocks after London and New York. But size is not everything, it seems, and the city fell outside the top five in the rankings of global financial centers and lagged significantly behind its closest Asian rivals Singapore and Hong Kong.[1] As a consequence, by 2012, Tokyo did not even make it into the top 10 places where companies planned to open new offices, according to London-based think tank Z/Yen, which compiles the Global Financial Centres Index.

Z/Yen’s index, known as the GFCI, surveys about 3,000 financial-services professionals and looks at 84 cities, also utilizing data from the World Economic Forum, United Nations, and other sources. It scores financial centers across several categories: business environment, financial sector development, infrastructure, human capital, and reputational and general factors. The top two spots for the last two decades always belonged to London and New York, while Hong Kong and Singapore jostled for next in line. Tokyo has, at times over the past decade, slipped behind Zurich and San Francisco.[2] Hence, with a shrinking of staff at investment banks globally since the start of this decade, Tokyo became a prime spot for shedding headcount—especially at non-Japanese firms.

At issue here was not just the dynamics of the Japanese financial sector, but the health and governance of the country's corporates in general. Japan was not seen as a growing market; its economy was deflationary. Tokyo still had the image of being expensive and not an easy place for non-Japanese skilled professionals and their families to live. On top of this came the earthquake, tsunami, and Fukushima nuclear disasters of 2011, sparking the departure of some foreign financial professionals for other cities in Asia.

Third Arrow Concept

To turn around Japan's deflationary economy, the administration of Prime Minister Shinzo Abe saw that it had to boost the financial sector. The goal was set for Tokyo to reclaim the mantle as the leading Asian financial hub. "My administration has the objective of turning Tokyo into a financial city, a hub of Asia. So, we would like to grapple with various reforms to that end,"Abe told the Council on Foreign Relations in New York in 2014.[3]

These various reforms approach the issue on multiple fronts. The first made use of the Special Zones initiative to designate Tokyo as a zone focused on improvements in the banking and finance sectors. Other reforms, discussed in separate chapters in this report, look at how to improve Japan Inc.'s corporate governance and how to attract overseas financial professionals through improvements in immigration procedure and better access to education and health services for foreign families.

In terms of the domestic market, the government identified the key areas to reform as being financial infrastructure, transparency at the country's banks, lending and export support for small and medium-sized enterprises (SMEs), and the pension system. In addition, as part of the broader Abenomics agenda, the government outlined plans to build closer financial sector ties with other Asian nations through trade deals and currency swaps.

In this sense, the reforms were evenly spread between personal, corporate, investment and geopolitical finance.

Infrastructure Reaching Out

Japan's effort to become the financial hub of Asia—even as competition for the position heats up due to desires by China to achieve the same—is based partly on improving the industry's infrastructure.

Since 2014–2015, the Tokyo Metropolitan Government, which is in charge of the effort, has outlined the vision as an improvement in securities settlement systems, standardization of bond issuance documentation, and more real-time money transfers by financial institutions and companies. In addition, the city said it needed to develop globally minded people through means such as improving English education and making more financial administration information available in English.

For the average consumer, this means, among other things, being able to use overseas credit and cash/debit cards in Japan. This may seem like a given for most developed economies, but in Japan the retail banking system had stood apart from global integration. As recently as the early 2000s, the most common cash/debit card system in Japan, PLUS, was not accepted abroad, and the reverse was often true for European and North American card systems in Japan.

Today it is possible to withdraw cash with a foreign card in Japan, but only through a limited number of ATMs. Many travelers to Japan are further surprised to find many ATMs working essentially "office hours," with service breaks in the late evening, overnight, and on weekends. While the availability of cash and credit services is improving for foreign visitors, there is still a long way to go.

The problems in adapting to foreign credit cards is partly due to the fact that Japanese lenders retain arcane systems and infrastructure in a lot of their banking operations, not just regarding ATMs. To this day, to open a personal bank account and carry out significant operations, most Japanese banks require a customer to bring a *hanko* (registered name stamp); a signature does not suffice.

It also is not unheard of for Japanese credit companies to deny a transaction if they think the signature on the receipt does not closely resemble the one the client has registered on the card. Presumably, because Japanese credit company staff are less comfortable with English, they are less likely to understand small yet common flourishes in signatures in the roman alphabet.

Culturally, the Japanese prefer cash to credit, and this means many small shops and restaurants in Japan do not accept card payments. This is despite Japan being among the first countries in the world to issue credit cards, and there being almost three cards per member of the population.

The Abe administration has begun to tackle this aversion to non-cash payments by allowing public services such as taxes to be paid by credit or debit. METI claims that it has persuaded more retailers in tourist areas and all taxis in major cities to accept cards.[4] How far this has come will be best measured by the time of the Tokyo 2020 Olympic and Paralympic Games. Until then, it is fair to say that most travel websites advise visitors to Japan to carry ample cash.

On a corporate level, improvements in Japan's financial infrastructure have centered on two areas: improving fund settlement systems and making the listing of bonds and stocks in Japan more attractive to foreign companies.

For the former, the Bank of Japan built and introduced, in late 2015, a system that allows the Bank of Japan and financial institutions to settle funds and Japanese Government Bond purchases efficiently and safely online. This is to eliminate the risk that a seller delivering Japanese government securities to the buyer does not receive payment, and vice versa.

As for the latter, changes include a standardized documentation template for bond sales and more information on the markets being made available in English. In addition, the government announced an initiative to increase the trading of foreign stocks on Japanese exchanges to 25 percent of total volume. The current figure is about 12 percent. Average daily stock trading on the Tokyo Stock Exchange in 2015 was about ¥2.9 trillion, meaning the target represents about ¥725 billion each day in foreign listed companies being traded on Japanese exchanges.

However, getting companies to list in Japan or to use Japanese trade and exchange services because of easier bond issuance procedures, or simply to offer English language services may not be enough, according to an ACCJ member who spoke with the ACCJ Task Force.

"Tokyo remains a deep and liquid market, so if the correct policy changes are put into place, then an increase in listings may occur," said the ACCJ member. However, these changes should include more favorable tax rates and a drop in listed entity cost structures, as well as financial infrastructure improvements, in order to draw foreign firms, he said. What Japan has going for it versus Hong Kong and Singapore is its bigger liquidity pool and a more robust domestic economy, according to the ACCJ member.

The Tokyo Stock Exchange has also added new products to attract overseas investors. The exchange established a listed infrastructure fund market with the government taking on responsibility for promoting environmental improvement projects for such funds. The government is also pushing for the establishment of LNG and electricity futures trading to complement deregulation taking place in the utilities space. Should Tokyo succeed in establishing a market in liquified natural gas (LNG) futures it would be the first bourse to do so. Despite Japan having the advantage of being the world's top buyer of LNG however, the market has resisted change from what is traditionally a system of direct contracts between sellers and buyers.

Attracting Professionals

For now, the Abe administration has made progress is altering the visa and immigration procedures for highly skilled professionals.

These include setting up a new visa category for such professionals based on a points system that scores applicants on their income level, industry experience, language skills, publications, and so on. The benefits of the visa, as touted by the government, is a fast-track to a Japanese permanent residency or "green card," a longer visa term of up to five years, the ability to sponsor a visa for domestic helpers and invite parents to live in Japan, and easier requirements for a spouse to get a full-time work permit.

In the 2016 Strategy, the government promised to make Japan the easiest country in the world to get permanent residency for highly skilled professionals. The aim is set out simply as to "create a more livable and workable environment for expatriates." As well as the benefits regarding domestic help and inviting parents to Japan, there are also initiatives to provide Japanese language support to all expatriate children up to junior-high school by 2020 and broaden the number of medical facilities with staff that have the language skills to treat foreign patients.

In spite of this, the visa category introduced in April 2015 attracted only about 1,500 people by the end of that year—64 percent of them Chinese. This probably shows how little awareness there is of the measures in the international community. It also suggests that those most aware and ready to seize the opportunities are already fluent in Japanese and living in the country.[5]

Banking on a Revival of Spirit

Japan's banking sector was a large contributor to and victim of the so-called Lost Decades in the economy from the 1990s. Indiscriminate lending practices by the banks were a main driver behind the asset-inflated bubble economy. As the banks got back on their feet through government capital infusions, mergers, and cheap credit from the central bank, their loan mentality changed to one of extreme caution.

For much of the next two decades as the banks consolidated in order to survive, they often avoided the risk of lending outside of their related business groups, while corporates largely passed on borrowing, opting instead to pay down debts from earnings. The result was an increase in the culture of cross-shareholdings. Banks would own stock of corporates, and vice versa, to secure trust.

In the banking sector, Abenomics set out to break up this pattern of behavior. It urged banks to wind down cross-shareholdings, to take the lead in corporate governance reform, and to look to new markets outside Japan and Japanese firms for growth. Progress can be seen on all three fronts.

Japan's three major banking groups, Mizuho, Sumitomo Mitsui, and Mitsubishi UFJ, announced in November 2015 that they would significantly reduce cross-shareholdings within three to five years.[6] At the time of the pledge, that reduction was worth several trillion yen in equity.[7] This was a major boost for investor confidence in the Japanese market, according to Nobuchika Mori, commissioner of the Financial Services Agency of Japan, speaking in New York in March 2016.[8]

Mizuho, which had just slightly less than ¥2 trillion in domestic equity holdings in March, said that it would reduce its cross-shareholdings by 40 percent over the next few years. The bank's president, Yasuhiro Sato, vowed on November 13, 2015 to "constantly reduce" the cross-shareholdings by gaining understanding from the companies involved.[9]

Mitsubishi UFJ, which holds more than ¥5 trillion in domestic equities, said over the summer of 2015 that it had tested those holdings against undisclosed new criteria and found that about a fifth did not make the grade. The bank has since said it will cut the total value of its cross-shareholdings to 10 percent of tier 1 capital from about 19 percent now. Sumitomo Mitsui's new target is to reduce its ratio of cross-shareholdings to tier one capital by half over the next five years.[10] Its cross-shareholdings stand at around ¥1.8 trillion.

The move by the banks was a direct reply to the demands in the government's 2015 Strategy, the *Financial Times* wrote in November 2015. The newspaper also noted that calculations by the Nomura brokerage indicate the cross-shareholding ratio across corporate Japan, excluding insurers, fell to its lowest-ever level of 10.8 percent in the most recent financial year, although the pace of reduction is slow. The brokerage estimates that the ratio will drop to around 9.9 percent by the end of the 2017 financial year, the paper said.[11]

Welcoming Outsiders

Regarding corporate governance, the government urged banks to each introduce at least one—preferably two or more—independent outside directors. Banking subsidiaries that are wholly owned by listed bank holding companies were also encouraged to consider introducing independent outside directors. The point was to shake up the board by adding non-executive directors willing to challenge and critically analyze management actions.

This would also mean that policies and decisions of the board would require more than just the signoff from the chairman, who is often the previous CEO of the company. Boards in Japan have typically consisted of directors whose position is aligned with management and not that of other stakeholders (including shareholders), and at least one "outside auditor" hired by the company (and thus loyal to management).

As of 2015, Japan's top three banks, known as megabanks due to a series of mergers since the economic bubble burst, each had boards where outside directors made up at least a third of the executives. Mizuho led the pack with almost half its board categorized as outside directors.[12]

Around 80 percent of regional banks listed on the Tokyo Stock Exchange's first section had at least two outside directors as of July 1, 2015, according to a Jiji Press survey. The number of such lenders stood at 69, or 81 percent of all 85 regional banks and banking groups on the first section, up fivefold from 14 in 2014 and 13 in 2013. Jiji Press said, "80 percent of listed regional banks have multiple outside directors."[13]

Moves to use outside human resources to improve corporate management have started to spread in the regional banking industry, which prior to 2015 lagged behind major banks, according to Jiji. As part of this, a trend has emerged to appoint women from different industries, though local business heads, financiers, and lawyers still account for many of such directors, the news service noted.

Most importantly, the reforms have helped promote more active business practices by Japanese banks. The banking sector, which holds nearly US $850 billion in government bonds and US $1.3 trillion in current accounts of the Bank of Japan, is shifting focus from attracting deposits to selling products such as mutual funds, according to the Financial Services Agency.

Japan's megabanks are moving more into financing global mergers and acquisitions that do not involve Japanese corporates. In 2015 the banks extended US $473 billion—a record level of financing—taking a hand in 59 percent of all M&A loan packages, up from 46 percent a year earlier, according to data provider Dealogic. Makoto Kobayashi, head of Mitsubishi UFJ's financial solutions group at its banking unit, told *The Wall Street Journal* (WSJ) in December 2015 that the country's largest bank by assets sees an opportunity to move well beyond financing acquisitions by Japanese companies.[14]

"We've seen an increasing number of financing deals for non-Japanese M&A activities this year, and I feel our presence has been more recognized," Kobayashi told the WSJ. The bank's alliance with Morgan Stanley has helped it expand its role in global deal financing, he said. The Japanese bank took a 20 percent stake in Morgan Stanley in 2008, and the two have joint ventures in Japan.

As well as lending, Japanese banks have expanded abroad through acquisitions. Mitsubishi UFJ, in 2013, took a ¥560 billion controlling stake in Thailand's Bank of Ayudhya PCL., the same year that rival Sumitomo Mitsui Financial Group bought a US $1.5 billion stake in Indonesia's Bank Tabungan Pensiunan Nasional. In 2016, Mitsubishi UFJ took a roughly 20 percent stake in Security Bank, the Philippines' fifth-largest lender by market value.

More acquisitions will follow, promised the new CEO of Mitsubishi UFJ, Takashi Oyama, soon after his appointment in April 2016. "We'll consider any opportunities for non-organic growth" in the United States, he told Bloomberg, adding that this could involve the acquisition of another "reasonably large" regional bank.

Oyama confirmed that the mood of Japanese banks, so fearful of risk in the 1990s and 2000s, has changed. He said he was not afraid of competing head on with US banks and would seek to enter the top 10 lenders' list in the United States based on deposits.

The biggest risk for Mitsubishi UFJ may be the instinct to retreat into protective mode, Oyama also told the WSJ in April. "The business environment is changing so quickly. Quick decision-making will be crucial. If we only stick to a defensive stance, we won't be able to survive."

Taking Positions in Asia

The above acquisitions in Southeast Asia by the banks, dovetailed with the policy the Abe administration, has taken on making Japan a more important part of the Asian financial system.

This has taken the shape of promoting interconnection of ATM systems in Asia, while renewing and expanding bilateral swap arrangements with Association of Southeast Asian Nations (ASEAN) member countries. In theory, the latter is specifically directed at strengthening the financial markets in Asia that will benefit Japanese exporters and corporates looking to expand abroad or pursue contracts in the ASEAN region. In practice, it is hard to assess how much economic benefit this effort has created.

Among the headlines the ministries roll out are the arrangement of additional funding into schemes such as the Chiang Mai Initiative Multilateralization Agreement (CMIM), a multilateral currency swap arrangement among the ten members of ASEAN, China, Japan, and South Korea. After the 1997 Asian Financial Crisis, CMIM was set up to manage regional short-term liquidity problems and to facilitate the work of other financing arrangements by organizations like the International Monetary Fund.

Japan also doubled its bilateral swaps with Indonesia and the Philippines, renewed the same with Thailand, South Korea, India, and Singapore, and worked on other bilateral agreements in trade and financing in Asia.[15]

Nonetheless, it is not clear whether such initiatives are entirely the product of Abenomics reform or ongoing relationship maintenance. They also seem more likely to help the geopolitical—as opposed to the economic—goals of the Abe administration; namely, establishing friendly relations with ASEAN members to counter China's territorial claims and military build-up in the region.

Nippon Export Insurance

A stronger impact on Japan's exports and trade in Asia may come from another government measure. In accordance with changes made to the Trade and Investment Insurance Act, which reforms the functions of trade insurance, the state-owned Nippon Export and Investment Insurance (NEXI) agency is being converted to a special stock company (wholly owned by the government).[16]

By making the agency a special corporate entity, the government hopes NEXI will become more efficient and mobile. Currently, NEXI handles risk on Japanese firms' exports, investments and loans that are not covered by private insurers.

The GOJ's Infrastructure Export Strategy aims to facilitate deals with other countries for large infrastructure projects utilizing Japanese technology.

Initially, despite the legislative changes, Japan lost out to China on the award of a contract to build a high-speed rail system in Indonesia. That loss, in early 2015, led to a rethink. After realizing that the fault was in the comparatively conservative guarantees and higher costs that Japan included in the Indonesian bid, the Japan Bank for International Cooperation announced that it would ease conditions on yen loans for emerging economies in Asia. In a late-2015 bid to build the Indian high-speed rail system, Japan was successful. That contract is valued at close to US $15 billion.

Easier Approach to Lending

Similar to the way Japan has pushed its megabanks to be more adventurous and focus abroad, the Third Arrow is hoping to do the same for the country's SMEs. The premise here is that SMEs, which account for 99.7 percent of Japan's 4.2 million companies, can become an even bigger engine of growth for the economy than the blue chips because the majority have yet to tap into overseas business potential. As part of a government presentation in 2016, SMEs were labeled "Japan's numerous hidden champions." The target that the government has set is to double SME exports to ¥25.2 trillion by 2020 from about ¥13.8 trillion in 2015.

Such targets, which push together a group of companies simply on the basis of their size, do not take into account the fact that, once an SME is successful and its business grows, so does its staff count and it simply stops being an SME. Still, what it instructive in this case is the way that the government has approached the problem of why Japanese SMEs have yet to tap the potential of foreign markets through export or opening of operations abroad.

According to 2015 research by academics led by Professor Tomohiko Inui of Gakushuin University, only 25 percent of Japanese manufacturing firms with 50–300 staff are exporters, while 60 percent of larger firms sell abroad.[17]

The problems smaller firms face include a lack of information about foreign markets and the difficulty of finding good foreign partners. The researchers noted that larger enterprises can overcome these problems due to their wider information network, their own sales channels, overseas partners and their having larger staff resources to investigate opportunities. Where Japanese firms especially benefit is through their banking relationships, with lenders regularly playing the role of "information conduits" in addition to their financial services, the researchers reported.

Getting more banks to lend to SMEs would not only help these smaller companies with loans, deposits, leases, and payment and letter of credit services, but would also give them access to the banks' knowledge of overseas recruiting, advertising, tax systems, and administration, the report said.

"The government should recognize that SMEs strongly need useful information on export markets in order to lower the fixed costs of exporting and consider how to provide useful information effectively to SMEs," Inui and his co-authors said in their report.

One reason for making such a recommendation, which may seem common sense, is that Japanese SMEs struggle to get credit. "Nowhere in the world is it as hard for SMEs to get decent financial support via loans and financial products" as in Japan, according to Ernie Olsen, the former Japan head of Royal Bank of Scotland (RBS) and now a consultant with Tokyo-based OCC KK.

The lending problem dates back to the conservative policies the banks took on after the bubble economy collapsed and they had to survive on government bailouts, as noted earlier. What Japan needs to do is to revamp loan credit standards to boost lending, Olsen suggested. Since today's blue-chip Japanese companies are cash-rich as never before, that boost in lending has to come from loans to the SME sector.

To address the issue, the government has pushed for easing credit standards (such as asking financial institutions to take into consideration not just the financial condition of debtors but also the growth potential), without placing an unnecessarily high reliance on guarantees or collateral. Per the policy initiative, "Less attention will be paid to small and low-risk exposures pertaining to safety and soundness, and banks' asset classification, subject to effective credit risk management with appropriate provisions, will be accepted by on-site inspections."[18]

Whether this translates into more loans to SMEs and the unleashing of Japan's "hidden champions" remains to be seen in credit extended, investment, and growth figures. For now, economists worry that looser credit could lead to problems in the future with troubled borrowers if economic conditions take a turn for the worse. Increased borrowing will also depend on SMEs taking the initiative to expand and taking the plunge on loans.

One scheme the government does have in encouraging the SMEs to be more ambitious is designating the role of promoting foreign expansion to the state-owned Japan Bank for International Cooperation (JBIC).

As part of the Third Arrow initiative, JBIC has been asked to help companies improve profitability through loan products linked to global business development. In its own quarterly magazine, published July 2015, JBIC stated that its new Medium-Term Business Plan for Fiscal Years 2015–2017 was to "contribute to exploring and creating new business opportunities that will lead to the sustainable growth of Japan through supporting the strengthening of Japanese companies' overseas business deployment and resource acquisition by exercising the financial intermediary function that is unique to JBIC."

In addition, JBIC has rolled out new products such as subordinated loans and financing for Leveraged Buyouts (LBO) to further stimulate activity in the private sector.

Jeff Allan, writing for *Investment in Japan*, notes that in 2014-2015 SMEs started to take advantage of JBIC's role with an increase in their pace of borrowing from the lender.[19] Faced with a shrinking population, and hence weakening demand at home, SMEs are extending more effort to research overseas business. According to the JBIC 2015 annual report, commitments increased from about $1.5 billion in 2011 to $3.2 billion in early 2015. In the last nine months of 2014 alone, JBIC made 82 deals that totaled about US $880 million. A year earlier, the bank had 54 deals worth about US $153 million.

Japan's smaller firms are looking for growth in other Asian markets that include China, Indonesia, Vietnam, and Thailand. These emerging countries offer far more rapid growth for a variety of Japanese industries in which they can expand. JBIC sees particular interest from component makers in the auto industry, as well as firms in the food industry, as the primary source of funding requests, according to a Bloomberg interview with JBIC chief Hiroshi Watanabe in 2015.

"They're not just following their large partners in developing business overseas," Watanabe told Bloomberg.[20] "They're also seeking to diversify their business locations because the domestic market is shrinking."

Former RBS Japan head Olsen does strike a note of caution on how far JBIC can go in helping SMEs without Japan adopting a centralized system of credit bureaus.

"My inclination would be that anything offered to support SMEs is a step in the right direction. That said, there is no way for JBIC or any other lender to provide the needed credit to the appropriate borrowers without the full file credit bureau that we've been advocating for over a decade," Olsen said, noting that previous attempts by the Tokyo Metropolitan Government to create a specialized lender to SMEs back in 2005 ended with the bank, ShinGinko, going bust within three years. Without a credit-scoring bureau, the bank had to be resuscitated with taxpayer funds. The issue of credit bureaus is yet to be resolved.

Pension Reform

The final piece of major financial industry reform in the Third Arrow agenda has been in the pension system. Like in many other countries, Japan's welfare system is coming under increased strain due to the changing demographic of an increasingly elderly and declining population.

The number of individuals and companies (legally or not) opting out of making state-defined pension contributions is on the rise, because they do not trust that it can provide for their future means.

There is reason for such distrust. As far back as 2007, the Organization for Economic Co-operation and Development forecast that the projected population decline would mean a national pension replacement ratio of 24.4 percent by 2049. As much as 40 percent of the self-employed are not covered by the public pension system at all, according to state data, which also shows that employer contributions are not at a sufficient level.[21] [22]

What the government has tried to do is introduce a social security identification system known as My Number. This allows all state agencies to track personal information through one channel, making it easier to chase non-payment of social security. At the same time, the government is promoting a greater degree of personal responsibility in the pension system. This includes both asking the population to think more about investments to supplement their post-retirement income stream and a reform of the state pension fund (which is discussed in Chapter 3).

Japanese pension funds have typically been "defined benefit," not "defined contribution," thus asset managers hold all of the risk in their decision making and are more likely to invest in safer assets. Through promotion of "defined contribution" plans, employees themselves will contribute fixed amounts but receive payouts that vary with investment performance. In 2012, the government set a goal of reaching 20,000 companies that adopt "defined contribution" plans by 2020. As of March 31, 2015, there were 19,832 companies that had done so, according to the Ministry of Health, Labour and Welfare.

The Bank of Tokyo-Mitsubishi UFJ, advertising giant Dentsu, and others joined this list in February 2015. Tax incentives and a buoyant stock market in 2015 increased these plans' appeal. However the turbulence of the Japanese stock market in 2016 may offer headwinds to this initiative. The Nikkei 225 Index closed barely up on the year, 0.42 percent higher than the 2015 close.

Tokyo-Mitsubishi UFJ allows workers to contribute up to ¥10,000 per month as an add-on to the bank's defined-benefit pension. As a point of reference, about 80 percent of enrollees take lump-sum payouts instead of monthly income after retiring. Low-yielding, guaranteed-principal investments make up 60 percent of assets under management. Slightly more than half of assets have annual yields of 2 percent or less showing that there is opportunity to move to riskier assets, according to Nikkei research.[23]

Further measures that Japan could benefit from in this area include increasing the limit on tax-deductible pension contributions to levels comparable to the Untied States, allowing employee matching of employer contributions and withdrawals before retirement age under certain conditions and introducing an after-tax retirement saving plan similar to the 401(k) plans in the Untied States.

Private Equity and Alternative Investments

As is often the case with alternative investments, the issues facing this industry do not fit easily into either "Banking and Finance" or "Corporate Governance and Legal Reform." For example, the Stewardship Code mentioned below has had a profound effect on expectations concerning return on equity (ROE) as well as banking and M&A.

Capital formation is slowing or shrinking in Japan. This means that it has been hard for casualty insurance companies to increase their assets, revenues and profits. Many fire and marine insurance companies have merged in Japan and are making overseas acquisitions to search for growth. One impact has been a kind of backward or upward integration of best investment practices from the acquired company into the Japanese parent company. For example, Tokio Marine & Nichido acquired US firm Delphi Insurance. Delphi has developed a solid investment portfolio partly by including allocations to alternative investments. Now Tokio Marine is looking at increasing their investments in these areas, due in part to the influence of strategies from its new subsidiary.

Also, the Government Pension Investment Fund (GPIF) and Japan Post Bank have, in the last four years, announced and followed through with their plans to allocate more to alternative investments in order to improve investment returns. Since 2014, the amount of money being allocated to alternatives has increased dramatically. According to Preqin, a major investment database, the assets under management (AUM) of Japanese institutions claiming to invest in alternatives has increased as follows (amounts in US$ trillions):[24]

	2014	2016
Private Equity	13.4	19.0
Real Estate	8.3	18.3
Hedge Funds	6.7	10.3

In April 2016, Japan Post Bank announced that it would start to allocate between 1 percent and 3 percent to private equity (from zero previously). With total assets of US$1.7 trillion, this means roughly US$20–50 billion of new money will flow into global private equity funds, mostly to offshore fund managers who will be able to handle the large individual orders from Japan Post Bank. In addition, the bank is an influential thought leader among Japanese institutional investors, so others are closely studying and imitating its investment strategies.

According to Triple A Partners Japan President Frank Packard, more than half the life insurance companies and non-life insurance companies covered by the firm since 2013 have either started (or restarted for the first time since the global financial crisis in 2008) allocating to private equity and hedge funds.

Private equity and so-called "revitalization strategies" (the new and acceptable term for shareholder activism) are also growing in the public markets. One example has been the increased attention—and success—that international investors are having in effecting changes in Japan.

From almost a zero base, in the past 20 years many new Japanese fund managers have started domestic private equity activities. To be sure, the trend started before Prime Minister Abe came to power in late 2012; yet his policies have strengthened the first wave of private equity entrepreneurs and encouraged these activities.

Historically, Japanese institutions had invested much more in overseas private equity managers than in homegrown versions. This occurred for several reasons. Often, private equity managers were associated with "vulture" investors that caused stakeholders lots of pain, such as the public perception of what happened to companies such as Aozora Bank (the former Nippon Credit Bank) and Shinsei Bank (the former Long-Term Credit Bank of Japan). The visible stress, layoffs, and restructurings associated with American-style activist and private equity investors were frowned upon by Japanese society.

This has changed under Abe. Now there is a vibrant industry of private equity investors from Japan actively investing in Japan, ranging from venerable 20-year-old institutions like JAFCO to global quality firms like J-Star and J-Will Partners. There are a wide variety of global and Japanese groups investing in everything from venture capital and start-ups to buyouts and restructurings.

Notes

1 Tokyo made its way back to No.5 in 2016. See www.longfinance.net/global-financial-centre-index-19/976-gfci-19-the-overall-rankings.html
2 www.ft.com/fastft/2016/04/06/financial-centre-rankings-rule-britannia-singapore-trumps-hk/
3 www.cfr.org/asia-and-pacific/conversation-shinzo-abe/p33494
4 http://japan-magazine.jnto.go.jp/en/special_credit.html
5 http://asia.nikkei.com/Politics-Economy/Policy-Politics/Japan-eyes-shorter-path-to-permanent-residency-for-some
6 http://asia.nikkei.com/Business/Trends/Profits-squeezed-by-Asian-slowdown
7 Ibid.
8 www.fsa.go.jp/common/conference/danwa/20160310/01.pdf
9 www.reuters.com/article/japan-banks-results-idUSL3N1342IC20151113
10 www.ft.com/content/b5a3407c-8b4b-11e4-be89-00144feabdc0
11 www.ft.com/content/bf714ea6-8b76-11e5-8be4-3506bf20cc2b
12 www.mizuhobank.com/company/release/pdf/20160303release_eng.pdf
13 www.japantimes.co.jp/news/2015/08/17/business/corporate-business/80-percent-listed-regional-banks-multiple-outside-directors/#.V75iEJN94UE www.japantimes.co.jp/news/2015/08/17/business/corporate-business/80-percent-listed-regional-banks-multiple-outside-directors/#.V75iEJN94UE
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17 http://voxeu.org/article/little-help-my-bank-japanese-smes-export-decision
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20 www.bloomberg.com/news/articles/2015-04-02/japan-s-small-companies-are-borrowing-from-jbic-to-expand-abroad
21 www.oecd.org/japan/PAG2015_Japan.pdf
22 https://data.oecd.org/pension/net-pension-replacement-rates.htm
23 http://asia.nikkei.com/Business/Trends/Shift-to-defined-contribution-plans-continues
24 www.preqin.com/docs/reports/Preqin-Japan-Based-Investors-November-2016.pdf. The table shows the total AUM of these investors, not the amount of money invested in alternatives.

3 Corporate Governance and Legal Reform

For a man accustomed to scrutinizing corporate progress on a quarterly basis, Seth Fischer shows great restraint when asked to evaluate Abenomics.

Has the Third Arrow of structural reform been fired? "Yes, but the effects of the Third Arrow will only be measured in years, not in hours or weeks or even months," said Fischer, the head of Hong Kong-based fund Oasis Capital Management. "These changes—in terms of return on equity, in terms of corporate governance, in terms of thinking as an investor—take years to have an impact in companies' values."

Despite the oft-painted image of hedge-fund managers seeking immediate returns, Fischer is happy to note that the progress in corporate governance reforms is "genuine." He picked off examples: carmaker Suzuki selling its stake in Fuji Heavy Industries in August 2016 to eliminate cross-shareholding (Fischer: "Their reason was a direct copy from the Corporate Governance Code") and a revamp of compensation structure at Takasago Thermal Engineering to reflect personal performance, not age/seniority. In addition, more than 100 Japanese companies have added a return on equity (ROE) target to their mid-term plan.

Rarely discussed in financial statements and management discussion and analysis (MD&A) of companies, ROE is now one of the prime targets Japanese companies look at, according to Ernie Olsen of OCC KK. As one example of how the idea is taking root, Olsen points to domestic Google searches for the term "ROE," which were up four-fold in 2015 from 2012, when the Abe administration took office.[1]

As a result, Oasis Capital has 60 percent of its capital now invested in Japan, compared with 35 percent a few years earlier, Fischer said in an August 2016 interview. That is one promising indicator for a set of reforms that seek to change the fundamental structure of business relationships in Japan.

While much of Third Arrow has focused on legal reform in particular industries, its ambitions to improve the corporate governance culture extend much further. It is nothing less than a fundamental change in the nature of ties among business, investors, and society, with the onus put on each party to become more proactive and invested in the actions of others.

What this means is a development in the concept of "best practices" that gives investors both an incentive and the means to hold companies accountable. While cultural norms take time to transform, progress in corporate governance reforms in Japan since 2012 has been significant. It is also picking up pace with the arrival of entirely new, and perhaps unexpected, market entrants, such as short-seller activist funds. The latter have even built a business model based on reinforcing the government's message of good corporate governance.

Given the state of the nation's demographics, corporate governance reforms could be key to the attractiveness of Japanese stocks and bonds. The message behind the governance reforms is that Japanese companies (including pension and other investment funds) need to rediscover their hunger, be ambitious in expanding both at home and abroad, seek higher equity returns and productivity, and pass on the benefits to all stakeholders—staff, shareholders, and society in general.

The reason for their success may be that, rather than trying to foist change on the powerful big-business lobby single-handedly, the government has co-opted the domestic and international investment community and the population in general to be interested in promoting better corporate practices.

Pre-Abenomics

The power of Japan Inc. to resist outside influence on managerial decisions could be seen when the big-business groups lobbied successfully in the early 2000s to shoot down government proposals that would have required all companies to appoint at least one outside board member.[2]

Until the December 2012 election of Prime Minister Abe, Japanese stocks had been in the doldrums since the Lehman Shock of 2008.[3] The Japanese yen had surged against the US dollar, crimping profits of major manufacturers and exports, while the country's demographic outlook and growing debt pile, as well as industry-specific regulations, acted as a disincentive to many potential foreign investors. Japan's FDI was among the lowest of OECD countries. Its TOPIX stock benchmark was less than half of its 2007 level.[4]

The global financial crisis of 2008 left Japanese companies even more cautious about using their cash for capital investment or M&A. Instead, the cash piled up in low-interest bank accounts and few, if any, investors objected to strategies that generated small yet steady returns.

As well as weakening the global competitiveness of Japanese firms, the low returns also caused problems for Japan's institutional investors, led by the Government Pension Investment Fund (GPIF), that were staring at rising payouts to baby-boomer retirees.

Third Arrow Concept

The arrival of the Abe administration conceptualized the issue as follows: Japanese companies have lower productivity than Western peers, especially in services, and are slow to respond to changes in the global operating environment.[5] A feature of many Japanese companies is their overly diversified businesses, where profitable divisions subsidize those that perform poorly to save jobs and retain the status quo. This also leaves too many domestic firms competing in a single area with mergers resisted (and even discouraged under previous administrations).

The reforms in corporate governance were aimed at helping Japanese companies increase earning power and productivity, change risk appetites to look at new opportunities, exit from less profitable areas, and allow innovation and entrepreneurship, thereby generating more jobs. The government said it would focus on reforms to encourage capital spending on innovative products and services, and to achieve higher returns, as measured by ROE. The other focus was on making companies more accountable to a range of stakeholders, including shareholders, through the introduction of independent directors and elimination of cross-shareholdings.

The main actor driving the reforms has been the Financial Services Agency (FSA), which created a council of market experts to help it produce the policies that would win market support. Furthermore, the FSA also set up an advisory panel that meets monthly to follow up on implementation of corporate governance.

"Government policies and structural reforms that create the conditions for long-term growth cannot succeed without better performance from Japanese companies, which can only come from greater efficiencies and attention to return on equity that supports the interests of shareholders.[6] Ultimately, the success of improvements in corporate governance requires a change in mindset," the US–Japan Business Council (USJBC) said in a report in March 2016.

A Tale of Two Codes

Given the resistance of corporate Japan to outside influence, the FSA first promoted the creation of a Stewardship Code similar to the legislature in the United Kingdom. The Stewardship Code, drafted in 2013 and published in February 2014 after a largely positive reaction from the investment community, was voluntary.[7] It asked institutional investors to show that they are fulfilling their fiduciary duties and challenging the companies they invest in to perform better. This meant making public the way that the investors operate, such as disclosing their policies on voting at company shareholder meetings and proxy voting.[8]

The FSA has subsequently warned that it expects pension and other funds that sign the Code not only to avoid a "box-ticking approach," but to "have each investor continuously endeavor, in light of its specific conditions and situations, to be innovative and to differentiate itself so that activities of signatories overall will exceed the minimum standards."[9] The agency advocated a "principles-based" approach where investors would comply with the spirit of the Stewardship Code, as opposed to rigidly following rules.

As of December 2016, there were 214 institutional investors signed up to the Code, including seven trust banks, 152 investment managers, 26 pension funds and 22 insurance companies.[10] However, to date only one non-financial, private pension fund has signed the Stewardship Code—a glaring gap, given that private pension funds are some of the most important players in the investment field.

With much of the investor community aware of public expectations, even if not galvanized to action, the government's focus turned to governance practices in the corporate sector. A Corporate Governance Code was drafted and came into effect in June 2015, with a "comply or explain" requirement for at least two outside directors. It also urged the elimination of cross-shareholdings with client, partner, and group companies and the introduction of a number of new governance practices and disclosure categories.[11]

The FSA explains the Code as promoting dialog between investors and companies. In reality, it aims much higher. To date, Japanese management had neutralized pressure from the investment community through cross-shareholdings, or arranging for a corporation's clients/partners/group companies to buy and hold stakes. The latter are more inclined to vote in line with management policy, and without independent directors there are no voices on the board to promote shareholder views and challenge executives.

Like the Stewardship Code, the Corporate Governance Code is not a rigid law. By allowing companies to opt out of adopting the principles in the Corporate Governance Code (and explaining their reasons for not complying to their investors), the FSA made the document more palatable to corporate Japan while requiring a much greater level of transparency and disclosure about practices at each company than existed before. As a result, more than 2,000 companies have accepted most of principles in the Corporate Governance Code, according to a September 13, 2016, Tokyo Stock Exchange presentation.[12]

Although it is still early days, and a number of companies are only superficially complying with key principles, the Corporate Governance Code is not a paper tiger because investors can raise issues based on the vastly increased disclosures. The Corporate Governance Code's creation has also spurred other developments that are adding momentum to corporate governance reform overall, such as an increased focus on ROE, risk appetite, and capital allocation. While implementation is voluntary, companies that sign up to the Corporate Governance Code have to give an explanation if they choose not to comply with its five general principles, 30 principles, and 38 supplementary items (total 73).[13] Again, the FSA has warned against preparing boiler-plate answers and this time the investment community is motivated to challenge management decisions because of the Stewardship Code.

In addition, new forces have joined the push to make sure Japan Inc. does not brush away the latest reforms as simply a bureaucratic procedure. The Japan Exchange Group, owner of the Tokyo Stock Exchange (TSE), and Nikkei, the country's largest business media group, joined forces at the start of 2014 to create the JPX–Nikkei Index 400. The index picks its component stocks based on "companies with high appeal for investors, and which meet the requirements of global investment standards, such as efficient use of capital and investor-focused management perspectives," according to the Japan Exchange website.[14]

The criteria include that companies: adopt or schedule the adoption of International Financial Reporting Standards (IFRS), as opposed to a Japanese or US version of GAAP accounting standards; provide disclosures in English; and achieve a three-year ROE of 40 percent or more.[15]

Laying this groundwork, international investors became more confident in taking on the role of active or "soft activist" investors. There has been a notable increase in the number of so-called "engagement funds" that seek friendly interactions with companies in order to help them increase their share prices. More aggressive players have also emerged.

Activists

Activist investors have traditionally been shunned in Japan because many domestic institutional investors have business ties with listed companies and are loath to damage those links, according to Bloomberg News.[16] Nowadays, such investors are less likely to be viewed as undesirable.

Foreign investors led by Daniel Loeb, principal of New York-based hedge fund Third Point Management, and Seth Fischer, head of Oasis Capital, have pushed through real change using both the carrot and the stick. The former persuaded store operator Seven & i Holdings to appoint his pick as president, and the robot maker Fanuc to raise dividends. The latter championed Nintendo's move into smartphone games and challenged mobile phone giant KDDI to explain why they own minority stakes in electronics firm Kyocera and Japan Airlines.

"The Corporate Governance Code and the Stewardship Code are the cores of our increased engagement with Japanese company management," Fischer said.

Not all the activist campaigns have succeeded, but their very existence in a market used to consensus and decisions made behind closed doors is significant. The Codes have also encouraged some domestic investors such as Tsuyoshi Maruki, who founded his Tokyo-Based Strategic Capital in 2012, to take on more aggressive actions such as filing lawsuits to overhaul bad corporate practices.

"If one always adopts a friendly engagement style, such as having gentle and warm meetings, would the management really change?" Maruki told Bloomberg News in May 2016. "After the meeting, it would probably end at a comment like, 'They were nice.'"

Evidence that investors in Japan are becoming more motivated to challenge management is the number of new activist funds being created. Japan-focused activist funds, including friendly and more aggressive types, represent 22 percent of such funds started in 2015 globally—even as the number of activist funds in Japan account for no more than 1 percent of 513 activist funds globally, Bloomberg reported, citing data by research firm Preqin Ltd.[17]

If a measure such as the JPX–Nikkei 400 was a carrot, the early 2016 arrival of short-seller funds in Japan has been a definite stick.

Funds such as US-based Citron Capital and Glaucus Research, which made their name through outing fraudulent Chinese stocks listed in the United States and Hong Kong, have launched campaigns in Japan saying that, while the reforms of the Abe administration have promised a more transparent and accountable corporate Japan, many companies have yet to deliver.[18] These funds have taken on some of Japan's biggest names including trading house Itochu and robot maker Cyberdyne, challenging them to explain what the funds call accounting manipulation and hyping of their stock, charges that the companies deny.[19]

While many Japanese companies, and even regulators, deride the tactics of short sellers, after the exposure of massive accounting fraud in recent years at the country's top companies, including Toshiba and Olympus, the corporate sector is no longer able to claim it is beyond reproach.[20]

In fact, according to Tokyo Shoko Research Institute, the number of Japanese companies disclosing improper accounting has almost doubled in the last five years to a record 58 cases in FY2015–2016.[21] So, it may be no surprise that even the *Nikkei* business newspaper, which is traditionally something of a cheerleader for Japan Inc., has kept the tone of its coverage of short sellers almost neutral.

The data shows that Japan's corporate reforms are yielding results: 60 percent of companies had reduced their cross-shareholdings in FY2014.[22] The percentage of companies (on the first section of the Tokyo Stock Exchange) with outside directors has risen to 98.5 percent in 2016, almost double from five years ago.[23] In addition, as of December 2015, about 30 percent of the companies that did not comply with the Corporate Governance Code said that they plan to do so in the future, according to Tokyo Stock Exchange data.[24]

What is still a question is how willing companies will actually be to follow the spirit of the Corporate Governance Code. Mizuho Securities made an assessment of the 1,857 corporate governance reports submitted by the end of 2015, with the Code coming into effect in June of that year. "Our impression, unfortunately, is that many of these reports consisted mostly of bureaucratese and other formulaic language, and that few reports were used as an opportunity for management to express their business philosophies directly to investors," Mizuho said in its January 2016 report.

As a consequence, the returns Japanese equities are posting are still below the global level, and reforms made so far will likely take time to seep into the business culture. Companies on the broader TOPIX index had an average ROE of 7.4 percent as of the first quarter of 2016, compared with 9.2 percent for the MSCI World Index, data compiled by Bloomberg show.[25]

As the *Nikkei* wrote in November 2015, the improvements in corporate governance helped bolster investor confidence and stock prices, yet the market "must not become complacent."[26]

For investors such as Maruki, it is clear that "there's huge room for improvement in terms of corporate governance in Japanese companies."[27]

The corporate governance reform process continues. Policies that are now under discussion include measures to consolidate corporate reporting, address the problem caused by "advisor" positions held by retired directors, reduce the concentration of shareholder meeting dates near the end of June, and encourage corporate pension funds to sign the Stewardship Code.[28] With issues like these in mind, the Company Law and the Stewardship Code are slated for revision in 2017, and the Corporate Governance Code's first revision is likely to come after that.[29]

At the same time, spreading awareness and knowledge is also of key importance. One of the most important principles of the Corporate Governance Code is simply that companies should train directors so that they have sufficient knowledge about their duties, governance practices, and other key matters—both before their appointment and during it. "We saw a significant increase in companies asking us to provide training for them in 2016," says Nicholas Benes, representative director of the government-certified nonprofit The Board Director Training Institute of Japan (BDTI).

GPIF Reform

One of the biggest catalysts that could drive corporate governance reform forward is the Japanese state pension fund, also known as the Government Pension Investment Fund (GPIF). It is the world's largest public pension fund with US $1.3 trillion under management.[30] It is estimated that a 1 percent increase by the GPIF in its allocation of cash into the Japanese market would add ¥1 trillion to the market, according to Deloitte. Despite its potential influence, the fund historically kept a low profile in terms of investment opinions, keeping 60 percent of its money in Japanese bonds, a further 11 percent in overseas bonds, and 5 percent in cash.[31]

The GPIF is an independent administrative institution that manages and invests the Reserve Funds of the Employees' Pension Insurance and the National Pension with funds entrusted by the Ministry of Health, Labour and Welfare. It is pressure from that ministry that the government used to push through several initiatives:

- to encourage the GPIF to invest half its funds into Japanese and foreign equity (from less than a quarter previously);
- to make the GPIF adhere to the Stewardship Code and become a more active voice in the domestic market; and
- to allow the GPIF to break its salary caps to attract foreign and domestic high-level professionals and boost internal controls, risk management and investment options.[32]

In the next stage, it appears likely that the GPIF will mention the Corporate Governance Code explicitly in its Investment Policy.

It may be too much to expect the GPIF to take the kind of aggressive activist investor stance of foreign hedge funds, but the fund has taken some steps forward. In 2014, it selected a friendly activist fund Taiyo Pacific Partners LP to help manage some of its assets because of its non-hostile approach to bringing about change, according to minutes of the fund's investment-committee meeting reported by Bloomberg.[33] [34]

In 2015, the GPIF appointed transition managers for domestic equities, international bonds and international equities. These firms, including BlackRock Asset Management, are helping the fund shift into foreign investments and stocks.[35] At the same time, the GPIF established a Code of Conduct to be observed by its investment advisory committee, executives and staff to improve public trust in the organization. The Code of Conduct calls for better governance through increased social responsibility, fiduciary duty, compliance with laws and maintaining the highest professional ethics and confidentiality.[36]

Unlike sovereign wealth funds, and due to its pension liabilities, "When we look at the size of the GPIF, it is clear that it needs to have the same or even a higher level of governance through a clear decision-making system, strong internal auditing, a sophisticated risk management system, and a secure IT system. The GPIF is on the path toward being a better organization," Deloitte said in a 2015 report on the changes.[37]

The size of the GPIF, however, has also worked against the movement to improve corporate governance in Japan. The fund's larger mandate in stocks means that together with the Bank of Japan, the two state entities now control close to 8 percent of the stocks in the Japanese market and are the biggest shareholder in every fourth company listed on the first section of the TSE, according to a *Nikkei* report on August 29, 2016.[38] Unless the GPIF becomes a seriously active shareholder, this risks pushing up the value of stocks irrelevant of financial results and taking away the pressure mechanism on management to pursue corporate improvements.[39]

NISA Reform

A reform of the country's pension funds in light of a declining population is imperative, yet the government admitted that even an improvement in the pension system would not provide the population with enough retirement income in future decades. The focus thus shifted to promotion of personal investments—no mean feat in a country where more than half the private wealth sits in cash or cash equivalents in bank accounts.

In January 2014, Japan introduced a Nippon Individual Savings Account (NISA), a tax exemption from capital gains and dividends for investments by individuals of up to around ¥1.2 million per year over a five-year period, a scheme based on the United Kingdom's ISA model.[40][41] The NISA legislation also provides that the tax-exempted investment can be moved at market value to a regular account after the five-year period has ended, thus allowing a cumulative investment of ¥6 million to be exempt from tax for up to ten years starting in 2014.[42]

Traditionally, the population steers clear of risky assets, with only about five percent of household financial assets being held in stocks, according to the Bank of Japan. The formation of these tax-free investment accounts, however, was more than just a way to channel private wealth into investments and retirement planning. It also had the effect of reinforcing corporate governance since retail investors tend to buy shares with higher dividends and more simple (and transparent) business models. Thus, companies that aim to boost profits and their share prices—as opposed to those stagnating in low-return but stable assets—are simultaneously rewarded.

The power of retail investing in Japan had been close to non-existent. Still, in just two years since the launch of the NISA program, about 6 million tax-free accounts opened as of February 2015, and the number was expected to break 10 million in fiscal year 2015, according to the *Nikkei* newspaper.[43] Funds in NISA accounts have doubled to more than ¥6.4 trillion in 2015, with investments continuing at a solid pace despite a stock market downturn spurred by a slowdown in the Chinese economy and lower commodity prices. Retail investors are buying ¥1.15 trillion worth of shares above what they sold and are focusing on those with higher dividend yields, according to the *Nikkei*.[44]

In 2015, the scheme was extended to minors, allowing parents or grandparents to invest up to ¥800,000 per year tax-free in so-called Junior NISA, as a way to encourage the transfer of wealth to younger generations.[45] Although the NISA program will end in 2023, the securities industry is pushing the government to make it permanent, a measure the FSA is expected to consider.

The goal by 2020 is to have roughly ¥23.5 trillion in investments in NISA style accounts.[46] The major headwind that the initiative faces is the recurring perception among the general population that "stocks are high-risk" and that "Japanese markets will weaken." There is also wariness due to the poor performance of recent headline initial public offerings such as Japan Post and LINE, whose stocks declined in the months immediately after their listings.

Such concerns about personal investing may abate with greater education in financial markets—especially among younger people. One example is the recent popularity of the "Investor-Z" manga series in one of Japan's most read weekly comic books, *Morning*. The title is run by Japan's top manga publisher, Kodansha, and has a circulation of more than 200,000. The series, aimed at teens and young adults, follows the exploits of a 13-year-old schoolboy as he uncovers investment frauds, and is written by well-known manga artist Norifusa Mita.

Mita told the *Nikkei* newspaper in a 2014 interview that the Japanese see investing as "dirty money," but these attitudes must change and are already starting to do so among young people.[47]

Adoption of IFRS

One of the key changes in corporate governance has been the Abe administration's push for a move by Japanese companies to present their financial reports according to International Financial Reporting Standards (IFRS). This was done through dialog with the big-business lobby Keidanren and others, and through legislative change.

As of December 2012, when Prime Minister Shinzo Abe came to power, only ten companies were using IFRS—tepid progress since the standard was introduced in Japan in March 2010.[48]

In October 2013, Cabinet Office Ordinances were revised to encourage further application of IFRS in Japan. This revision eliminated two requirements that stipulated which companies are eligible, according to the IFRS Foundation. As a result, the number of companies eligible to apply IFRS increased from 621 to 4,061 at that time, covering virtually all listed and unlisted companies preparing consolidated financial statements for listing purposes.[49]

The TSE announced that, as of June 30, 2016, 141 companies (accounting for 29 percent of the TSE market capitalization) had adopted or plan to adopt IFRS. The companies include 115 that have already adopted—or are in the process of adopting—IFRS, and another 26 companies that have publicly stated that they plan to adopt IFRS. The TSE also announced that an additional 233 companies (19 percent of the TSE market capitalization) have stated in their most recent financial statements that they are considering shifting to IFRS.[50]

Independent Directors

As discussed earlier, the battle to make the introduction of independent directors a permanent feature in the market and to increase diversity on Japanese boards (which tend to comprise older Japanese managers with little experience outside their companies), has largely been won. While companies can still avoid appointing independent directors, the fact that they must then explain their reasons for doing so—and the increasing numbers of firms that are already employing independent executives—is forcing a change in the accepted norm.

As TSE managing director Masaki Shizuka put it: "Now that the adoption of outside directors has become common, I feel the question has changed to whether the board of directors, including outside directors, is really useful."[51]

What comes next is making sure the new directors can, and do, enact change, serving as a strong check and balance on related party transactions, cross-shareholdings, accounting practices, and the influence that retired top managers retain and exert in Japan.

The monitoring of how the Corporate Governance and Stewardship Codes are implemented and their "ongoing review" will be key, according to Benes, the head of the Board Director Training Institute of Japan (BDTI).[52]

"The government should evaluate the Corporate Governance Code every year and revise it on an ongoing basis, as in countries like Germany," Benes wrote in a 2015 presentation on the BDTI website.[53]

Particular areas to pay attention to will be whether companies will be eventually required to disclose all compensation to former board members, including those who become advisors after they resign, and whether more clarification is made on how a director is defined as independent.

Benes is also concerned that the reforms do not do enough to form truly effective, fully independent committees for nomination and compensation oversight—areas which are at the very core of modern corporate governance and are the most important roles for independent directors in most developed countries[54].

Ultimately, the success of corporate reforms will be judged on company actions and profits. Since the initial concept of the Third Arrow was to stimulate companies to be pro-active and more responsive, both to global market conditions and shareholder demands, there is enough evidence to show that both are moving in a positive direction.

In 2015, despite a weakened yen, outbound activity continued to drive the Japanese M&A market, reaching a record high of US $87.8 billion, a 53.4 percent increase compared to

2014, according to data collected by Thomson-Reuters.[55] At the same time, FDI increased by 19 percent from a year earlier to exceed ¥20 trillion for the first time in 2014, well on the way to the government target of ¥35 trillion for 2020, according to JETRO data.[56]

The data also shows a rising trend of FDI from Asia, which accounted for 60 percent of the total in 2014.[57] Notable cases were Singapore's Wuthelam group partnering with Nippon Paint, and Thailand's food conglomerate Charoen Pokphan Group buying shares in Itochu trading company to become among its top five shareholders.[58] Taiwan's CTBC Financial Holding, meanwhile, bought Japanese bank Tokyo Star.

The above are all examples of improved regulatory transparency and effort by Japan to make it an attractive financial hub within Asia, according to the USJBC.[59]

Oasis Capital's Fischer expects more to come as the potential is unleashed and Japanese corporate confidence grows. "There is an enormous universe of very cash-rich companies in Japan sitting on unused assets for years and decades. They should be using that cash and securities by investing in their business, M&A, or buying back their own shares. Cash sitting in the bank forever doesn't help anyone."

Legal Reform

Fundamental policy changes such as those contemplated by the Third Arrow must necessarily be implemented through reform of laws and regulations (see Appendix 1 for further details). According to the 2014 Strategy, 44 laws were amended in numerous fields in order to trigger processes required to begin implementation.[60]

Among the various initiatives, one of the most interesting reforms is the introduction of the Industrial Competitiveness Enhancement Act, whose purpose is to clarify "gray-zones" in existing legislation and to provide special arrangements for corporate field tests, where necessary, in order to allow new technologies (such as driverless cars) to be tested under real world conditions.[61]

According to METI, as of September 2016, action has been taken on 83 applications for clarification of certain gray zones and 16 applications for case-specific deregulation.[62] Following are a few examples.

Example of Action on Gray Zone:[63]

"Concerning the System to Remove Gray Zone Areas, METI received 13 requests and sent nine notices of results to the entities in reply to the applications."

As an example, it was confirmed under the System to Remove Gray Zone Areas that exercise instruction given by fitness club staff based on a doctor's instruction/advice, practiced unaccompanied by medical judgment and skills (such as teaching stretching and training methods using machines at the club), would not fall under medical practice, which is only allowed by doctors. This confirmation enabled the public to more easily evaluate and access highly trusted private healthcare services connected with medical services."

Example of Action in Regulatory Reform:[64]

“Concerning the System of Special Arrangements for Corporate Field Tests, METI received five requests and sent four notices of results to the entities in reply to the requests.”

As an example, a special measure was established that allows entities in the logistics services sector to utilize electric-motor-assisted bicycles to drive delivery carts with higher power than is allowed via existing legal standards. This measure is expected to contribute to expanding opportunities where women and the elderly are employed, realizing a low-carbon society and revitalizing the logistics industry.

Example of Action Regarding Business Restructuring:[65]

“METI has approved nine cases for business restructuring plans and specified business restructuring plans.

“Looking at one of the applications, METI approved a plan submitted by Mitsubishi Heavy Industries, Ltd. and Hitachi, Ltd. according to which the companies will merge their businesses sectors for thermal power generation systems and leverage their strength so as to enhance measures for satisfying customer needs and related services, thereby aiming to lead the industry as top-level companies in the world.

“As another example, METI also approved a plan submitted by Nippon Steel & Sumitomo Metal Corporation and Toho Titanium Co., Ltd. according to which the companies will merge their businesses in the area of developing a new foundation for manufacturing highly qualified and competitive titanium alloy, thereby expanding their business in the global market of titanium alloy for aircraft.

“Through business restructuring efforts, these companies are expected to improve productivity and acquire competitiveness to win in global markets.”

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4 Energy Industry Reform

It is not possible to write a report on Japan's energy industry—be it nuclear power, coal-fired plants, wind farms, or liquefied natural gas facilities—without considering the events of March 11, 2011.

On that day—referred to in Japan as "3/11"—a magnitude-9 earthquake off the country's northern Pacific coast generated a tsunami that killed more than 15,000 people and left thousands more missing. In the process of also laying waste to scores of towns and villages along hundreds of miles of coastline, the tsunami knocked out power to Tokyo Electric Power Co.'s nuclear generation plant in Fukushima Prefecture, about a three-hour drive northeast of Tokyo.

The loss of power and the subsequent failure of backup safety systems caused the unprecedented meltdown of three reactor cores at the Fukushima plant and the mass evacuation of more than 120,000 people from nearby areas.

Before 3/11, Japan had 54 operating reactors generating about 30 percent of the country's electricity. It also had ambitious plans to add another 14 reactors and boost atomic power generation to 53 percent of the total by 2030.[1] While Japan had anti-nuclear groups similar to those in other countries, there was little in the way of widespread organized opposition to the country's nuclear energy expansion plans. That all changed after 3/11.

The reaction of the public to the disaster was a testament to the resilience of the Japanese people; however, the ensuing policy debate over the role of various sources of energy has not enjoyed the same type of solidarity. Rather it has exposed the fault lines between the incumbent utilities and the new players, and shed light on how Japan struggles to find the right balance between new and old sources of energy, weighs the costs of maintaining a nuclear fleet, and develops new technologies.

Power On

According to the Federation of Electric Power Companies in Japan, the country was introduced to electricity on March 25, 1878, when an arc lamp was switched on in Tokyo. By 1887, the Tokyo Electric Lighting Company was distributing electricity for public services.[2] During the initial spread of electric power in Japan, Siemens provided 50Hz equipment as the grid was built-out in Tokyo and East Japan, while GE provided 60Hz equipment to Kansai and West Japan. This difference in standards became embedded through the two regions of the power grid, and partitions Japan's national grid even today, so that power can only be moved between the two parts of the grid using frequency converters. The total transmission capacity between the two grids is 1.2 GW.

As Japan rapidly modernized, hundreds of power companies started businesses. By the time World War I was over, they had merged into five main operators. That all changed during World War II, when the state took control of all electricity production.

The industry was restructured yet again as the nation rebuilt from the devastation of World War II, with the establishment of nine regional electricity utilities. These utilities were named for the regions they supplied, running in geographical order from the far north to the south—Hokkaido, Tohoku, Tokyo, Chubu, Hokuriku, Kansai, Chugoku, Shikoku, and Kyushu. The tenth member of the group joined as Okinawa Electric Power Co. in 1972 when the islands were returned to Japan from US administration.

This structure provided the power for Japan's post-war economic expansion and gave each of the utilities dominance over electricity generation, transmission networks, and distribution to end users in each geographic region they served—during a time when the country emerged as the world's largest economy after the United States. But the system also resulted in largely region-by-region rather than national electric grid infrastructure, as power generated in one region is also consumed there with little inter-regional transmission, especially between 50Hz East Japan and 60Hz West Japan. This proved a major shortfall in the response to the 3/11 disasters, and continues to hamstring Japan's development of plentiful wind resources in Hokkaido and Tohoku. While electricity monopolies existed elsewhere in the world, that did not stop criticism and doubts about having such a fundamental mechanism as energy supply dominated by single enterprises in each of these areas of the country.

Supply Security

The response from the monopolies in Japan was to repeat a mantra that echoes through Japan's corporate life today: stable dependable supply. Of course, all economies and businesses desire stability in power supply because it is fundamental to operations and success. Yet in a country such as Japan—that is riddled with active volcanoes, accounts for 10 percent or more of the planet's seismic activity, regularly gets buffeted by typhoons and floods, with most of its land mass made up of craggy mountain ranges, all while having precious little in the way of natural resources—stable dependable supply takes on a special cachet.

"The electric power companies work closely with each other to enhance the stability of electricity supply to customers nationwide," states The Federation of Electric Power Companies on its website.[3] "For example, they exchange or provide electricity via extra-high voltage transmission lines linking the entire country from north to south, in order to cope with emergency situations resulting from accidents, breakdowns, or summer peak demand."

However, this apparent policy conceals a severe flaw in the design of Japan's national electricity transmission network. Even though the knowledge of this flaw is available to the public, few policymakers are willing to discuss the different cycles of electricity still deployed in Eastern and Western Japan.

The statement from The Federation of Electric Power Companies illustrates the difficulty that the GOJ has in bringing the interests of the whole nation into balance with the political power of the electric utility industry. The lack of compatible systems across the country preserves regional interests at the expense of national sustainability and cost-effective power generation.

Still, criticism of this dominance of all stages of the power generation and supply network continues, not least among those who point to inadequate cooperation to deal with emergencies by interregional transmission, and the high price of electricity in Japan.[4] The response from the utilities is again the mantra that they ensure stability of energy supply and that this comes at a cost.

Beside "energy stability," the sister term of "energy security" is another touchstone used in Japan. Japan's total imports in 2014, for example, were valued at ¥85.9 trillion (US $823 billion). Of that amount, almost a full one-third, or more than ¥27 trillion, was spent on imports of fossil fuels.[5]

Japan is typified by an "Extreme Energy Dependence," to use a term coined by Professor Andrew DeWit at the School of Economic Policy Studies in Tokyo's Rikkyo University. Imports of fossil fuels in volume terms confirm this: Japan gets 96.9 percent of its natural gas from overseas, imports 99.4 percent of its coal and receives a full 99.6 percent of its oil supply (shipped in on fleets of tankers), according to data compiled by Professor DeWit. By any measure, these figures are astounding and demonstrate the vulnerability of Japan's economy to supply disruptions and the importance of energy security in the country's psyche.[6]

Against this backdrop, the world's energy industries prior to 3/11 were talking of a so-called "nuclear renaissance." Plans were afoot for expansion of nuclear energy plants around the world, including Japan, not least as a major source of low-carbon energy amid concerns about climate change.

But the Fukushima nuclear disaster, following the nuclear accidents at Chernobyl in Russia and Three Mile Island in the United States generated a "three strikes and you are out" mentality globally among those just skeptical or agnostic about nuclear power. This was certainly the case in Japan as the Fukushima events and their aftermath unfolded.

This was the status of nuclear power, a mainstay of Japan's energy policy, when Abe was elected prime minister for a second time in December 2012 in a landslide win for the LDP.

Abe came back into office after defeating the Democratic Party of Japan and faced a public that had endured one of the worst calamities in the nation's recorded history.

Leaving Nuclear?

The prime minister at the time of the disaster, officially referred to as the Great East Japan Earthquake, was Naoto Kan of the Democratic Party of Japan. In his role as head of state, Kan had helped support Japan's nuclear industry by encouraging exports of the technology.

Fukushima changed all that for Kan, and in subsequent press conferences he explained how the disaster turned him against the use of atomic power, saying industrial accidents can cause damage to a local area, but a nuclear disaster has the potential to cause damage and ruin to an entire country.[7]

Consequently, while still in power, Kan and his party demanded that the Hamaoka Nuclear Power Plant south of Tokyo be closed and announced a shelving of all plans to build new reactors. A few months after Fukushima, Japan looked set to exit the nuclear power industry in the face of public outrage as the disaster capped years of news reports of faked safety assessments by operators throughout the country.[8] Kan indicated that, despite the country's perilous vulnerability in energy security, nuclear power posed a greater risk and Japan should end use of the technology.

As part of this shift in strategy, in August 2011, the government passed a bill to introduce a so-called feed-in tariff (FIT) system for renewable energy, modeled after similar schemes in Europe. The system started operating in July of the following year, requiring electricity generating companies to start buying power from renewable energy sources at fixed prices set by the government.[9] As with other countries that have adopted FIT systems, the goal was to establish "fixed" revenue models to encourage investment and diversification into sources of renewable energy, such as solar, wind, hydro, geothermal, tidal and biomass.

Globally, the popularity of FIT systems for renewable energy has been driven by concerns that continued release of carbon into the atmosphere from the burning of fossil fuels could cause unpredictable changes to climate and weather patterns. This was a clear factor in Japan, too, but the Fukushima nuclear disaster caused by an earthquake and tsunami in a country regularly hit by earthquakes and tsunami was another important driver behind the country's adoption of a FIT system.

As described above, at the time the government approved the FIT system, polls showed around 70 percent of the public opposed use of nuclear power. That was mirrored in a government white paper in October of the same year, calling for reduced use of nuclear power in the country.[10]

However, when Abe and the LDP were voted back into office in December 2012, they had different ideas. The LDP has been in power for most of Japan's post-World War II period. As such, the party was one of the main architects of energy policies that promoted the use of nuclear power and the building of atomic power plants throughout the country.

The Abe administration could not ignore the anti-nuclear power sentiment in the country, but its energy policies faced some critics because the government said it would establish a sustainable mix of power generation for the next ten years, without defining what part nuclear power would play.[11]

As part of reforms in the wake of the Fukushima disaster, in September 2012, a new regulator was put in charge of Japan's nuclear power industry and given teeth to upgrade and toughen safety measures.[12] This was the Nuclear Regulation Authority (NRA), which was established to replace the Nuclear Industrial Safety Agency. The latter, known as NISA, was widely criticized for failing to enforce safety standards, an example being the failure to require the building of stronger tsunami defenses at the Fukushima plant of Tokyo Electric. It was revealed after the disaster that academics and geologists had warned that the Fukushima plant was in an area susceptible to large tsunamis based on the area's geological record.

NISA had failed to require Tokyo Electric to act on this information, which along with a long list of repeated violations of safety procedures over many years at various nuclear power plants, led to the abolishment of the agency and its replacement with the NRA. The Kurokawa Report commissioned by the government to report on the causes of the Fukushima plant disaster concluded that the incident was in many respects man-made.[13] The report criticized the close relationships and lack of independence of NISA and others involved with the nuclear power industry, which formed part of a so-called "nuclear village."

In addition, NISA fell under the umbrella of METI, which had a conflict of interest as it was also in charge of the promotion and expansion of nuclear power. Under the new structure established in 2012, the NRA was placed under the Ministry of the Environment to separate the regulation of nuclear power from its promotion.[14]

New Rules

"The Nuclear Regulation Authority has started in a situation in which public trust on nuclear regulation has been completely lost," said Shunichi Tanaka when installed as NRA chairman at the time. His stated goal was for Japan to set the highest standards for atomic power regulations in the world.

Tanaka and his short-handed but expanding team took on this unenviable task with some gusto, particularly sensitive to establishing a track record that would distinguish the NRA from its disgraced predecessor, NISA. The NRA established new and tougher safety procedures and regulations for running nuclear reactors, and began to implement them nationwide.[15]

These quickly started to have a significant impact since reactors are closed for regular maintenance in Japan every 13 months. So, as nuclear plant operators completed their regular maintenance and went through the process of applying to restart the reactors, they faced the new regulator and an entire raft of tougher safety regulations. The operators needed time and investment to meet the new standards, and so the process continued, with reactors going offline for maintenance and being unable to pass NRA standards to restart. By September 2013, all of Japan's 43 operable atomic reactors were shut down and stayed that way for almost two years.

It was not until August 2015 that a reactor run by Kyushu Electric in its Sendai plant on the southern Japan island of Kyushu restarted, after passing the NRA approvals process. Another four reactors have since passed NRA safety tests, but two have been blocked from restarting by court orders after citizen group filings.

As of late November 2016, Japan had just three nuclear reactors in operation.[16] The prolonged period with all Japan's nuclear fleet offline meant the country required other energy sources.

The nascent renewable energy industry could not yet handle the task, so Japan had to turn to coal, liquified natural gas (LNG), and oil-fired power plants to prevent outages and supply the electricity needed to keep Japanese industry humming along. This caused a massive jump in Japan's imports of fossil fuels, which in 2014 reached the ¥27 trillion cited by Professor DeWit earlier.

This huge drain on cash increased pressure by the government to approve more restarts, although a dramatic drop in oil and LNG prices from mid-2014 onward has relieved any pressure based upon Japan's trade balance, with the merchandise trade balance turning positive again by late 2015. Besides the temporary drain on the nation's coffers, the surge in the amount of fossil fuels being burnt also meant that Japan's power plants were throwing more carbon up into the atmosphere. This added to calls for the restart of nuclear plants. The NRA insisted it would not be hurried in its safety tests and kept to its schedule which, as noted, had just three reactors running toward the end of 2016.

Energy Forecasts

Before looking at developments in energy industries in the country since 3/11 and under the Third Arrow, it is worth considering some forecasts compiled by the Institute of Energy Economics, Japan and published in July 2016.[17]

The Institute, as its name suggests, closely follows the ebb and flow of nuclear plant restarts in the country, fossil fuel import trends, renewable energy developments, and what all of these mean for the price of energy and its effect on the country's economy. In the July report, the Institute noted that, as the nuclear industry adjusts to and complies with NRA safety regulations, gradual restarts of reactors should continue.

However, it noted that the actual process of restarts is difficult to assess because, in some areas, citizens opposing the use of nuclear power have taken to the courts to block the restart of reactors. This is what happened in the case of reactors numbers three and four run by Kansai Electric in its Takahama plant in Fukui Prefecture, which supplies power to the region around Osaka and Kyoto.

While both passed NRA safety standards and were essentially ready to restart in early 2015, an injunction in the Fukui district court blocked them for over ten months. The injunction was finally lifted upon a rehearing, and both reactors restarted in early 2016. One reactor suffered an automatic shutdown after only three days, due to a generator malfunction, and residents in neighboring Shiga Prefecture persuaded a court there that despite the NRA's approval to restart based on its safety regulations, this did not adequately guarantee the safety of the plants. The court issued a second injunction, the remaining operating reactor was shut down, and both reactors were blocked from operation. Kansai Electric lost a rehearing, but as of December 31, 2016, was reportedly seeking other means through the courts by which to have the decision overturned.[18]

The emergency shutdown at Takahama highlights another issue: Nuclear power plants are among the most complex and expensive engineering facilities. Taking a whole fleet of these plants offline for years at a time is not only costly but also not what they were built for: They were built to operate and generate electricity.

While that seems an obvious statement, the fact Japan's reactors have been shut for so long can increase the likelihood of equipment malfunction when they are awakened from dormancy. This scenario is one that nuclear engineers and anti-nuclear activists largely agree causes an increased risk of failures and accidents.

Energy Simulations

While noting the uncertainties surrounding reactor restarts, the Institute of Energy Economics has run simulations of Japan's future energy mix through fiscal year 2017 (ending March 31, 2018). It uses four scenarios (assuming different numbers of reactors switched on and generating electricity) and the consequent effect on the economy, energy security and the environment. (The scenarios are subject to revision.)

The Institute's so-called "reference scenario" assumes seven reactors will have restarted by the end of fiscal year 2016, and a total of 19 reactors by the end of fiscal year 2017, to generate 119.8 terawatt hours (TWh) of electricity. As of December 2016, only three were operating, making the fiscal year 2017 goal of 19 seem very optimistic.[19]

Even using the Institute's figure, the amount of electricity generated is 42 percent of the corresponding figure in fiscal year 2010, or before the Great East Japan Earthquake. The reference case forecasts that spending on fossil fuel imports will fall by ¥4.7 trillion, while the cost of electricity will rise and CO_2 emissions will fall. The scenario sees Japan's economy growing a slow 0.7 percent in fiscal year 2016 and 0.9 percent in the following fiscal year. Primary energy demand in fiscal year 2016 is forecast to decline owing to a slow recovery in manufacturing, but also due to energy saving measures.

The decline in energy demand will slow in fiscal year 2017, although the projected start of more nuclear reactors along with the expanded use of renewable energy will reduce use of oil and natural gas. For renewable energy, the Institute of Energy Economics forecasts the rapid pace of expansion in recent years will throttle back with the end of the surge in investment prompted by the introduction of what it terms a "generous" feed-in tariff (FIT).

Some uncertainty has been introduced into regulatory framework due to the government's constant change in the rules for development of projects under the FIT, the yearly review of FIT rates and reductions in the tariffs paid to renewable energy providers, especially for solar installations, and the termination of the FIT system for solar installations over 2MW in size that are not METI-certified by March 31, 2017, which were replaced with a very limited auction system for such large solar projects to be implemented from Fall 2017. Another factor is that some sites that had received approval for installation and construction of facilities to generate solar power had not been built within a required time frame and so the permits had been canceled.

Nevertheless, "the operating capacity of renewable power generation (excluding large-scale hydro) by the end of fiscal year 2017 will reach 65GW," according to the Institute's report. In tandem, the cost burden for renewable energy will expand over 20 years to an estimated ¥56 trillion. This estimate is based on all the 87GW of renewable energy projects approved by March 2016—of which 79.9GW is solar—coming onstream, the report says. It is, however, not likely that all 87GW will be built.

The increase in use of renewable energy and the expected restart of more nuclear reactors will reduce Japan's CO_2 emissions by 11.4 percent in fiscal year 2017 compared with the level in fiscal year 2013, according to the Institute. As indicated, when Japan introduced the FIT program to attract non-carbon energy investment, and as Abe went through retoolings and fine-tuning of his Third Arrow energy policies, the country experienced a flood of applications to build renewable energy projects.

Gold Rush

Something of a gold rush mentality took hold as the government served up its FITs, guaranteeing revenue to the owners of these projects from the utilities now required to buy the non-carbon produced electricity. Japan's initial FIT for solar was set at ¥40 per kilowatt-hour (plus consumption tax) compared with Germany's at the equivalent of ¥27 at the time, which attracted a huge crowd of investors, said an industry consultant.[20]

Some unscrupulous brokers moved in looking to make fast money selling once-worthless land as prospective solar farms, helped by the fact that the initial permit system did not require proof of financing or construction plans. Also, some brokers offered land for solar farm projects that dangled tantalizing FIT cash, neglecting to explain the land was far from any grid connection and the high cost of building such a connection.

In the early months after the FIT introduction, Japan seemed set to repeat the boom-bust cycle seen in FIT-backed solar markets from Germany to Spain and Italy. About eight months after FIT went into effect in Japan, the government approved about 12GW of solar power projects, or more than double the previous capacity.

However, while approval meant eligibility for the FIT, it did not guarantee grid connection or development rights, said a consultant involved in those early projects. The consultant explained one case in which a client applied to develop a solar farm on land they owned, only to find that someone else had been granted a license to develop the site.[21] The government then started cracking down to push out unscrupulous speculators, requiring applicants to show proof of land ownership or a leasing agreement as part of the application process. "It was the Wild West," said the head of a foreign equipment supplier.

Then, as the government started to work on improving the system—not least adding staff to handle the flood of applications for renewable energy projects—loopholes started to become obvious in the laws that obligated the power companies to give access to the electricity grid, said an analyst at the time. The utilities, who control the transmission and distribution system, could say that they have enough power signed up and that they do not have the capacity to take more, but there is no third party to evaluate whether or not the utility's statement is accurate, the analyst said.

Regardless of these teething problems with the FIT, it succeeded to make Japan the second-largest market for solar power in 2013, 2014, and 2015, and solar PV now contributes significantly to cutting Japan's peak electricity demand during daylight hours in many regions.

Renewable Shift

Japan, under the Third Arrow, is committed to deregulating its electricity industry and moving to greater utilization of non-carbon energy supplies.

In July 2015, METI put out its latest revision of a paper entitled *Long Term Energy Supply and Demand Outlook* that examined the country's energy mix through 2030.[22] The paper shows a clear shift to a non-carbon energy supply, which in the report includes nuclear, and targets as much as 46 percent of generation capacity from non-carbon sources by 2030. The forecast breaks out atomic and renewables, and at the top end envisions 22 percent from nuclear and 24 percent from renewable energy. Private sector analysts, led by Bloomberg New Energy Finance, have criticized the government's "energy mix" paper for its politically influential nature. They suggest that, in fact, Japan will be likely to achieve 10–12 percent nuclear power, and that coal's share should fall much faster than METI forecasts. Meanwhile, METI seems to think rooftop solar introduction will slow, even as most private analysts believe its price (and the price of battery energy storage) will continue to drop steadily between now and 2030, encouraging widespread introduction.

According to a June 2016 report by the Japan Association of Corporate Executives, the latest paper by METI on long-term energy utilization shows a significant shift from the comparable figures that were released in 2009; whereas nuclear-generated energy was expected to make up 49 percent of Japan's energy mix at that time (it is now less than half that figure). An unofficial translation is available at the link found in endnote 22.

The Japan Association of Corporate Executives, known as Keizai Doyukai in Japanese, is regarded as a think tank of Japan's thought leaders. It comprises chief executives and presidents from scores of Japan's leading companies and, as such, its views offer insights into how corporate Japan sees the future.[23] Significantly, the views are expressed by the signatories in their personal capacities rather than as representatives of their companies.

Its June 2016 report is titled *Aiming for a Zero Emissions Society, to Lead the World Policies to Encourage the Spread and Growth of Renewable Energy*.[24] The report's introduction touches on what has already been illustrated in this report, namely: how essential energy security is to a country like Japan, which is lacking in its own natural resources; how the oil shocks of the 1970s and then the Great East Japan Earthquake in 2011 drove home this point; how public confidence in nuclear energy has been undermined; and how "energy production in Japan is in the midst of a transformation."

Leaders' Thoughts

The Keizai Doyukai report also concerns itself with carbon emissions, noting that Japan's greenhouse emissions have increased to 1.364 billion metric tons of CO_2, up 60 billion tons from the 2010 figure. Households and industrial users have seen 25 percent and 40 percent rises in energy costs respectively.

It points out that, in particular, policies to mitigate global warming need to be implemented now or never. To cut greenhouse gas emissions and improve Japan's critically low level of energy self-sufficiency at the same time, it is essential that Japan makes active use of zero emissions generation resources that also will make Japan more self-sufficient, such as nuclear power and renewable energy.

In addition to its pledge by international treaty to reduce greenhouse gas emissions by 26 percent from their 2013 level by 2030,[25] the Japanese cabinet released a "Global Warming Countermeasure Plan" in May 2016 that sets a long-term target of an 80 percent reduction in greenhouse gas emissions by 2050 (securing at least 50 percent of its electricity from zero-emissions sources by 2030), in line with the Paris Agreement.[26] The achievement of this domestic goal will contribute to the global effort to tackle climate change, and is "our obligation as a developed country."

The Keizai Doyukai report points out that many nations are moving toward zero-emissions targets. In 2030, more than 60 percent of Europe's, and more than 40 percent of even natural gas and coal-rich America's electricity, may be generated from zero-emission sources.

The report also refers to METI's most recent Long-Term Supply and Demand Outlook, which states that Japan can use energy conservation to raise energy efficiency by 17 percent while maintaining 1.7 percent annual economic growth. This is while keeping energy consumption in 2030 at 2013 levels. The report points to not just how energy is produced, but how it is consumed as an important part of Japan's energy policy and efficiency goals.

This entails capital investment and, as the report notes, dovetails with the increase in domestic investment that the government is seeking. Put another way, a ¥37 trillion investment in energy efficiency could reap just over twice as much in energy savings (¥78 trillion) according to a December 2015 study by the Development Bank of Japan cited in the Keizai Doyukai report.[27]

Nuclear Question

As regards nuclear power, the Keizai Doyukai notes that assuming public acceptance, nuclear energy should be used as a baseload power source and constitute a minimum of 20 percent of Japan's generation capacity in 2030. This is in line with the Basic Energy Plan approved by the Cabinet that says Japan's "reliance on nuclear power should be reduced as much as possible."[28]

However, another aspect of the nuclear power outlook in Japan is the general rule that reactors obtain an initial operating license for 40 years.[29] Under that scenario, nuclear power would make up only 15 percent of Japan's power supply in 2030 even if all reactors were restarted. To reach the goal of having 20 percent of electricity from nuclear by 2030, reactor lifetimes would need to be extended, as has happened in other countries. The regulator has indicated it will consider 20-year extensions and a number of reactors have applied already for such extensions. The question remains if that would be acceptable to Japan's public from a safety aspect and the weight of the public's voice in this debate.

The Keizai Doyukai's report says that considering the uncertainties associated with nuclear energy in Japan, the government's stated goals to reduce reliance on nuclear power "as much as possible," and the target to "have an energy mix of 50 percent zero-emissions sources by 2030," means that renewable energy will very likely need to be used to a greater extent than is currently anticipated.

As a result, the report advises that rather than focusing on the expense and difficulties in switching to greater use of renewable energy, the government needs to promote the idea to the public that the costs are a "proactive investment and innovation in order to develop a new industry."

Citing the example of what has been achieved in Germany (which aims to supply 35 percent of its energy from renewable sources by 2020 thanks to broad public support for greater use of renewable energy),[30] Japan should aim to become a center of growth and initiative in the expansion of use of renewable energy and to become a zero-emission society, says the Keizai Doyukai.

The report cautions, however, that there is a limit on what the private sector can do and requests more support from local and central government in easing regulations and making them more transparent, such as shortening the period for environmental assessments, facilitating agreements with other interested parties and removing excessive, repetitive, or needlessly complicated rules.

Two examples given are local and central governments' "establishment of a compensation system to ease the concerns of interested parties about the drying up of *onsen* (hot spring baths) as a result of geothermal power plants or water table decreases due to small hydroelectric facilities."

Promoting public-private partnerships is another means of encouraging renewable energy projects, which could help marry the interests of companies, local governments, and financial institutions while helping to revive regional economies. The latter point is developed further in what the Keizai Doyukai refers to as "local production, local consumption."

This could involve government initiatives and subsidies to build, say, a data center, medical laboratories, or energy research center in the same area as a renewable energy project, achieving both regional development and expansion of renewable energy capacity at the same time.

Extensive development and use of smart meter and smart grid systems, along with storage battery and research into hydrogen technology, are other fields that have been identified by the Keizai Doyukai. As an indication of Japanese industries' commitment to investment in this field, the report argues that delaying investments in renewable energy now will only add to costs later.

Energy Conservation

METI has also identified investment in residential demand-side energy management to promote energy savings, and the Abe administration has published a detailed plan to increase residential sector energy efficiency (EE) and demand response (DR) efforts.[31]

Japanese market reforms and smart meter investments provide an invaluable opportunity to build a market for new EE/DR services, enable economic growth, support household budget savings and reduce greenhouse gas emissions, as well as creating new jobs and services through innovation.

Solutions like the Energy Efficiency Resource Standards (EERSs) adopted across the United States have already achieved such results. The right policies enable households to benefit from energy savings and encourage providers to make energy saving efforts. Energy savings from the introduction of these programs can replace retiring power plants, or displace or defer the need for new generation or transmission investments.

In Japan, in particular, introduction of EE and DR can reduce dependence on imported fuel while helping meet goals such as the Abe administration's commitment to reduce greenhouse gases 26 percent below 2013 levels by 2030, with about 40 percent of the reduction coming from the residential sector.[32] With current per-capita household energy consumption in Japan 1.5 times that of other OECD countries like France or Germany, the residential sector represents a huge untapped opportunity for EE/DR, and is an obvious focus for Japanese policymakers.

Working with Japan's energy providers enables the launch of large-scale EE/DR programs, and consequently creates a market for EE/DR innovation. This runs the gamut from recycling of older, inefficient appliances and building materials; energy-efficient appliances, and efficiency-promoting devices (smart thermostats, etc.); improved-efficiency lighting, water heaters, and residential heating/cooling solutions; and the purchase and installation of renewable energy technology, such as solar panels and solar water heaters.

Many Japanese policymakers hope that retail competition and deregulation of electricity and gas sales will spur innovative customer-facing energy-saving services. However, experience has shown that retail competition alone will not lead to meaningful investment, because energy providers in competitive markets tend to compete on costs, rather than services in deregulated electricity and gas markets.

Significant Opportunities

These include recovery of program costs as well as any resulting lost revenues from decreased gas/electric sales—and incentives for meeting/exceeding targets—such that energy providers can continue to create shareholder value. Such a system creates an EE/DR market that fosters competition and innovation and, as a result, leads to regional economic growth.

As Japan's policymakers deliberate how to integrate safe, steady, and affordable power into the nation's energy mix, discussion has focused on the generation side. However, just as important is demand-side management and Japan's residential sector offers significant opportunity.

After the 3/11 earthquake, tsunami, and nuclear disaster, Japanese households responded heroically to public calls to voluntarily reduce their electricity usage when energy savings were a critical necessity. The consumer in Japan understands the importance of energy conservation and will adopt technology and services that help them manage their energy consumption, cut waste, and reduce household energy budgets.

Broader benefits include creation of new jobs in the energy sector and achieving environmental goals, making residential EE/DR a growing business field in Japan.

Taking a step back to look at the electricity (and also gas) market liberalization planned in Japan, Peter Weigand, chairman and CEO of Skipping Stone LLC, an electric power consultancy, has identified some of the challenges.[33] Weigand notes the purpose of the liberalization is to lower the cost of energy and cites five main actions underway, followed by an assessment of their successes, problems, and solutions:

1. Reorganization of monopoly electricity utilities into holding companies with units that will compete in the liberalized generation and retail markets. (The transmission and distribution business unit remains regulated.)

2. Opening all customer classes to enable purchasing in a competitive market from retail energy marketers and utility providers, with utility tariffs phased out over time.

3. Creation of a wholesale marketplace for buying, selling and trading electricity, which will also enable financial markets, such as futures trading.

4. Opening the natural gas (LNG) markets to enable customers to purchase from competitive suppliers.

5. The creation of a "negawatt" (demand response) market, where households sell unused power into the grid.

Roadblocks to Overcome

While all the liberalization initiatives progress over time, there are problems that are hindering the desired impact of lowering the cost of energy to consumers and business. The following highlights some key issues and potential solutions.

Utilities are not yet participating in the JEPX wholesale electricity market to a large extent, although, according to the *Nikkei*, the utilities will funnel larger portions of their excess power into the wholesale market beginning in 2017.[34]

Currently the JEPX lacks liquidity, which in turn limits the ability of retail marketers to effectively offer a variety of pricing options to customers. A related issue is retailers buy roughly half of their requirements from utilities on bilateral contracts known as "backup supply." Utilities sell at standardized prices in these contracts because the retailers all have very similar consumer price plans. If utilities were required to put the same amount of "backup supply" into JEPX, this would help solve the lack of liquidity.[35]

Japan's electricity markets need market makers to provide liquidity, flexibility and a variety of wholesale pricing methods and risk products, but currently there is no METI license available should a market maker desire to enter the market. There are large market makers in electricity and natural gas in the United States interested in entering the Japan market, but the plans are on hold because there is no mechanism or license that would enable them to participate.

During the years prior to the April 2016 full retail market opening, utilities were allowed to make "special deals" with high-voltage customers at below normal tariff. This is one of the reasons the high-voltage retail market never reached its potential. The situation remains today and is keeping those large-volume customers out of reach for retailers and those supply volumes from participating in the wholesale market. There are many successful retailers from the United States and European Union that are in the process of entering the Japanese energy markets. These entrants would have a positive impact on competition and should benefit consumers with more choices and potentially better savings.

While METI has welcomed these international retailers, the process and hurdles required to open a retail energy business in Japan are substantial. These regulatory hurdles exist on many levels in the electricity business in Japan and will need to be dealt with as part of Third Arrow reforms in the future.

Despite these challenges, international retail energy companies are likely to identify ways to enter the retail electricity markets in Japan. Skipping Stone's Peter Weigand notes that his firm established offices in Tokyo in August 2014 specifically to engage in energy liberalization.

Conversations

At a White & Case renewable energy briefing in Tokyo in October 2016, a government official said Japan has not based the reform of its power markets on any one country, but rather, had heavily borrowed from European experiences. The positives from reform are that new business models and new business opportunities have emerged, he said. For example, companies offering electricity retail price comparisons on websites have sprung up in Japan, along with companies that provide insurance in the electricity balancing market.[36]

An analyst at the briefing agreed that innovation in electricity retailing was growing, such as bundling of services like "electricity plus groceries" or "electricity plus telecom services." Telecoms provider SoftBank has tied up with Tokyo Electric to provide electricity and telecom packages.[37] KDDI has an agreement with Kansai Electric[38] and Chubu Electric in a similar tie up.[39]

The analyst added that "electricity reforms were never going to push utilities out of the market." Rather, the utilities have become more innovative and sought out new business opportunities. In the analyst's view, Tokyo Electric is among the most innovative, citing the company's tie-up with Sony Corp. in services related to the so-called Internet of Things or linking of various household appliances and operations, including monitoring of electricity usage.[40] Tokyo Electric as a rejuvenated partner in the renewable energy business is a plus. And the fact that the opening of the retail electricity market has already seen 1.5 million people switch providers as of July 2016 is another positive.[41] Some 200–300 companies applied to METI to be part of the wholesale electricity market, showing diversity and the prospect of competition.[42]

But drawbacks remain. For example, utilities still control access to the grid and will do so until 2020.[43] One foreign investor in Japan's wind market and other renewable projects noted the utilities have essentially said the current grid is "full." Utilities need to make grid upgrades and other investments to expand capacity; however, more regulatory willpower is needed to push the utilities to be more proactive, he said. The analyst at the White & Case briefing said the main utilities and J-Power own 85 percent of Japan's power generation assets, making it difficult for new investors to come in and build power stations.

There is little incentive for incumbent power players to sell electricity to the wholesale electricity market, without which one cannot develop trading in electricity on exchanges and daily price discovery and competition. Only about 2 percent of electricity in Japan trades on the wholesale market.[44] In Europe, the big utilities own less of the total generation assets, and this makes the wholesale electricity market attractive for all players there.

More to Do

The analyst added that Japan could do more to promote the use of renewables in its energy mix plan through 2030, calling the targets set relatively weak. Unlike in the United States, companies in Japan face complicated hurdles to conclude direct purchase agreements with renewable projects. This holds back development of renewable energy, said the foreign investor.

To get renewable projects over the line, developers are being told to fund new transmission lines or power storage capacity, both of which are expensive options. The investor said Japan could look at cheaper ways to get more renewable energy online, such as a single electricity system regulator for the whole country as opposed to each region controlled by the main utilities.

In its defense, the government official said Japan is finding its own way, step by step, and not everything can be fixed immediately, which was also the case in Europe and the United States. The government may introduce more legislation to improve the situation with grid access.

The official also pointed out that the government is increasingly interested in stimulating more price competition in supply of natural gas because there is no nationally connected gas pipeline network, only individual pipeline systems controlled by separate entities.

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5 Healthcare Reform

A healthy, well-educated population is considered by some in Japan to be a form of national security. Thus, the Third Arrow in Abenomics has targeted the healthcare industry as a main strategic sector. It may prove to be one of the biggest challenges.

The government is focusing on extending healthy life expectancy and promoting the pharmaceutical and medical device industries, said ACCJ Healthcare Committee Chairman Bill Bishop, who has worked for both drug and medical devices companies in Japan for more than two decades.

This is in response to an aging population—one in four of Japan's 127 million people is over the age of 65, and this will rise to one in three in 20 years.[1] It is also an attempt to revitalize Japan's competitiveness within the healthcare industry. Among those issues, sustaining the universal healthcare system while providing effective public health and nursing care insurance and services is the most pressing.[2]

The country is taking positive steps to take a leading role in regenerative medicine and has revamped its approval process for new drugs and medical devices.[3] Japan "gets" regenerative medicine much better than many other countries, according to John Harris, vice president and general manager, cell therapy, at Cytori Therapeutics.[4] "It helps to bring in such medicines to the market faster and that is very positive," he says, adding that the United States is now starting to put together similar legislation.

Total health spending accounted for 10.3 percent of GDP in Japan in 2012, compared with 9.3 percent in the United Kingdom and 16.9 percent in the United States, the Organization for Economic Co-operation and Development has said.[5]

Third Arrow Concept

The first Abe administration healthcare reform initiative under the Third Arrow was the revision of the rules for the distribution of non-prescription drugs on the Internet. A law was enacted permitting virtually all non-prescription drugs to be sold via the Internet,increasing the purchasing method options and improving consumer convenience.[6] "In addition, the promotion of the Internet, expanded use of Health IT solutions, and the development of related ICT infrastructure hold the potential for creating new industries and innovation," said Bishop.

The second initiative was the so-called Advanced Medical Highway. Bishop said this program is designed to give patients access to a combination of both services covered by health insurance as well as safe and advanced healthcare services not covered by insurance, for the treatment of cancer and the latest medical procedures, such as regenerative medical therapies.

A system for professionally evaluating these drugs and treatments was established to this end. The target is to reduce the period between the first visit to a regular medical facility and the implementation of advanced treatments by half—to three months overall from about six to seven months.

The third initiative was aimed at promoting the use of regenerative medicine. The field of regenerative medicine offers a pathway to deal with diseases that are not currently treatable. The use of regenerative medicine can have a considerable impact by improving the quality of life of patients and relieving the burden on caregivers, such as the families of patients. The relevant law was enacted in the fall of 2013. It provides new rules for the use of regenerative medicine where its effectiveness for a certain number of diseases, as well as the safety of these technologies, has been proven, said Bishop.

The fourth initiative was aimed at promoting the use of information and communication technologies in the health and medical sector, Bishop said. The digitization of prescriptions, for example, should simplify outcomes research by centralizing detailed information about the treatments that patients receive. Used in this way, the advent of big data has the power to enhance the effectiveness of future medical treatments.

Implementation

"Gray zones" related to the healthcare industry, such as private sector guidance on physical exercise to prevent lifestyle-related diseases, have been removed. Online sales of nonprescription drugs have been enabled, and a "control tower" for R&D in the medical area came in the form of the formation of a Headquarters for Healthcare and Medical Strategy Promotion and Japanese National Institute of Health Sciences.[7]

Next, a nonprofit holding company system was created to allow multiple medical and social welfare corporations to be managed in an integrated manner through general meetings of members. This system also allows for spinning off university hospitals as separate entities to be managed along with other hospitals.[8]

Incentives are also being offered to individuals to stay healthy and prevent disease. The government will need to clarify the conditions under which each insurer of the public healthcare insurance system can provide healthcare points or cash benefits to individuals. A public health insurance premium system is also being considered under which the premiums can differ in a fiscally neutral manner based on the individual's own efforts on health and disease prevention.[9]

Further Steps

The Agency for Medical Research and Development (AMED) was set up in October 2015 to promote disease research and develop advanced analytic technology based on databases of clinical samples in collaboration between industry, academia, and government.[10]

Participating drug makers can use the databases to conduct research and evaluate drug candidate compounds. AMED is now considering setting up centers to address undiagnosed diseases around the country over the next three to four years.[11] Other developments under consideration are to allow patients not qualified for clinical trials to somehow otherwise access new drugs under investigation.

As dramatic shifts in population demographics and rapid advances in technology have significantly altered the healthcare field, the Health Care 2035 Advisory Panel was established to develop a long-term vision for policies required to meet the needs of the next two decades.[12] The panel will analyze strategies to address issues including public health promotion, healthcare system sustainability, contributions to global health, and community development.[13] Some of these issues are described in further detail in the sections below.

Price Changes

While new policies have been put in place, such as tax cuts and incentives to encourage international companies to conduct research and development in Japan, there are some areas that give the healthcare industry some concerns. One is that the government is looking to cut product prices for budgetary reasons.

Currently, price cuts occur biennially, but the government has explored the idea of shortening the period to yearly. Should the cuts become too dramatic, company strategies toward Japan may be altered, offering its citizens less progressive medical options, according to some industry professionals.[14]

"One of the things that Japan had going for it has been predictability," Cytori's Harris said. Yet while the Abe administration has championed innovation and new medicine, the Health ministry's goal remains to cut industry costs. In becoming more frugal, the ministry has already started lowering price premiums offered to new drugs and devices but with the announcement of the Drastic Reform of Drug Pricing System in December 2016, the government signaled its intention for much more significant cost cutting. That could hurt the image of Japan's market and diminish its attractiveness for the healthcare industry, Harris said.

The Drastic Reform of the Drug Pricing System contains several concepts of great concern to the pharmaceutical industry. This idea of a shift to an annual price system is a knee-jerk reaction, said an official in the pharmaceutical industry. While the MHLW is indicating that a shift to annual repricing will be focused on the off-patent sector, where prices tend to fall more slowly than in other markets, the high-level proposals within the drastic reform framework also suggest changes targeting innovative drugs. These changes include a "zero-based review" of the price maintenance system, price review at the time of indication expansion and changes to pricing methodologies including the Foreign Price Adjustment. "There's no way that the Japanese health system can be made sustainable through cutting the costs of the most innovative drugs," said an official in the pharmaceutical industry.[15]

The official gave one example of meeting an ex-health minister and discussing one of the new "miracle cure" drugs to treat Hepatitis-C coming out soon. The drug offers a complete cure in ten weeks for a disease that was once terminal. Despite this miracle of innovation, the ex-health minister said the drug was a "disaster" for Japan, not because it worked, but because it was too expensive in light of the government's finances.

The pharmaceutical official's argument is that you need drug makers to be motivated to spend resources to develop such drugs, and if Japan is not willing to pay a premium for such drugs at the beginning, then these drugs may not come to Japan as speedily as they do today. The reason is that drug pricing in other less developed markets often references Japan and other first-mover markets. If Japan prices a given drug low—and for instance that drug is launched in China—then China will reference Japan's low price to set the drug's price in China.

"If that's the reaction, how is it going to bode for new miracle cures we have coming soon for Alzheimer's and cancer," the official said. Japan used to get new drugs five years later than the United States, the United Kingdom, and France because of its stringent testing. By harmonizing its regulatory requirements and also through adoption of the price maintenance scheme, Japan has effectively ended its "drug lag." New drugs are now approved in Japan on par with other developed countries in the West. Japan has also now been brought into early clinical trials by major pharmaceutical companies. Should Japan change its policies and no longer adequately reward drug and medical technology innovation, it could risk reversing all the progress that has been made in this area.

The official said it is understandable that countries need to reign in healthcare costs, but there are other avenues to reducing expenditures than just lowering prices for innovative drugs. The pharmaceutical expenditure represents one quarter of the total government expenditure on health and even the Ministry of Health, Labour And Welfare's (MHLW) own data shows that the pharmaceutical sector is stable compared to the rapidly increasing expenditure in the other 75 percent. As one example of where significant healthcare savings could be met, Japan remains one of the few developed nations to allow smoking in most public places. Were the country to cut the number of its smokers, including through limiting access to smoking in public, the costs associated with treating lung cancer and other related illnesses would drop.[16]

Other solutions for Japan to cut its healthcare bill include reducing the number of hospitals and hospital beds and optimizing the remaining resources, Harris said. One more measure would be to get serious about implementing the use of more generic drugs. This initially is indeed part of the structural reform push by the Abe administration, yet Harris argues that the policy is not being fully enforced.[17] Companies are still allowed to have branded generics and to keep certain premiums even after the exclusivity period expires. This simply pushes up the overall cost of medicine, Harris said.

Innovative medicines make a politically expedient target for price cuts due to publicity around some recent anomalies such as the HepC drugs and Opdivo. However, apart from minor amendments to address gaps in the system, new drugs are already well controlled and, in fact, may represent part of the solution to ensuring a sustainable healthcare system in the long term. While ensuring that the pharmaceutical sector is as efficient as possible, the government should safeguard the gains achieved through its sustainable pro-innovation policies and focus on areas of healthcare expenditure that are grossly out of alignment with OECD averages. It is in these areas of high inefficiency that genuinely significant savings can be made without compromising patient safety.

Mergers & Acquisitions

Japanese companies have increased their overseas acquisitions since the start of Abenomics, with 2015 being a record year for foreign M&A at more than $95 billion.

Takeda Pharmaceutical Co., Japan's largest drug maker by sales, is looking to the United States and Europe for growth, and is in advanced talks to acquire a stomach-drug business from Valeant Pharmaceuticals International Inc.[18] The company has staked its future on growth overseas after making two big purchases—Millennium Pharmaceuticals Inc. in 2008 and Nycomed A/S of Switzerland in 2011—for a combined total of about US $23 billion.

Takeda has told investors it wants to buy US companies developing drugs for cancer, gastrointestinal conditions, and diseases of the central nervous system, such as Alzheimer's. Takeda's pursuit of US acquisitions was indicative of a broader uptick in interest among Japanese pharmaceutical companies, such as Astellas and Shionogi, which are seeking to reduce their reliance on the domestic market.

Remedy 4.0

As part of the Third Arrow initiative, Japan is at the global forefront of moves to bring regenerative medicine products to market and create a regenerative medicine industry, according to Nomura research. Over time, the healthcare and pharmaceutical market has undergone a paradigm shift from naturally derived substances to small molecules, antibody therapies, and the advent of regenerative medicine.

Nomura sees SanBio, Cyberdyne, and Fujifilm Holdings leading the charge in driving the regenerative medicine market. Evolving treatments and drug discovery will create a ¥2.5 trillion market as increased use of regenerative medicine is likely to herald a change in the way stroke, age-related macular degeneration, and other chronic and intractable diseases are treated through the use of cell therapy, and by harnessing medical robotics to restore motor functions.

Regenerative medicine looks particularly promising from the standpoint of healthcare economics, as the discovery of cures will enable patients to reenter the workforce and reduce the amount spent on medicine and long-term care. As development of a regenerative medicine industry progresses, Nomura expects the scope will broaden.

Development is well advanced already in such fields as central nervous system disorders and cardiac muscle regeneration, but eventually the industry will encompass regeneration of the kidney, pancreas, and other more complex organs. Japan Tissue Engineering became the first company in Japan to win approval to manufacture a regenerative medicine product in 2007.[19]

Digital Records

One potential growth area for Japan's healthcare industry—and a focus of the fourth healthcare reform initiative—is likely to be in marrying robotics and Big Data management with a new generation of medical devices. The country already has deep experience with automation in the auto industry, has scores of IT firms that focus on data collection and analysis, and collects reams of medical data. While Japan does not yet have cradle-to-grave medical records, large amounts of data exist since companies and the state are responsible for ensuring employees and citizens undergo yearly health checks.

The unification of hospital data logging and collection alone would be a great plus for the country, Harris said, citing the lack of a universal hospital IT system in Japan. If health and health-related data are used more efficiently by companies and by the state, Japan should be able to prevent more diseases.

Hitachi, Toyota, and Daiwa Securities are turning to digital medical records to cope with the aging population. With digital patient records, the government hopes healthcare resources will be allocated more efficiently, and medical costs reduced, through preventive care.[20]

From the perspective of international companies, the impact of the Third Arrow reforms on the healthcare industry has been rather limited. In 2000, Japan introduced mandatory insurance, funded by taxation for long-term care services, as the country began to worry about its aging population. The real impact of Third Arrow reforms has been to make the domestic industry more competitive.[21]

An International Perspective

From the perspective of international companies, there has been little to no real impact of Abe's Third Arrow reforms on the healthcare industry. Much of the impact of the Abe administration's structural reforms has been on making the domestic market more competitive. However, much of the market's growth is from international companies.

The bureaucracy's focus on budgetary concerns by cutting the price of innovative drugs and large-market growth products is at odds with the Third Arrow's goal to promote Japan's pharmaceutical industry. Instead, there is an opportunity for the country to reassess and stabilize its pricing mechanisms. The hard question that international companies want to ask the government is: If most of the growth in the market is coming from non-Japanese companies, but prices are continuously being cut, what incentive is there for businesses to stay?

Corporate tax policy is another hindrance to more investment in Japan by medical device companies. Today, many medical device companies are relocating their regional headquarters to Singapore because of advantageous tax breaks.

"If Japan employed the same types of tax benefits, I cannot imagine a single medical device company that wouldn't want to build a regional infrastructure here," said Cytori's Harris. "The sheer size of the domestic Japanese market dwarfs that of Singapore, so having a regional HQ in Japan would [enable us] to leverage the robust local market here."

Notes

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6 Innovation and Entrepreneurship

In a speech in 2015 at Stanford University—meant more for a Tokyo audience than the one in Palo Alto—Prime Minister Shinzo Abe proclaimed that his goal was to reform Japan by capturing the dynamism of Silicon Valley. On the same trip, he visited San Francisco to try to convince Governor Jerry Brown to buy the Shinkansen bullet train system for California's planned high-speed rail network.

Abenomics is not the first time that Japan has attempted to create a more dynamic, innovative business culture. Many of the reforms aimed at enhancing innovation and entrepreneurship were started in the administration of Prime Minister Junichiro Koizumi. The reforms target universities, government research laboratories, the tax system, and the stock exchange, among others. Most of these reforms date to the early 2000s, but they are the product of debates that go back to at least the 1970s, when a few economists and bureaucrats began pointing out that the business culture and infrastructure driving Japan's high growth at the time would not be suitable for a time when competition would require productivity and innovation—when Japan would need to find ways to encourage, fund and reward new ideas and products.

As is often true with government reform, the ideas were not new, but the drive to implement them occurred as the result of a crisis. Japanese bureaucrats are skilled at taking advantage of a crisis as an opportunity to gain consensus and drive through new programs and reforms. The crisis that sparked the Koizumi reforms was the bursting of the so-called IT bubble around the year 2000.

For the Abe administration, the Lehman shock of 2008 provided the opportunity to expand on those reforms, and to give them further momentum through an aggressive monetary policy. Separate from these government policies, Japan's large companies went through two major rounds of restructuring in the early 2000s, and then once again in 2009.

In many cases, the results of these changes will not become apparent for several years. Universities are a good example, where reforms were aimed at removing impediments to innovation, rather than to directly fostering innovation. Once removed, it will take time for the new structure to have an impact and, even when it does, the cause-and-effect relationship may not be obvious.

Also, to the extent that these reforms are aimed at encouraging investors and entrepreneurs to take business risks, by definition the results will include both failures and successes. There is a tendency in Japan to dwell on failures, so it will take time to accumulate enough success cases to confirm that reforms have also had a positive impact.

Corporate Reform and Large Companies: Too Big to Succeed?

Many of Japan's large corporations have undergone extensive reform and restructuring throughout this period. This restructuring has only partly been the result of government policy. In most cases, companies have been driven by a sense of crisis and a need to survive.

In his book *Revolutionizing 100-Year-Old Companies*, the former CEO of Hitachi, Takashi Kawamura, points out that there are 3,000 companies in the world that are more than 100 years old, and 80 percent of them are Japanese. Kawamura became a national hero when he headed the turnaround of Hitachi in 2009, a year when Hitachi had the largest deficit in Japan's corporate history. In calling for a revolution, he made the claim that Japan's large old-line firms, which once drove economic growth and productivity, now inhibit innovation by sucking up talent and resources. Being big and surviving for a century is not, by any means, "good" in Kawamura's view.

Kawamura points out, for example, that the top five companies in the United States consist entirely of relatively new firms such as Apple, Google, Microsoft, Qualcomm, and Walmart. In Japan, the top five list begins with Toyota and includes the megabanks Mitsubishi and Sumitomo, as well as Hitachi and NTT. The only company near the top that is less than 100 years old is Honda, which was started by Soichiro Honda 69 years ago, in 1948.

It is significant that, while Kawamura called for a revolution to enhance entrepreneurship and encourage start-ups, at the same time, he spearheaded the successful turnaround of Hitachi and its group companies. In a sense, this reflects the overall strategy—and perhaps the overall dilemma—of corporate and governmental Japan. How can Japan revitalize its established corporations, many of which are still world leaders, while spawning innovative companies capable of competing in new fields such as information technology, sensors, robotics, and biomedicine?

Reforms similar to those that Kawamura started at Hitachi can be seen in many of Japan's 100-year-old companies. For example, Hitachi completely restructured its corporate governance, bringing in outside directors, including non-Japanese. Although the governance structure at the board level does not necessarily make a company more competitive, it can, if done effectively, reduce the inbred nature of top management and enhance accountability. It can also be effective if, as in the case of Hitachi, the new governance structure brings a sharper focus on the restructuring process, where the board takes the responsibility to set the criteria for what to keep, discard, reform, and acquire.

Although this so-called "choose and focus" strategy has become somewhat of a cliché in Japan, it is the best term to describe what took place at companies like Hitachi. Kawamura's team took advantage of the crisis of 2009 to unbundle and restructure many of its divisions and subsidiaries.

In the process of choosing and focusing, nothing seems to have been sacred. One striking example is seen by climbing to the top of the tower at the Hitachi Museum, situated in the middle of Hitachi City. The tower once offered a view of Hitachi factories for as far as the eye could see; but now many of the roofs of those factories have the iconic Mitsubishi three diamond logo, a result of Hitachi spinning off its power business—the most sacred one of all—to a joint venture with Mitsubishi Heavy Industries.

SMEs, Start-ups and Entrepreneurship

While some of Japan's large companies are restructuring to enhance innovation and competitiveness, can Japan spawn a more vibrant start-up culture?

There is a tendency among Japanese and foreign observers to jump to cultural explanations of Japan's "predicament" when it comes to entrepreneurship and start-ups. For example, Japanese have an inherent fear of failure. Japanese prefer large, stable companies for employment. Japanese do not want to be the "nail that sticks out above the rest," and so on.

As with any such clichés, the opposite can also be found to be true. For example, the small and medium-sized enterprise (SME) section of the Ministry of Economy, Trade and Industry (METI) website states that 99.7 percent of all firms in Japan are SMEs, 70 percent of all employees work at SMEs, and 50 percent of all value-add in the Japanese economy occurs at the level of SMEs.[1] These statistics belie the notion that all Japanese prefer to work for large companies. One could easily argue that Japan is the land of small companies and fiercely independent proprietorships.

This dual structure can be found in nearly every segment of Japanese industry where there are a handful of large companies, supported by a large number of smaller firms. In some cases, the smaller companies are mere subcontractors of the larger firms. But in many cases, such as precision machinery and components, the smaller firms are the primary source of innovation, craftsmanship, and proprietary know-how and technology.

Two very different industrial segments that illustrate this dual structure are the electronic components industry and the coffee industry.

Electronic components and connectors are an area where Japan remains a world leader, with companies such as Hirose, TDK, Murata, and JAE. Supporting these companies is a chain of small (and in some cases micro) companies that specialize in high-precision dies, stamping, and plating. In terms of profitability and return on investment, one of Japan's most successful component manufacturers, Hirose Electric, maintains a "fabless" business model that depends on the supply chain of smaller, mostly domestic firms.

In terms of coffee, Japan is the world's third-largest consumer of the beverage after the United states and Germany. Large companies, such as UCC and Key Coffee, dominate the market, but Japan also has the world's largest number of small, independent roasters who cater to sophisticated regional and neighborhood markets of coffee connoisseurs.

The vast number of independent roasters is supported by a system that allows for distribution of green coffee beans in small lots of 60-kilogram bags. The origin of the product can be identified to the level of individual orchards in the coffee producing areas of Central and South America, the Middle East, and Southeast Asia. The intricate structure of the industry is partly attributed to the sophisticated population of coffee connoisseurs in Japan, and can be compared to microbreweries or boutique wineries in other countries.[2]

Whether it is electronic components or coffee (or other) industries, if small, innovative companies are seen as a sign of entrepreneurship, then Japan does not lack for entrepreneurs. But these are not the kinds of companies that PM Abe was talking about in his speech at Stanford.

Although SMEs are a pillar of the Japanese economy—and they have sufficient political clout to command the attention of METI and policy makers—there is a difference between Japan's traditional SMEs and the "start-ups" that the Abe administration says it is seeking. The biggest qualitative distinction is growth.

Most of Japan's traditional SMEs do not seek high growth. Many are "lifestyle," family businesses with a narrow technological focus and good quality that can satisfy their customers and command a niche share in a niche market. These companies play an important role in the supply chain, but they have neither the potential nor the aspiration to become a Qualcomm, Google, or Apple.

Two Japanese economists who have looked at this issue since the 1970s are the late Hideichiro Nakamura and Tadao Kiyonari who coined the term "venture businesses" to describe high-growth companies that are funded by equity from venture capital investors. Even in the 1970s, a period when Japanese companies appeared invincible, Nakamura and Kiyonari warned that Japan was evolving towards a system that would make it increasingly difficult to establish new companies and could discourage the kind of entrepreneurship that spawned postwar "start-ups" such as Sony, Honda, Kyocera, and Omron.

Although they were considered renegades in the 1970s, over the years Nakamura and Kiyonari established an audience both in the bureaucracy and the corporate community, and they maintained a constant dialogue with venture capital groups in the United States and their Japanese counterparts. The concepts and framework that informed policymakers in the Koizumi and Abe administrations can partly be traced back to the legacy of these two economists. These concepts can be divided into three main areas:

1. Tax Reform and Corporate Finance System Reform
2. Government-Funded R&D
3. Education Reform

Let us examine each of these in more detail.

1: Tax Reform and Corporate Finance System Reform

Since SMEs play a big role in the Japanese economy and have considerable political clout through various trade and industry organizations, the Japanese government provides a number of programs to protect and promote the welfare of small businesses. These include government-sponsored debt financing programs, subsidies for R&D, tax breaks, and protective laws (such as the law for subcontractors which limits the length of payment terms from large to small firms).

A favorable corporate tax rate is seldom necessary as an incentive because, in many cases, SMEs can take full advantage of liberal tax deductions and as a result pay little or no corporate income taxes. This is one reason why Japan needed to move to a VAT/ consumption tax system.

This support infrastructure has protected the well-being of family-owned firms, where equity is held within a family and transparency is not an issue, except with the tax authorities. Some of these family "lifestyle" businesses may be highly successful and some grow to the point that they can become listed companies or seek equity financing. Often, however, if the company completes an initial public offering (IPO), the result is a lucrative exit for the family rather than the financing of a new growth vector for the business. This is not the Nakamura-Kiyonari venture business model, nor what Abe is talking about when he refers to start-ups.

The key components of a venture business or start-up infrastructure are early stage equity financing, a system of tax incentives for investors, and a system for investors to exit and realize their capital gains, either through an acquisition or an IPO. The ideal result of this process is a mature business that can sustain growth through cash flow and equity financing.

Japan has been addressing each of these components, although the government took on the reform of the stock exchange before tax reform and improvements to pre-IPO venture financing. This has resulted in problems and some negative publicity.

Stock market reform began in 2004, when Japan's first new stock trading system in more than half a century was officially organized under the name JASDAQ. The name was derived by replacing the "N" in NASDAQ with a "J"; this took the relatively meaningless NASDAQ acronym, which originally stood for the National Association of Securities Dealers' Automatic Quotation system, and rendered it into a Japanese-English acronym which had even less meaning. The JASDAQ exchange later spawned an exchange for start-ups that continuing the penchant for curious acronyms—was called MOTHERS, or the Market for High Growth and Emerging Stocks.

The ideal pattern for a new start-up is to go through phases of angel investing, followed by investments from venture capital funds and, finally, when the company has a proven product and is able to serve its market but needs cash to grow, to embark on an IPO. Ideally, a relatively long gestation period with patient, experienced, hands-on venture funds allows a start-up to concentrate on its product and its technology, and to reach a stage of relative maturity before going public. Ideally, the public offering is not a goal in and of itself, but a step in the process of financing the development of a business.

While the bar for public listings on the Tokyo or regional stock exchanges had been prohibitively high, suddenly the criteria set by the JASDAQ and MOTHERS systems were dropped significantly. The result has been a series of IPOs of relatively immature, profitless companies.

With the help of Japan's aggressive retail brokerage system led by Nomura Securities, the IPOs succeeded in the sense that they took place. The stock often ended up being bought by retail investors, individuals with less discernment of core financial numbers than institutional investors might look for.

As a result, the companies ended up with cash on their balance sheets and, often, cash in the pockets of their founders. But, given the high legal and accounting expenses of an IPO, and the more shortsighted demands of outside shareholders, companies that went public too early have too often ended up floundering. Often the IPO strike price ended up being the peak of a newly issued stock rather than the starting point of an upward trend. The process concluded in disappointment for both investors and management. All too often, such companies lived for a few years off of the IPO cash and then disappeared.

Japan has some history of venture capital funds. For example, JAFCO, a pioneer venture fund was founded in the early 1970s by Nomura (it officially goes by this acronym, which originally stood for the Japan Associated Financial Company). JAFCO itself is a public company listed on the first tier of the Tokyo Stock Exchange, with approximately 25 percent of its outstanding shares owned by Nomura.

Many of Japan's start-ups have received some portion of their early financing from JAFCO but, rather than operating like a hands-on venture capital fund, the business model of JAFCO seems to lack a coherent strategy. It has made small investments in a huge array of companies, with the idea that a few will be able to complete an IPO, even if most might fail. As a result, JAFCO has been more of a cause of premature IPOs than a source of funding to prevent their occurrence. JAFCO's recent attempts to change its strategy illustrate the problems with venture capital in Japan and point to a possible solution.[3]

A venture capital firm with a more standard (i.e. Silicon Valley) operating model, but a rather unique history, is The University of Tokyo Edge Capital (UTEC), which was founded by the University of Tokyo in 2004 as part of Japan's extensive university reform during the Koizumi administration. At the time of its founding, UTEC hired a seasoned team of joint venture partners and associates with experience in foreign (mainly US) joint venture funds. As with the US model, money in the funds came from investors in Japan and overseas. As of December 2015, UTEC was on its third fund, with a combined total of US $300 million, and had a portfolio of 65 investments with nine exits by IPO and eight exits by M&A.

In addition, tax reforms beneficial to both start-ups and investors have been an essential element in developing a venture capital infrastructure in Japan. For example, tax reforms have included R&D credits for special research and experimentation, as well as accelerated deduction of tax reserves for certain investment losses of qualified corporate investors and special taxation of angel investments for individual investors.

2: Government-Funded R&D

Japan began a thorough restructuring of its system for government-sponsored research in 2001. Similar to the restructuring of the university system, government research organizations were made into semi-independent corporations with a board of outside directors for evaluation and supervision. The goals for the restructuring were multiple, including:

- Improving coordination among industry, university and government laboratories
- Improving the management and exploitation of intellectual property and research results
- Regular review and oversight of research projects by outside experts from industry and academia

For applied (i.e. industry-related) research, the two principal research organizations are the National Institute of Advanced Industrial Science and Technology or AIST (with a budget of approximately ¥100 billion) and the New Energy and Industrial Technology Development Organization or NEDO (with a budget of ¥130 billion). Both are supervised by METI. In addition, there are several medium-sized research organizations, such as the National Institute of Material Science or NIMS (with a budget of ¥22 billion).

For more basic research, the Japan Science and Technology Agency or JST is supervised by the Ministry of Education, Culture, Sports, Science and Technology (MEXT), with funding of ¥130 billion.

In order to encourage regular review and discourage bureaucratic obsolescence, programs are funded for a period of five to seven years. As an example, AIST encourages collaborative research with private companies, private/public consortia and non-Japanese private and public research institutes. The restructuring of AIST and other government research centers into semi-independent corporations allowed them to own and exploit intellectual property such as patents.

Within the organizational framework of AIST is the Innovation Center for Technology Transfers and Start-ups (ICTES) that promotes the development of start-up companies and licensing as ways to exploit “seeds” which come from research projects.[4] Since its formation, ICTES has spawned over 120 start-up companies.

One area of success that has arisen from close collaboration between government laboratories and industry is nanotechnology—specifically, materials used in the semiconductor and liquid crystal display industries. Although the end products in those industries may no longer be made in Japan, domestic companies still dominate both the supply of materials and the equipment used to make the products. Japan’s competitiveness in these areas has been—and continues to be—promoted by a tight collaboration among government, private and academic research groups.

3: Higher Education Reform

Japan implemented a major reform of its national universities in 2004 to improve the quality of higher education and enhance the role of universities in innovation, research, and development. This has been touted as the most dramatic reform in higher education since the Meiji Era.[5] As with many recent reforms in Japan, it was promulgated through a series of laws under the Koizumi administration and pre-dates Abenomics.

In comparison to the US market, national universities form the basic core of higher education in Japan. [Please see the Report of the CULCON Education Task Force.[6]] There are 86 national universities spread throughout the country. Of those, the University of Tokyo and Kyoto University are the oldest and are generally regarded as the most prestigious. Overall, national universities are viewed as having higher standards, though there are a few private universities that also merit top praise, such as Waseda, Keio, Doshisha and Ritsumeikan.[7] Because of the national universities' importance in the educational system, a major reform such as that of 2004 has an impact that extends nationwide, including to the 600 or so private and almost 100 public and prefectural universities.

In contrast to the postwar period, universities in the Meiji Era played a key role in Japan's industrial development. This was similar to the role that land-grant colleges played in the United States. The first national universities were Tokyo and Kyoto, which supplied administrative and technical expertise for the nation's government. These were followed by Tohoku University (Sendai), Kyushu University (Fukuoka) and Hokkaido University (Sapporo), which became centers for engineering and agricultural research to support economic development in their respective regions.

The basic mission of national universities changed in the immediate post-war period when, in response to the perception of excessive collaboration with the military in the 1930s and 1940s, the Ministry of Education imposed legal restrictions that prevented government universities from directly cooperating in corporate research.

As a result, national universities became ivory towers focused on basic and pedantic research—often irrelevant to private industry. The Ministry of Education (MEXT) maintained authority over budgets at both national and private universities.

With the huge increase in student populations in the high growth period of the 1960s and 1970s, the education ministry disproportionately expanded the engineering, science, and medical faculties. But, without comparable increases in laboratories and faculties, universities became little more than pipelines to funnel manpower to Japanese companies.

Entrance into these schools was notoriously difficult, but once a student passed the entrance exam, graduation was all but guaranteed. There was little attempt by the ministry to form centers of focus or excellence; budgets were allocated evenly and thinly across the system. The system worked reasonably well because Japanese education in math, physics, and biological sciences at lower grade levels was of sufficient caliber that students could emerge from weak, irrelevant, and uninspiring university courses with sufficient skills to be properly trained on-the-job by their employers.

In this context, the university reform of 2004 was a major change in the legal structure of national universities. Similar to government research laboratories, the national universities were transformed from purely government organizations reporting directly to MEXT into semi-autonomous legal corporations with a governing board.

As independent "corporations," they could now own patents, accept grants from private companies and foundations, sign contracts for research, and commercialize technology from their own laboratories. The University of Tokyo took the lead by founding the in-house venture capital fund previously mentioned—UTEC.

By their nature, universities—whether in Japan or elsewhere—are inherently conservative organizations, without obvious objective criteria to measure success or failure. One description of a university is a group of individual, independent scholars joined together by the air-conditioning system. To try and transform this kind of organization depends on the will of the constituent members of the faculty, and the common result is intransigence and passive aggression. The fact that Japan's leading universities are national government institutions makes them somewhat more amenable to government policy and reform compared with leading universities in other advanced countries, such as the United States.

Despite difficulties, the impact of the 2004 reform has been transformative. Perhaps more than providing a new direction for Japanese universities, it is more accurate to say that the reforms removed many of the shackles of the postwar period. Entrepreneurial professors can now seek new sources of research funding and work on projects cooperatively with commercial companies. The long-term impact of the 2004 reforms will come with cases of success both in research as well as in spawning successful start-ups.

An additional policy change under the 2004 reforms is the establishment of government–private laboratories of technical specialization and excellence on specific campuses. Now it is possible to establish unique, differentiated laboratories for nanoscience, bioscience, and medical research.

The Globalization of Universities

When Walter Mondale was US Ambassador to Japan, he chose to tackle the imbalance in the Japan–US exchange of university students. At the time, Japan was sending many more students to the United States than were being sent to Japan (45,000 versus 1,500).[8] He sought to correct this imbalance in two ways.

First, he lobbied with Japan's Ministry of Education, Culture, Sports, Science and Technology to commence English-speaking graduate programs at national universities and, second, under the Japan–US Friendship Commission, he helped bring about the organization now known as the US–Japan Bridging Foundation, which offers US university students grants to help cover their expenses for studying in Japan.[9]

Although Japanese universities were reluctant at first, after some prodding and outside pressure programs started on nearly all national campuses and in all departments. Graduate students could now take their courses and write their theses in English. These programs then migrated to major private universities such as Waseda, Keio, Doshisha, and Ritsumeikan.

Today, in terms of numbers, the main beneficiaries of these programs are not Americans but students from other Asian countries and Eastern Europe. Particularly in engineering and the sciences, non-Japanese PhD candidates and post-doctorate scholars make up more than half of the total student body. Many of these students are funded by government scholarships provided through the education ministry. Visa reforms have allowed these students the opportunity of staying in Japan after they finish their degree, and even to stay on and form their own companies.

This internationalization at Japan's universities is not totally new. At the turn of the 20th century, Japan's universities took in huge numbers of students from China and the then-Japanese colonies of Korea, Taiwan, Micronesia, and Manchuria. Most senior government officials and military officers in China from the 1910s through to the 1930s spent a period of time studying in Japan. This came to a natural halt due to military events of the late 1930s and, at least in China's case, was not restarted until relations with Japan were resumed in the 1970s. So, perhaps the international trend seen at Japan's universities should really be seen as a re-globalization. This trend is also making a virtue out of a necessity, because foreign scholars help to make up the deficit incurred through a decline in the Japanese population and its overall aging.

Conclusion

Most of the reforms relating to tax, stock exchanges, government research, and universities were started under the Koizumi administration, but they have been expanded and refined under the Abe administration. In some cases, such as the reform of universities and government research and development, the primary motivation may have been economics as much as innovation. But by making government institutions semi-independent, and bringing in a process of evaluation through outside experts, the overall accountability and relevance of academic research has increased. The direct economic impact of this cluster of reforms is difficult to evaluate, partly because it has been a process of removing impediments and correcting weaknesses rather than the direct promotion of innovation. Nonetheless, in the long run, it is not overly optimistic to expect positive results.

Notes

1 METI's definition of SME's is a manufacturing firm with less than 300 employees, wholesale firms with less than 100 employees, or retail firms with less than 20 employees
2 "Coffee Life in Japan," Prof. Merry White, UC Press, 2012
3 www.dealstreetasia.com/stories/after-1000-ipos-japans-biggest-venture-firm-to-change-course-54227/
4 https://unit.aist.go.jp/ictes/en/index.html
5 Kagami, Shigeo, PhD. "RIETI Workshop: Entrepreneurship Education at the University of Tokyo." Research Institute of Economy, Trade and Industry. January 21, 2013. Accessed January 5, 2017. www.rieti.go.jp/en/events/13012101/pdf/kagami.pdf
6 www.mext.go.jp/a_menu/kokusai/culcon/__icsFiles/afieldfile/2013/06/13/1336327_2_3.pdf
7 "私立学校の振興." 私立学校の振興:文部科学省. May 1, 2010. Accessed January 5, 2017. www.mext.go.jp/a_menu/koutou/shinkou/main5_a3.htm.
8 Lev, Michael A. "Japan Bids To Narrow Imbalance Of Exchange Students With The U.S." *Chicago Tribune* (Online). May 28, 1996. Accessed January 6, 2017. http://articles.chicagotribune.com/1996-05-28/news/9605280089_1_ambassador-walter-mondale-japanese-universities-japanese-markets.
9 "Bridging Foundation." Bridging Foundation About Us Comments. Accessed January 5, 2017. www.bridgingfoundation.org/about-us.

7 Labor Market Reform

Much of the Third Arrow focuses on business policy and social contracts, yet arguably the most important and controversial topic that the government aims to tackle sits at the crossroad of the two: the labor contract.

In Japan, the labor contract does not simply provide a person with income; it defines one's identity and lifestyle. Socioeconomic issues—ranging from the size of insurance payments to the availability of kindergarten to community status—are influenced by the name of the company an individual works for and the type of employment contract they have. Be that as it may, Japan increasingly faces pressures that have become catalysts for labor reform, such as immigration, demands for gender equality, recognizing the need for more entrepreneurs, as well as disillusionment with long working hours that leave little time for anything else—or may even lead to death from overwork (*karoshi)*.

It is said, "If you change the Labor Contracts Law, you change the way society—and thus Japan—runs." That should speak volumes as to how daunting a task it is to change labor market regulations and corporate practice in Japan, and how long it will take to effect serious change. So why would the Abe administration seek to take it on? The answer is that the Labor Contracts Law, and the attendant corporate practices, no longer meet the needs of Japan's economy, and thereby directly and indirectly inhibit economic growth, prosperity, and work–life balance.

Context

There are two popular words in Japanese that describe a comfortable situation: *anzen* (safe) and *anshin* (stable). Nowhere is this felt to be more important than in the case of employment. The thinking goes, "Get a safe, steady job as a 'regular' employee, then you can find a marriage partner and you (and your family) are set for life."[1]

It may seem that, in a country with barely a 3 percent unemployment rate, this safe and stable working circumstance had been largely achieved; but that is not the case. The reality is that, ever since the Japanese economic bubble burst more than two decades ago, the labor market has undergone a drastic upheaval as companies began increasingly turning to the employment of non-regular or temporary staff to obtain flexibility with respect to salary and termination. This, in effect, created a two-tiered labor force. As of 2015, about 40 percent of workers were temporary and were paid an average of 38 percent less than so-called regular staff, government data show. This statistic highlights the harsh dichotomy between Japan's societal ideal and reality.

The axioms of Japanese "regular" employment: lifetime-employment brings a company-dictated career and compensation, and a management hierarchy based on age. The career path of most Japanese (males) would boil down to entering a firm as a fresh graduate, earning a pittance for the first decade, then seeing wages rise significantly as one enters his 40s, which is when one can expect promotion to section chief. In the meantime, work absorbs the majority of one's life, including evenings and weekends and, because of postings to other locations, many employees can spend years of their lives away from the locale where they own a home and where their family lives.

This style of employment is based on a *seishain* contract, for which the usual translation is "regular employee." The *seishain* system, however, differs from the West in that it is a labor contract without a defined job description (*mugentei shain*). Employees are not hired for a particular position in a particular place. They are treated as members of a society. This means that the employee can be posted wherever the employer thinks is necessary at any given time. This flexibility for the employer is offset by legal protections for the employee, who cannot be fired for being unable to perform an assignment because he or she was not hired to do that specific job. The law says employers must find alternative work for underperforming employees, thus creating a kind of social contract between government and business in which the latter is, in a way, responsible for local employment levels.

Traditionally, Japanese firms have preferred to have this flexibility because most use a job rotation system wherein employees change positions every one to five years. The changes can be as small as a promotion within the same department and as major as a transfer to another country under a different division in a completely different area of expertise.

The idea is to give the employees a comprehensive understanding of the corporate "society" of which they have become members. They are generalists who, if anything, "specialize" in knowing their own organization well. They learn broadly about the business from factory floor to planning section to overseas sales. Eventually, imbued with experience in different areas of the company, such employees can rise to managerial level because they have an understanding of the *genba* (i.e. how things work on the ground). As one would expect from this practice, almost every senior executive at large companies in Japan has worked for the same organization for his or her entire life. The mantra given to the class of fresh graduates by the CEO or another senior executive in the spring (which is invariably when all new employees enter the company) is that "each of you has the chance to become a future president of this company." Needless to say, this is not true for non-regular employees.

While this type of employment system still exists in some Western institutions, such as the diplomatic service or academia, it has been phased out in most developed economies in favor of increasingly job-specific employment practices. Meanwhile, Japan's Labor Contracts Law has seen little change in decades. Even the Abe administration calls it "rigid" and one of the so-called Six Burdens on the nation.[2]

The lifetime employment (regular employee) system has roots in the socialist-leaning Japan of the 1950s and 1960s, where much of the economy was based on manufacturing, and when labor unions had sizable weight in negotiations (hence the need for senior staff to get a taste of all factory lines before being promoted). The practice of assuring protection from termination was accepted at a time when economic growth was rapid, and many Japanese companies' strategies were volume-based, requiring few rapid adjustments and lateral hires. During that period, the risks of *not* having enough staff were high, and the risk of having to downsize was small.

These practices were also based on a societal norm of having "the man at work and the woman at home." In this gender split, the man could work late nights and weekends, and be posted to another domestic location or overseas on short notice, while his wife kept the home and family life ticking by herself. This away-from-home posting for the corporate warrior has its own term in Japanese: *tanshin funin*.

However, Japan's economy no longer works the same way as it did from the 1950s to 1980s. Since the asset-inflated bubble burst, a great many manufacturing jobs have moved abroad; the sector now accounts for only 20 percent of the total economy. As Japanese companies have become far less likely to see rapid growth in business (see Chapter 2), they have become more cautious about domestic expansion and new hires. As mentioned earlier, in order to circumvent the fact that the law pertaining to long-term labor contracts makes it almost impossible to reduce staff, corporate Japan has turned to temporary-worker and part-time worker arrangements to run many operations. Though termed part-time, many such workers put in 40 hours a week.

Until recently, workers on a contract basis were not only paid less, but they also had a three- to five-year limit on their employment term. Unlike the United States, where temporary work can lead to a full-time role, in Japan the contract was simply rolled over (or canceled). Escaping this cycle of temporary or short-term work is difficult, and saving for retirement is near impossible. According to Bloomberg News, in March 2014 around 60 percent of employment offers were for non-regular employees. This is the direct cause for why Japan became the only developed country where average pay has fallen since 1997, down 15 percent.[3]

Third Arrow Concept

The ultimate goal of the Third Arrow is to reform laws and practices so as to foster deeper labor markets with far greater mobility, and to incentivize employees to be more productive in their jobs and more in charge of their careers and their hours. This encompasses everything from encouraging companies to laterally hire staff and accepting new graduates on a year-round basis (as opposed to taking on a round of fresh graduates once a year), to spreading the use of more job-specific work contracts and clarifying procedures for how employment contracts can be terminated with predictable outcomes for both sides. Tax policy also comes into play as the spousal deduction system can work to incentivize (or discourage) married women from choosing to enter the workforce.[4] The government also envisions that—as more staff gain confidence to leave jobs to seek better opportunities—there will emerge a more fluid labor market, which will facilitate middle-age career changes and enable employees to pick the work environment and hours that they are comfortable with.

The result should be a more dynamic workforce, which is not constrained by age-based pay and hierarchy, and a more flexible workplace that allows women to continue employment after childbirth and men to take on more responsibilities at home. Performance and productivity, not number of hours spent at the office, are expected to become the primary focus. Better work–life balance all around will become more achievable. Prime Minister Abe, in 2015, termed this as a vision to build "a society where all 100 million citizens can play an active role."[5]

At least that is the *ultimate* goal. Given the context noted above, no one should be under the illusion that this can be achieved in a few years. The government is aware that the societal nature of the labor contract means that society as a whole needs to embrace the change before it happens. Hence, what we have seen so far is a lot of committees, polls, political discussions, and unnamed government sources in news stories gradually sketching out the paths that Japan will take regarding labor reform. This is not to say that there are no official suggestions on potential revision of the Labor Contracts Law. However, it is probably fair to say that core government papers such as the annual revitalization strategy, while being brave in acknowledging the emergence of a two-tiered labor schism between *seishain* and non-regular workers, talk about end-goals and national needs more than near-term concrete steps.

In the words of the 2016 Strategy: "As more and more Japanese workers will have a mindset of 'taking a job' rather than "serving a company for their entire life," our way of working is also anticipated to change significantly . . . We need to further examine how our way of working for individual workers will change, how labor outcome should be appropriately evaluated, and what we should do to attract more overseas high-quality human resources to Japan."

Certainly, the early-2012 gusto from Abe about tackling labor reform has been put on a slower track due to what he called "a lack of national consensus" on the issue, according to media reports.

What the government has tried to avoid in pursuing reform in the labor law is the suggestion that the changes are focused on allowing companies to easily fire *seishain* staff. Even steps taken to eradicate one of the uncertainties of temporary staff—a limit on their contract term—initially drew negative reactions.

However, a change to the Employment Contracts Amendment Act, which came into effect in April 2016, stipulates that a fixed-term, contract-based employee who continues to work in the role for more than five years can apply for—and be transitioned into—

permanent employment status. It is too early to see how this will work in practice five years from now.

Realizing the sensitivity of the issue, the government has proceeded by proselytizing about the spirit and purpose of new labor laws, regulations and guidelines before drawing them up in detail.

The government set up a labor market reform working group as part of its core policy vehicle, called the Council for Regulatory Reform.[6] The working group produced its first report in June 2013. The group has produced three subsequent reports and put forth proposals, yet only a few have been accepted so far. Among those that made the cut are measures such as "bring[ing] together representatives of labor, employers, legal academics, and labor specialists for an exchange of opinions on how to construct a better labor dispute resolution system."[7]

Similarly, amendments to the Labor Standards Law and the Labor Contracts Law, both of which call on companies to formalize conditions of employment, have been put off "for the moment" because forcing companies to specify the job description or to allow staff to move to a so-called new *seishain* status (where full-time staff is given a definite role) would "place a burden on the operations of companies," Professor Kotaro Tsuru of the Keio University Graduate School of Business and Commerce, who chaired the Council's working group on employment, told the Task Force in May 2016. Clearly, the government is proceeding with caution. It seems that it wants industry and citizens to accept the changes before making them law.

From the outset, the labor market working group of the Council for Regulatory Reform outlined that its goal was "smooth labor market turnover without unemployment." The working group defined this in its initial 2013 report as an environment in which workers know what their job titles and descriptions are, what hours they are signed up for, and on what basis they can be terminated, as well as how much compensation they can expect should this come through no fault of their own. The latter is an especially key point given how the termination dispute system in Japan focuses on the worker being reinstated in his or her job, not on monetary compensation. Moreover, the uncertainty of outcome in the dispute system and the length of time the process can take if it goes all the way to the courts (two or more years) serves no benefit for either party.

The working group also said it wants to strengthen the recruitment industry to help people find jobs more easily and give them greater mid-career mobility, as well as making more training and education programs available to help with the same. Finally, the working group outlined the need for more equal pay (between the regular and temporary staff, as well as between male and female workers), and to rationalize the dispatch worker system.

In subsequent reports to the June 2013 document, the working group also noted the need to promote different working hours and working conditions as a way to get more women joining the workforce, as well as improving internship programs, workplace health, innovation, and entrepreneurship.

How soon these changes will come about, however, is unclear.

Kill the After Party

Some progress on labor issues has arrived outside of academic and regulatory efforts.

As outlined earlier, *seishain* status allows employers leeway in dictating when and how much overtime their staff need to work, or to present them with workloads that can only be managed with long overtime hours. Corporations that abuse the system to the degree where workers are logging extended overtime hours on a regular basis have earned the label of "black companies."

Tackling the issue of black companies has proved harder than simply tightening regulations and amending laws in a society where overtime signifies a can-do attitude that leads to promotion. Take these comments made in late 2015 by Kazuo Inamori, one of the captains of Japanese industry, regarding a request by an overseas hedge fund to KDDI Corp., the company that he founded, to sell certain assets and raise dividends.

"Company leaders should seek to make all their employees happy, both materially and intellectually," Inamori told Bloomberg News.[8] "That's their purpose. It shouldn't be to work for shareholders."

While Inamori sounds like the traditional paternal Japanese boss, he also notes that keeping staff happy means working them harder than anyone else, which is in keeping with his Buddhist philosophy of *shojin* (elevation of the soul through devotion to a task). Inamori questions the growing tendency of Japanese to value leisure time, according to the report.

When the now-retired boss of a company that employs tens of thousands of Japanese makes this statement, it is fair to assume that for an employee to ask for greater work–life balance is not a good career move.

However, a month later a tragic event cast the zeal to work all hours in another light. A 24-year-old female employee of advertising giant Dentsu Inc. committed suicide after logging more than 100 hours of overtime in a month.

Dentsu is an extremely influential company in Japan and handles a lot of the government's public relations work. Consequently, once the court ruled in October 2016 that the employee's death was due to overwork, the issue remained top news in national media for months, even though extreme overtime is not so unusual in Japan. The government made statements to condemn the company, and the labor office made public the fact that they had warned Dentsu months before the death that its staff members were working beyond the labor-management agreement on overtime hours.

The tragic case dominated the news in October 2016, and it is probably no coincidence that the government decided to issue its first-ever white paper on *karoshi*, or death from overwork, in the same month.

With all this in mind, the prominence that labor issues have received in social discourse is starting to influence corporate thinking, albeit slowly. In October 2013, for example, one of Japan's biggest trading companies, Itochu Corp., said it would start to enforce a ban on overtime after 10:00 p.m. and encourage employees to get into the office by 8:00 a.m.

by offering a free light breakfast. In a nod to the late-night drinking culture of corporate Japan, Itochu President Masahiro Okafuji also banned the practice of *ni-ji-kai* (the party after the party) for internal gatherings, saying that all festivities should be concluded in the *ichi-ji-kai* (the original party).

Few companies initially followed Itochu's example. But, whether it be the focus on *karoshi* cases at companies like Dentsu or gentle government propaganda, more corporate stories on better work–life balance have started to emerge.

At the end of October 2016, motor maker Nidec—a company known for its fanatical attitude to work hours and a boss who famously scoffs at those who want to take long holidays—announced that it posted record-high financial results because it changed the work ethic inside the company. In an astonishing statement, Nidec President Shigenobu Nagamori declared that overtime was slashed 30 percent without affecting productivity. "There are no more *moretsu* working for us," the *Nikkei* reported him telling the media,[9] referring to the Japanese term for a die-hard workaholic. Nagamori said he aims to have zero overtime by 2020. And this is from a boss who used to ask staff to spend their Sundays at the office practicing bowing.[10]

Foreign Workers—On a Trial Basis

Measures Japan is taking to attract high-end professionals have already been described, especially in the financial and related industries (see the chapter on Banking and Finance). Efforts to attract high-end foreign workers requires careful coordination of Japanese tax law (including Japanese inheritance tax and income tax that would apply to such persons) with labor and immigration law and policy. The efforts to bring in more workers from overseas do not end there.

Currently, most of the non-skilled labor in Japan arrives through backdoor channels such as "training programs," which allow foreign nurses and factory workers to stay in the country for two to three years. Through such programs the number of foreign workers in Japan has nearly doubled to 908,000 in 2015, from about 486,000 in 2008, according to data cited by the media.[11 12]

This is not a permanent solution, however, and the projected decline in the population means that more than 80 percent of Japanese hiring managers have trouble filling positions, compared with a global average of 38 percent, according to a 2015 Manpower survey.

Because any conversation on immigration in Japan is sensitive, the Abe administration uses the term "guest workers" to refer to manual labor from overseas. The LDP has proposed to expand the "training programs" to five years and to create a visa category for non-skilled workers. There is also conversation in the media between lawmakers seeking to create more quotas for foreign staff in specific industries such as agriculture, manufacturing, and construction—especially as the Tokyo 2020 Olympic and Paralympic Games exacerbate a national shortage of construction workers.

How far these proposals will move in the near future is unclear, but with the Olympics being a definite deadline, it seems likely some movement on more immigrant labor will be forthcoming in the next year or two.

Gender Equality

Womenomics, a term coined in 1999 by Kathy Matsui (vice chair of Goldman Sachs Japan and chief Japan equity strategist for Global Investment Research), and which has been embraced by Prime Minister Abe to refer to his policy of bringing more women into the labor force, is discussed in detail in a separate chapter (see the chapter on Women in Business). To summarize, the disturbing reality of the present two-tiered labor contracting system is that women who wish to re-enter the workforce after childbirth are generally limited to low-paying, non-regular positions. In 2003, the government originally set as a general target that 30 percent of all corporate managers should be female by 2020.[13] At the end of 2015, this was lowered to 15 percent and, in private conversations, the presidents of some major Japanese companies at times scoff at the idea that women can ever become CEOs.

However, there is incentive for the government to take on this boys' club corporate mentality. Studies by Matsui show that, if female employment rates increased so as to match those of males, Japanese GDP would increase by around 13 percent.

Some small progress in bringing more gender equality into the labor force has been made. Women's labor force participation rate as a percentage of the total (among those aged 25–64) has risen sharply since 2010, government data show. In 2014, it even surpassed that of the United States at 74.5 percent, although it was still below the participation rate of Western European counties.

The biggest challenge for the government to convince more women to work will be to provide a childcare system that can support two working parents, something that has come under significant strain in metropolitan areas, including Tokyo, in recent years. The level of care will also need to correspond with office realities, Professor Tsuru of Keio University noted in his presentation to the Task Force, as the traditional *seishain* system where companies have the freedom to dictate overtime and place of work does not synchronize with parental responsibilities.

In this case, more flexible hours or strictly enforced working hour contracts need to be in place to facilitate greater female participation.

Is it Tough to Dismiss Staff in Japan?

From an employer standpoint, this is probably one of the biggest questions. Especially among foreign firms, there are numerous anecdotes that indicate the labor law is overwhelmingly on the side of the employee when it comes to dismissals. In one case, a new employee who did not pass security background checks was dismissed after two weeks and yet won the right to sue for compensation via the courts. This is despite the passing of background checks being one of the conditions of employment. In another case, a major US financial media and data company lost a court case and two appeals in a case brought by a dismissed employee who insisted in court documents on being reinstated in his job as opposed to demanding financial compensation.

Under the current system, unless the parties in a lawsuit agree to a financial settlement, the courts can only focus on job reinstatement as the legal resolution. Meanwhile, a worker disputing dismissal is docked up to 40 percent of the potential compensation if he or she accepts work elsewhere *after* the case has been filed in court, and potentially loses all chances of winning the case if he or she finds work *before* the case is filed, according to some legal experts. This gives the impression that such cases are evaluated as much on the individual situations of the worker and the company as on the merits of the dismissal, and makes a result (and the length of time it takes to arrive) difficult to predict.

Still, Professor Tsuru notes that, while the courts are very much focused on whether the employer tried to find alternative work for the employee before resorting to termination, the law's application in dismissal cases has become more "flexible." What has helped is the move by companies toward using *seishain* contracts with defined work descriptions. In addition, government policy has focused on promoting the idea of a standard monetary compensation amount to be used if that is acceptable to the parties, rather than having the courts focus mainly on job reinstatement.

Nevertheless, the government has to be cautious not to anger workers and labor unions by creating legislation that is then seen as making dismissal easy. Thus, initial efforts of the government's labor market working group have centered on mapping out the current dismissal process and finding ways to make it more predictable. This has included evaluating the work of the pre-court process, which involves dispute resolution via Prefectural Labor Boards and the Labor Relations Commission. Results show that the Labor Boards can offer much quicker resolution—but also much less money—for workers and their success rate is low due to low employer participation.

This means that "in some cases, unjustly dismissed workers cannot get compensation," according to Professor Tsuru. To address this, the working group is exploring ways to get companies more engaged in mediation at the level of Labor Boards. The Cabinet has also approved giving more powers to the Labor Relations Commission so that it can be involved in cases that have reached the litigation stage. Both of these measures aim to resolve disputes before they get tangled in lengthy court procedures.

At the same time, the government is encouraging the courts to broaden the relief they provide through considering options for resolution other than job reinstatement.

Finally, the working group has been concerned with finding a formula for standard compensation in terms of months of pay that could be suggested to all parties in a dispute. So far, the working group has determined that European compensation that can rise to 22 months (Spain) and even 32 months (Sweden) is too high. It also proposed that the compensation system in Japan should take into consideration worker seniority, since it has a greater influence on salary compared with other countries, Professor Tsuru notes.

There is a way to go before the government makes its final decisions on what the new dismissal compensation system should be, and there is strong opposition from small business owners to having a uniform compensation structure written into an employment contract. Setting a uniform amount is also difficult given the vast differences in the benchmarks around the world. As a result, much of government literature at present discusses the need for flexibility and the need to take into account the situation of the employer and employee, which generally run counter to standardization goals. However, all parties realize that labor court cases are likely to decrease once a consensus on the compensation model is achieved, because the result of litigation will become more predictable. That seems to be in the interest of all: employers, employees, and the government.

Notes

1 Which is one of the reasons for a low rate of entrepreneurs in Japan, a path that raises the risk of failure, generating opposition by parents and spouses and requires putting personal assets on the line to the bank should the business collapse.
2 From the "Abenomics Pushing Forward" presentation by the Bureau for Japan's Economic Revitalization, an agency under the Cabinet Secretariat, made to the ACCJ in October 2016
3 www.bloomberg.com/news/articles/2014-05-29/how-to-become-an-activist-start-as-a-japanese-part-timer
4 www.japantimes.co.jp/news/2016/10/09/business/economy-business/japan-labor-shortage-continue-spousal-tax-break-revision-falters-within-ruling-bloc/#.WKufiVV96Uk
5 www.japantimes.co.jp/news/2015/10/29/national/politics-diplomacy/abe-convenes-panel-tackle-low-birthrate-aging-population/
6 "Council for Regulatory Reform." Council for Regulatory Reform - Cabinet Office Home Page. Accessed January 7, 2017. www8.cao.go.jp/kisei/en/ .
7 From "Labor and Employment Reform," a presentation by Professor Kotaro Tsuru of Keio University Graduate School of Business and Commerce, to the ACCJ on May 24, 2016
8 www.japantimes.co.jp/news/2015/11/05/business/kyocera-founders-secret-make-workers-happy/#.WBxCLuF96Rs
9 http://asia.nikkei.com/Business/Companies/Cutback-in-overtime-drives-Nidec-to-record-result
10 www.bloomberg.com/news/articles/2015-07-16/at-japan-s-nidec-the-ceo-as-comic-book-hero
11 www.bloomberg.com/news/articles/2016-10-25/a-wary-japan-quietly-opens-its-back-door-for-foreign-workers
12 Wilson, Thomas, Mari Saito, Minami Funakoshi, and Ami Miyazaki. "Banned from working, refugees are building Japan's roads and sewers." Reuters. August 8, 2016. Accessed January 7, 2017. www.reuters.com/investigates/special-report/japan-kurds/
13 http://money.cnn.com/2015/12/07/news/economy/japan-women-senior-positions/

8 National Strategic Special Zones

It is hard to change a culture and a country all at once. With this in mind, China and a host of other developing economies have found success in creating zones with isolated micro-systems that do not disrupt the whole nation. In Japan, the same tactic has yet to bear noteworthy fruit, though there are isolated cases of progress. This may be because Japan's use of economic zones, while advertised to attract foreign business and investment, has in practice provided a safe space for experimentation, whereby firms and politicians bypass some laws and regulations either to promote particular projects or try out new economic models.

Prime Minister Shinzo Abe described the Special Zones as a tool to break the hold of vested interests. The wording often used in the government's policy papers is a breakthrough in "bedrock regulations," or the establishment of reforms that lead to "the most business-friendly environment, where the private sector can leverage its capabilities."[1] In this way, the Special Zones have become a kind of Swiss army knife for Abenomics, a space where many of the other reforms aimed at improving foreign direct investment (FDI), private-public partnerships, labor, innovation, and so on can begin life.

Special Zones also help obtain buy-in from local governments for the Third Arrow of Abenomics, since most of the zones are outside of the Tokyo area and purport to hand the authority and autonomy to the politicians on the ground. The national government describes its role as more of a supervisor and general strategist for such zones.

Given these characteristics, the Special Zones are best described as a work in progress, with more work done by some local governments than others. Overall progress here may also be suffering from the overly broad goals, vague wording and the involvement of so many levels of government.

Third Arrow Concept and Reform Outline

The National Strategic Special Zone Act is the backbone legislation specifying how to establish these areas. Promulgated in late 2012, with a final revision mid-2013, the act says that the purpose of special economic zones is to revitalize Japan's society and economy and help maintain sustainable long-term development. Again, the wording seems to be deliberately broad.[2]

The act says that special economic zones welcome companies, residents, and visitors associated with high-tech industries, or international business and economic activities. The act puts the focus on local laws to be introduced to attract a talented workforce and foreign businesses.

The act allows the Prime Minister's office to make several exceptions to rules and regulations inside the zones, including land-use restrictions and medical issues. There are also tax incentives for qualified taxpayers, including accelerated depreciation deductions and tax credits for investments in facilities, job creation, and R&D. In many cases, it allows companies or entities that would not normally be permitted to engage in a particular activity the ability to do so.

The government also promises to provide so-called assisted interest payments to designated banks to encourage loans to businesses at reasonable rates, and to provide advice to new foreign businesses to prevent labor disputes.

While the act focuses on high-tech innovation and products, the actual special economic zones do not. Initially, the government set up six special economic zones in 2014 with a mandate to look at improvements in a particular field. The Tokyo Zone (limited to nine wards of metropolitan Tokyo, Kanagawa Prefecture, and Narita City) took on the challenge of improving the city as a financial hub. More on this subject is outlined in Chapter 2.

The Kansai Zone (encompassing Osaka, Kyoto, and Hyogo Prefectures) was tasked with looking at international innovation in the field of medical care and entrepreneurial support, as well as developing international business.[3] Yabu City, which is in Hyogo Prefecture, was given the role of becoming a center for agricultural reform in hilly areas. Niigata City's focus was on large-scale agriculture. Fukuoka City was tasked to look at the employment system and start-ups, while Okinawa Prefecture's role was to innovate in tourism.

Since the establishment of the Special Zones, the government added three so-called "Regional Vitalization Special Zones" in September 2015. These again seem to overlap as both Semboku City (in Akita Prefecture) and Aichi Prefecture are, to an extent, looking at agriculture reform, while Sendai City[4]—like Fukuoka—is developing start-ups, though there is some differentiation in sector. Aichi additionally gets employment (same as Fukuoka). Semboku, like Kansai, picks up medical care.[5]

A further three National Strategic Special Zones (in Kitakyushu City next door to Fukuoka City, Hiroshima Prefecture, and Chiba City) were assigned in December 2015, with little information given as of summer 2016 as to what focus they would have. By the end of 2016, Kitakyushu was tagged as a center for employment system reform for business creation, Hiroshima as a zone for international exchange and utilization of Big Data, while Chiba was included in the Tokyo zone and tasked with looking at the special provisions in the Child Welfare Act concerning nursery teacher qualifications.[6]

While the Special Zones were given a particular focus, the government's own KPIs for the zones are overly general.[7] In 2015, the government said its aim was to improve the country's position in the World Bank's ease of doing business rankings by 2020[8], expand public-private partnerships and private finance initiatives to ¥12 trillion between 2013 and 2022, and double foreign direct investment in Japan to ¥35 trillion by 2020. One additional target was to see Tokyo ranked among the top three cities in the Global Power City Index by 2020 (it was fourth in 2012). The latter is published annually by the Mori Memorial Foundation to rank major cities according to their "comprehensive power to attract creative people and business enterprises from around the world."

By 2016, the government's KPIs for the reform as outlined in its Revitalization Strategy had shrunk to just two: the World Bank Index and the Global Power City Index. This somewhat arbitrary and bureaucratic focus on indices, in contrast to the vast number of areas of the reforms themselves, has not yet yielded results. As of June 2016, Japan ranked 34 (down two places from its ranking the previous year) on the Ease of Doing Business ranking,[9] and Tokyo's ranking in the Global Power City index was third (up one rank from the previous year).

In its defense, the Abe administration has identified the period until 2017 as focused on the establishment of Special Zones and preparation of reforms that could take place inside them. Much of the conversation is directed at these reforms building toward the Tokyo 2020 Olympic and Paralympic Games, and the overall target of attaining a nominal GDP of ¥600 trillion by then. Nonetheless, the reform outline continues to be vague, with the government's role in the process outlined as primarily "to encourage," "to promote" and "to respond."

The impression is that the government is seeking to encourage innovative thinking from the regions, in which they identify and plan what they wish to specialize in, allowing Abe and his team to come in as supporters—as opposed to ordering progress top-down. The Revitalization Strategy goes as far as suggesting the government will create new Special Zones, if necessary, to make a project or legislative measure happen.

Results to Date

For all the bureaucratic activity, it may be more useful to look at what the National Special Strategic Zones initiative has achieved in practice.

The ability to switch off certain rules inside the Special Zones has allowed the construction of several new medical facilities that introduce technology or care services approved in many other developed countries but not yet in Japan. A specialist eye hospital is due to open in Kobe in 2017 that utilizes the world's first iPS-cell technology to regenerate the human retina. The reform allowed the 30-bed facility to open on reclaimed land near Kobe Port.[10]

The reform has freed hospitals and clinics in the Tokyo and Kansai areas to offer medical care not yet covered by public health insurance, giving a chance for private medical firms that have secured approvals in the United States, the United Kingdom, Germany, France, Canada, or Australia to come to Japan without going through a lengthy screening process.

The inward tourist boom stimulated by the Third Arrow drive to weaken the yen has also created room shortages in hotels—a problem that is unlikely to be solved by the Tokyo 2020 Olympic and Paralympic Games by the hospitality industry alone. As such, the Special Zones reform has seen the easing of the Inn and Hotels Act, which allows businesses and entrepreneurs to convert empty housing stock into accommodations that can receive foreign travelers. Hotels and construction firms are part of the vested interests that Abe talked about, and opening up their fields to foreign and more domestic competition is still a contentious issue. This means that most of these permits to convert housing to hostels, Airbnb-like housing, and so on are still being carried out on a case-by-case basis.

In addition, the government has been careful to hand over a number of areas in Tokyo and Kansai for redevelopment. In the 2016 Revitalization Strategy, the government named as many as 29 Urban Reconstruction Projects in Tokyo alone that can update existing housing blocks via a more relaxed permits process. Some of these projects are directly connected with the Tokyo financial hub vision, including early drafting of plans on how to provide housing for the housekeeping staff that may arrive to cater to the (expected) growing number of foreign professionals arriving in Japan.

Many other reform initiatives being incubated inside the Special Zones are, as yet, at an early stage, and it is hard to see evidence to support claims of their success or failure. Measures to bring in more foreign human resources and businesses have resulted in an opening of a Tokyo One-Stop Business Establishment Center in April 2015. The center seems to be still in the process of adding staff and finding its way in the bureaucratic system that has agencies such as the Japan External Trade Organization operating similar services. And, while the center says that about 1,200 people have used the service in the first 18 months, many of its programs and information resources are in Japanese. This indicates that it is more likely to be used by—and be useful for—those already living in Japan and fluent in Japanese.

As evidence of how the Special Zones reform is less about attracting foreign business and more a way to reform domestic enterprises and cultural working norms, it is notable that most of the key projects the government outlined in the latest policy update are focused on Japan’s internal issues. These include goals to reduce waiting lists for nursing care, the testing of automated driving on Japanese roads, and introducing labor reforms inside the Special Zones to allow government officials to switch to working at start-up companies and to make sure contract and full-time staff receive equal treatment, among others.

Analysis

China’s special zones were a way for the country to bring in the capital and technology that would allow the nation’s enterprises to compete in exports. Japan’s Special Zones seem less about the desire to import technology as much as importing a mindset: Creating areas in which such social norms as “joining a company for life” are eased in favor of a flexible job-market, or where performance—not seniority—determines pay. While most firms in Japan no longer use seniority-based evaluations, it is still an extremely important factor in pay and promotion, which makes switching companies akin to starting from scratch like a fresh graduate.

As the 2016 Strategy notes: "It is necessary to share a future image of the new social system, as well as industrial and employment structures, and conduct reform in Japan as a whole, based on the map created for the goal." This, as already mentioned, shows the government is trying to promote change and hoping that it will win corporate support. It is not clear what the government will do, if anything, if Japanese businesses simply ignore the hint.

For foreign businesses, the Special Zones are paraded as bastions of equality because the deregulation inside their boundaries should put global firms on an equal footing with domestic interests. In reality, this may be tough to achieve, because the Special Zones are operated by local authorities which, as a rule, have fewer resources to publicize their new opportunities—especially in foreign languages. Two years on from being designated as National Strategic Special Zones, several do not have separate websites and rely on machine translations for visitors who can only access information in English, Chinese or Korean. Apart from not being user-friendly, the machine tools fail to translate the website tabs or PDF-format documents in which the Special Zone administrators outline their ambitions.

As such, one could say that the winners will always be the larger domestic companies that can take advantage of the initiatives in the Special Zones in native Japanese, and because of their larger human resources.

Perhaps fearing that domestic businesses could uproot and relocate to the Special Zones if the tax and other business conditions were significantly better than in the rest of Japan, government concessions in those areas have been project-specific to the locations.

Likewise, improvements in, for example, immigration procedures to bring more foreign professionals to Japan have largely centered on speeding up bureaucracy procedures or shortening timelines rather than changing laws. The same can be said about business registration via the One-Stop Business Establishment Center in Tokyo.

The current implementation of the Special Zones suggests that the government deems keeping current standard requirements and helping new businesses navigate them to be enough. That is a less radical approach than the slogans in the policy papers, and begs the question of whether it is enough to lure those not already involved with Japan.

Notes

1 "Japan Revitalization Strategy 2016." Japanese government policy paper. Accessed January 8, 2016. www.kantei.go.jp/jp/singi/keizaisaisei/pdf/2016_zentaihombun_en.pdf
2 The "law on National Strategic Special Zones" was finally enacted on December 7, 2013. "Tax Incentives for National Strategic Special Zones." PwC Japan. December 2014. Accessed January 8, 2017. www.pwc.com/jp/en/taxnews/pdf/jtu105-dec-2014-e.pdf.
3 "Abenomics" is Progressing! The Latest Progress and Achievements of the Abe Administration." Prime Minister of Japan and His Cabinet. April 2014. Accessed January 8, 2017. http://japan.kantei.go.jp/ongoingtopics/pdf/2014/140422_abenomics_rev.pdf.

4 Sendai City in Miyagi Prefecture is introducing a program for regional children's nurses and speeding up procedures for opening daycare facilities, including those operated by incorporated NPOs, as a means of facilitating women's active role in society and encouraging social business creation. http://japan.kantei.go.jp/97_abe/actions/201503/article6.html

5 "The Prime Minister in Action: Council on National Strategic Special Zones." Prime Minister of Japan and His Cabinet. March 19, 2015. Accessed January 8, 2017. http://japan.kantei.go.jp/97_abe/actions/201503/article6.html.

6 "National Strategic Special Zones ① : Latest situation on organization of zone conferences and approval of zone plans." Prime Minister of Japan and His Cabinet. December 12, 2016. Accessed January 8, 2017. www.kantei.go.jp/jp/singi/tiiki/kokusentoc/pdf/jigyou_all_e.pdf.

7 "Japan Revitalization Strategy Short- to Mid-term Progress Schedule." Prime Minister of Japan and His Cabinet. 2012. Accessed January 8, 2017. www.kantei.go.jp/jp/singi/keizaisaisei/pdf/koutei_en.pdf.

8 The goal is to be among the top three OECD nations; the index looks at the ease of starting a business, dealing with permits, utilities, property registration, lending, taxation, and other issues.

9 Japan's fall in rank is due to lower rankings in certain categories, including "starting a business" and "Getting credit." The full report can be read at this link: www.doingbusiness.org/~/media/wbg/doingbusiness/documents/profiles/country/jpn.pdf

10 "World's First iPS Cells Medical Center To Open in Kobe, Part of National Strategic Special Zone." The Daily Engineering and Construction News. October 14, 2014. Accessed January 8, 2017. www.decn.co.jp/?p=18659.

9 TPP

Despite the threat[1] of then-President-elect Donald Trump to withdraw from the Trans-Pacific Partnership (TPP) on his first day in office, the upper house of Japan's parliament ratified TPP on December 9, 2016, with the full knowledge that by its terms it cannot come into effect unless the United States ratifies the accord as well. Certainly, Prime Minister Shinzo Abe was sending a message to the United States about the importance of trade and investment in Asia, but there is an important connection to the domestic agenda as well.

In order to implement the treaty, a number of Japanese laws had to be enacted or amended. While the following legislative actions (with the single exception of a provision on product branding relating to certain geographical locations) were conditioned on the TPP coming into effect, the policy struggles with domestic vested interests have been largely won by the Abe administration:[2]

- Act on Temporary Measures concerning Customs
- Copyright Act
- Patent Act
- Trademark Act (the latter three acts are also grouped under the title "Intellectual Property")
- Law for Ensuring the Quality, Efficacy, and Safety of Drugs and Medical Devices
- Act on Prohibition of Private Monopolization and Securing of Fair Trade
- Act Concerning the Stabilization of Price of Livestock Products
- Act on Price Adjustment of Sugar and Starch
- Act on the Agriculture and Livestock Industries Corporation, Independent Administrative Agency

- Act on Protection of the Names of Specific Agricultural, Forestry and Fishery Products and Foodstuffs
- Act on the Provision of Information pertaining to declared original goods based on the Agreement between Japan and Australia on Economic Cooperation[3]

As of December 2016, the ultimate fate of TPP was still undecided by the remaining signatories, and the Trump administration had indicated that it would pursue a bilateral treaty with Japan. Nevertheless, the TPP's impact on the reform movement in Japan is undeniable and will likely form the backdrop to any future negotiations with the United States

The TPP was only one of several free-trade agreements the Abe administration has sought to conclude, though undoubtedly it was the flagship. Alongside the TPP, Japan has several bilateral deals in the works, including the Regional Comprehensive Economic Partnership (RCEP)—a proposed free trade deal that primarily involves the same members as the TPP, minus the United States, Mexico, and Canada, and with the addition of China, India, and South Korea. While RCEP and the TPP could be thought of as complementary, they also overlap on many issues.

To understand the strength of Japan's commitment to the TPP, it helps to consider the context in which the government pushed through this accord.

Context

It takes a lot to get the Japanese out demonstrating in the streets. So, when several thousand farmers, doctors, and even some lawmakers held public demonstrations in 2010 and 2011 against government plans for Japan to join the TPP, it was clear it was never going to be an easy sell.

Until the anti-nuclear rallies after the 3/11 Fukushima disaster, few issues caused as much passion and divided opinion in Japanese society as the potential for the country to join the TPP. This union, which proposed to dismantle trade tariffs between 12 nations bordering the Pacific Ocean, was touted by promoters (such as Japan's biggest business lobby, Keidanren) as the most important deal for the participating economies since the forming of the World Trade Organization. Critics, of which in Japan the farmers were the loudest, said it threatened to wipe out local industries.

While Abe and the Liberal Democratic Party (LDP) swept to an overwhelming election victory in late 2012, realizing the TPP membership still looked like a struggle. Even as Abe reiterated his commitment for Japan to enter talks with the other TPP member nations, he faced a barrage of dissent at home. Just a year earlier, more than 70 percent of local government assemblies issued statements either cautioning against or outright denouncing TPP.[4]

JA-Zenchu (the Central Union of Japanese Agricultural Cooperatives) was organizing street demonstrations against the TPP on a regular basis. Even some elements of Abe's own party were undermining his efforts. More than 200 of the LDP's 376 Diet members from both chambers (including Cabinet ministers) staged an anti-TPP meeting.[5]

It is no wonder that *The Economist* asserted in early 2013, as Abe prepared to meet with then-US President Barack Obama, that there was little hope that Japan would board the

TPP train.[6] After all, the skewed nature of Japan's voting districts, which favor rural votes, meant that the LDP was reliant on the farming lobby for electoral support.

Yet, for all the passion surrounding the trade pact, Abe made it clear that the TPP was never a goal in and of itself. The accord was a rallying point for broader structural reform in sectors that have traditionally relied on government protection to keep oversees competition at bay, areas such as agriculture and healthcare. What the government wanted was a change of mindset, to motivate such sectors to think about exports, to consider FDI opportunities, and to engage in the global marketplace as opposed to shrinking from it.

Abe also made it clear that the TPP was just one of the global trade pacts he was interested in. Besides the TPP, the government was also in talks over the above-mentioned RCEP, and direct free-trade deals with China, South Korea, and the European Union.[7] The other initiatives did not register in the public psyche or win nearly as much media coverage, yet they all followed a similar principle of making Japanese industry more globally minded and risk-tolerant.

"Emerging countries in Asia are shifting to an open economy one after another. If Japan alone remains an inward-looking economy, there would be no chance for growth," Abe said in a 2013 press briefing, according to the BBC. "This is our last chance. If we miss this opportunity, Japan will be left behind."[8]

Further, Japan's enthusiasm for the TPP did not originate with Abe. It was a direction supported by previous Japanese governments, including the now opposition Democratic Party of Japan, whose reign preceded Abe's. As Risaburo Nezu, a former trade negotiator for Japan's government and then executive fellow at the Fujitsu Research Institute told Bloomberg in 2012: "Any Japanese prime minister today will be thinking: 'I want in.'"[9]

Third Arrow Concept

The reasons to join the TPP, and indeed other free-trade deals, were varied. This was how the goal was outlined in Japan's policy statements such as the 2014 Strategy:

> *In order to strengthen the competitiveness of Japan as a business hub to promote investment in Japan, we must further reinforce macroeconomic and institutional approaches for improving the business environment through: breaking through the so-called "bed-rock" regulations accelerating the Trans-Pacific Partnership (TPP) and other economic partnership negotiations to remove obstacles to the cross-border movement of goods, services, and investment; reforming energy policy fundamentally to prevent energy costs, including electricity rates, from rising; carrying out a pro-growth corporate tax reform; and so on.*[10]

In real terms, joining the TPP was supposed to eliminate or significantly reduce many agricultural product tariffs and open Japan's farming to competition from cheaper Asian labor, as well as large-scale agriculture in the United States, Australia, and New Zealand. The United States pushed for Japan to open up its automotive industry to greater competition in return for allowing Japanese companies to manufacture US-bound cars with parts bought elsewhere in Asia.[11] In proposing a single trade arena similar to the European Union, the TPP deal laid bare competition between labor in different markets.

Since the final list of agreements on trade tariffs ran to cuts on 18,000 items (the Japanese checklist alone is a 1,133-page PDF), it is safe to say that this was a wide-ranging, detailed document. The idea was to link these changes to reform in labor practices, taxes, healthcare, agriculture, and corporate governance among others. Perhaps surprisingly, the TPP would be Japan's first-free trade accord with countries such as the United States, Canada, and New Zealand.

Underscoring the importance of the TPP as a catalyst for broader structural reforms in Japan, Abe appointed one of his closest allies, then Minister of Economy, Trade and Industry Akira Amari,[12] to oversee the TPP negotiations.

The negotiation process from July 2013, when Japan officially joined the talks,[13] until the accord's signing[14] on February 4, 2016, can be best summarized as rocky. The secrecy of the talks made them a target for environmental and labor NGOs, and added to political opposition in most of the 12 member states.

In Japan, Abe's team had to appease the farming lobby by promising to retain protection on five product areas: rice, beef, and pork; wheat; sugar; and dairy. Yet, in the course of the talks, Japan agreed to raise its quotas for rice imports, as well as to reduce, and in some cases phase out, tariffs on beef and pork. In the end, tariffs on more than half of agricultural products would have been removed under the TPP, a figure that was expected to rise to over four-fifths in time.[15] [16]

Spurring Change

Japanese politicians have often used "international commitments" as a lever to achieve domestic aims. Given the political capital that was spent by the Abe administration on successfully negotiating the TPP and its ratification, it might be argued that the current standstill regarding the treaty will weaken Abe's hand. However, this is unlikely to be the case. As noted above, the deal was pushed through parliament regardless of Trump's win in US elections, and the domestic policy debate is already won.

The biggest KPI linked to the TPP is ongoing reform in agriculture (discussed above), which has always been a "third rail" in Japanese politics. So far, that sector has seen a jump in the value of farming exports to a record for two years running (see details in the link found in endnote 17). Fundamental change in the administrative bureaucracy of farming in Japan is already underway and shows no sign of slowing.[18]

The drawbacks in these reforms are that, in order to push them through on behalf of TPP negotiations, the government made concessions to farmers on some farming subsidies. The scale of these subsidies was already "eye-watering," and yet the TPP motivated farmers, the political opposition, and even members of the ruling coalition to demand more cash. Should those concessions remain in a non-TPP landscape, the motivation for the sector to restructure on a more market-based footing may be undermined, according to a September 2016 report by Public Affairs Asia.[19]

Finally, the government promoted the TPP as a way to help bolster the nation's SMEs. In the 2016 Strategy, the trade accord was described as a "huge opportunity for local companies to do business outside Japan."[20] The details on this have so far been vague. The Strategy paper promised to bring in "experts acquainted with overseas business to provide comprehensive support in developing their business strategies, helping their access to local human resources, and cultivating their sales channels."[21] This may be a reference to the new role for the Japan Bank for International Cooperation (discussed in the chapter on Banking and Finance), which has been tasked with supporting SME activity abroad.

The biggest benefit the TPP process offered in terms of opportunities for business in Japan was a clear pledge by the government to integrate the economy with a broader Asia-Pacific marketplace. While the TPP itself may not emerge in the form originally envisaged, talks on other free-trade deals such as the RCEP continue and, as of the end 2016, are expected to pick up pace.

According to Japan External Trade Organization (JETRO), the government's export support agency, these free trade deals should lower the cost of investing in Japan and offer additional export channels to businesses ready to navigate the new economic landscape.

The idea of making Japan more attractive as a regional and global business hub, and pushing local firms to think outside of their domestic markets, has not changed despite the TPP stalemate.

Business View and Opportunities

In a private conversation in October 2016, a senior researcher of one of Japan's top trading conglomerates confided that he was far from convinced that the TPP would become a reality. Rather than prescience considering the outcome of US elections, the researcher was simply stating the position of his company: Consider all possibilities but do not bet the farm on any one.

For sure, the benefits of the TPP on his firm's business would have been notable. The opportunities in the export of Japanese auto components, textiles, machinery and ceramics to the United States would have markedly increased. JETRO estimated in one October 2016 presentation at a Tokyo seminar that the US market for textiles from TPP nations alone could be worth as much as US $115 billion.

And yet, the TPP was never seen by Japan Inc. as a silver bullet, the trading house researcher concluded. It was not expected, by itself, to unleash a major overhaul among top Japanese corporates, he said. Probably, the impact would have been greater for smaller firms seeing an opening among the raft of tariff changes, he said.

What Japanese firms seek most of all in developing markets in Asia are clearer rules on entry to the real estate, telecommunications, and retail sectors, among others, potentially opening up opportunities for Japanese firms. The TPP framework could have pushed for this. It may still come about via other trade deals such as RCEP, the researcher said. A slowdown in the Chinese economy makes that country more amenable to regional trade deals and more interested in the RCEP deal, he added.

Most importantly, what the TPP and other trade deals pursed under the Third Arrow banner did was give a signal to Japan Inc. that it needs to think more globally, and that call has been heeded, the researcher said. There is a notable growth in business confidence among Japanese corporates and more plans for international ventures than, say, five years earlier, he said.

Notes

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10 Women in Business

Japan is often said to be far behind many other countries in terms of the leadership roles women play. A closer look, however, reveals that Japan is recognizing the problem and making efforts to promote more women into high-profile government and corporate roles. The Abe administration is focused on promoting more participation by women in the workforce, requiring companies with 300 or more employees to report their plans in relation to managerial and executive positions.[1] ("The Act on Promotion of Women's Participation and Advancement in the Workplace," passed on August 28, 2015.)[2]

Kathy Matsui, who coined the term "Womenomics" with her first report on the topic in 1999, said the law would pressure companies by embarrassing those that do not participate.[3]

"We believe some firms will be relatively proactive in their gender disclosures and ambitious with their targets for females in senior management, while other firms within the same industry will likely feel sufficient peer pressure to follow suit," she said in a report released after the law was passed, according to *The Wall Street Journal*.[4]

Kumiko Hayashi, an opposition lawmaker with the Democratic Party of Japan, however, said the vast majority of Japanese companies are too small to be subject to the law's requirements, though the law encourages them to act on their own. These companies might have trouble formulating a plan to set and meet targets without help, she told *The Wall Street Journal*.

According to advocacy group Catalyst, women held 3.1 percent of board seats at leading Japanese companies, compared with 19.2 percent in the United States and 20.8 percent in Canada. This is the lowest ratio among the countries surveyed.

Third Arrow Concept and Reform Outline

The initial focus of the Third Arrow concerning women in business was on childcare waitlists, the first-grade barrier, and bringing the number of women in executive positions to 30 percent. While these areas have shown improvement, and the government has reported it has created jobs for an extra 1.2 million women since Prime Minister Abe came to power, they do not solve the main issue: Japanese women still feel they are confronted by a stark choice between career and family.

In 1999, Japan's female labor participation rate of 57 percent was among the lowest in the developed world. Japan stood out from its developed country peers with more than 60 percent of Japanese women not returning to work after giving birth to their first child. Typically, those women stayed out of the workforce until their children were grown. The prevailing view was that low female employment was simply a fact of Japanese life, and for a variety of reasons—most of them cultural—the system would be impossible to change.[5]

When Abe first adopted Womenomics—the idea of getting more women into working roles to boost the economy—as a core pillar of the nation's growth strategy in early 2013, many were deeply skeptical that top-down political pressure would lead to meaningful change. Remarkably, however, in less than three years, Japanese female labor participation has risen to a record high of 66 percent, surpassing that of the United States (64 percent).

Having said that, part of the recent spike in female employment is the result of acute labor shortages. Japan's unemployment rate has fallen to a historical low of 3.3 percent, and the job openings-to-applicants ratio stands at a 23-year high of 1.28X, meaning there are 28 percent more jobs available than Japanese who are seeking work.[6]

The situation is particularly harsh in service industries such as healthcare, construction, retail, and transportation. While the government is permitting more foreigners to work in some of these areas, supply remains scarce and employers have been forced to tap into the female talent pool. At the same time, in order to cope with a prolonged period of deflation, companies shrank their cost bases by shifting employees from full-time to part-time contracts. As a result, part-timers now account for more than 40 percent of total workers, with women accounting for about 57 percent of all temporary staff.[7]

Another factor driving higher female employment has been increased childcare capacity and childcare benefits. In 2013, the government set a target of expanding daycare capacity by 2019 to give places to the 400,000 children on waiting lists nationwide. During fiscal year 2013, 219,000 places at daycare were created—roughly halfway toward the goal—and, according to the updated plan, the 2019 goal has been raised to 500,000.[8]

While still playing catch up, the government will likely target increased daycare services in its upcoming fiscal spending package. In addition, the government augmented the ratio of replacement pay during parental leave from 50 percent to 67 percent for the first six months and extended entitlement to non-regular workers. Benefits for Japanese childcare leave now rank among the most generous in the developed world.[9]

When it comes to equal treatment for women in the workplace, there are calls that performance reports should be made mandatory, and that companies should appoint a head of human resources to take feedback about bosses and colleagues, and continue to give bonuses for promoting women to executive ranks.

There are also voices that say sexual harassment training should be mandatory. One idea is to have a dedicated human resources person in charge of sexual harassment issues. Recent media reports of "maternity harassment" (in which employers bully, demote, or fire pregnant employees) have increased dramatically, because people are newly aware of its illegality, *The Economist* reported.[10] A similar increase in public awareness of sexual harassment in the workplace should ultimately be beneficial to improving the corporate environment for female employees.

Analysis

The Abe administration has recognized that part of the government policy has to encompass encouraging men to be more active in raising their children and assisting with housework, a trend that has even extended into mainstream TV dramas dealing with these issues.

Due to the unequal treatment of part-time versus full-time employees, another focus area may be on allowing companies and employees to conclude labor contracts that encourage women to return to the workforce as regular employees and retain pay and promotion opportunities.

Other opportunities for change could come through creating tax breaks for corporations to encourage them to hire and promote more women, and the same for individuals to reduce financial burdens on families including single mothers. In order to achieve the stated goals of the Third Arrow, the current system of spousal tax and social security deductions needs to be amended in order to further encourage married women to work full-time outside the home.

Bringing senior citizens in as before- and afterschool childcare providers to support working mothers, thus tapping into Japan's growing ranks of retirees to staff childcare centers, could be another solution. A prominent female financier supports the idea of leveraging retirees and stay-at-home parents to provide childcare and afterschool care within local communities, as well as liberalizing immigration rules to make it easier to hire foreign domestic workers and caregivers.[11]

Progress has been made in this area over the past few years, such as the change in the law to allow non-Japanese to work as domestic help in some designated areas, but more could be done.

ACCJ Growth Strategy Task Force Vice-Chair Kumi Sato said: "By opening the Japanese market to foreign domestic workers, the GOJ is taking a welcome step toward labor reform that will ultimately contribute to a healthier and more vibrant economy by supporting women to continue their careers after having children. In the context of population decline, expanded availability of domestic workers means that families have additional childcare resources and access to support for some of the domestic burdens that can prevent full engagement in the workforce."

On the corporate front, Japan ranks second in the OECD for the longest number of hours worked annually. Much of this is caused by traditional seniority-based evaluation systems. What might help women in the workplace is if employers were to adopt objective and performance-based evaluation plans and promote more flexible work arrangements—including job-sharing and telecommuting.

More broadly, society needs to eliminate unconscious biases about gender diversity at work, schools, and homes, some argue. Common myths about Womenomics, such as those that suggest that higher female labor participation, will further depress Japan's birthrate when empirical evidence proves the opposite is true need to be overturned, she wrote in *The Japan Times*. It is also critical to engage male leaders through initiatives such as "male champions of change" and similar actions.

Japan's single-most valuable resource is its people but, with its demographic clock rapidly ticking, more aggressive steps must be taken to promote gender diversity so that everyone has the chance to maximize their potential. One could argue that diversity is no longer an option but an economic imperative that will benefit all. In a report last year, Goldman Sachs estimated that closing the gender employment gap in Japan could lift the country's gross domestic product by nearly 13 percent.[12]

The data that companies provide about women's employment and working conditions under the Act on Promotion of Women's Participation and Advancement in the Workplace—particularly attrition rates and working hours—will help female graduates decide where to work, Yoshie Komuro, CEO of Work Life Balance Co. told *The Wall Street Journal*. Those applicants "will now be able to see the attrition rate after 10 or 20 years, and choose from a long-term perspective," she said.[13]

Notes

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Appendix 1
List of laws related to the Third Arrow (as of December 2016)

1. Measures to stimulate productivity

1.1 Labor Reforms
- Act for Partial Revision of the Act on Improvement of Employment Management of Short-Time Workers (www.mh1w.go.jp/file/04-Houdouhappyou-11904000-Koyoukintoujidoukateikyoku-Tanjikanzaitakuroudouka/0000044195.pdf)
- Act on Special Measures against Employment Workers with Specialized Knowledge (www.mhlw.go.jp/file/04-Houdouhappyou-11201250-RoudoukijunkyokuRoudoujoukenseisakuka/0000066768.pdf)[1]
- Regulation of prolonged working hours and the introduction of measures concerning equal pay for equal work are under consideration by the Council for the Realization of Work Style Reform (Tasked with compiling a concrete action plan by March 2017. Presentation of a draft bill in the next ordinary Diet session at the earliest)

1.2 Women in Business
- Act for Partial Revision of the Act for the Promotion of Measures to Support Wholesome Development of the Next Generation, Who Will Carry the Society of the Future (www.mhlw.go.jp/file/04-Houdouhappyou-11903000-Koyoukintoujidoukateikyoku-Shokugyoukateiryouritsuka/0000044108.pdf)
- Act for Partial Revision of the Employment Insurance Act (www.mh1w.go.jp/topics/bukyoku/soumu/houritu/186.html)
- The law for accelerating women’s promotion (e.g. Make drawing up an action plan about women’s promotion mandatory to the nation, local public bodies, and large corporations) (executed in Apr. 2016)
- Increase of the Japan’s women’s labor force participation rate (surpassed that of the US in 2014. Japan: 75.2 percent, US: 73.7 percent (2015, age range: 25–64). Source: OECD)

1.3 Participation by Foreign Workers
- Act for Partial Revision of the Immigration Control and Refugee Recognition Act (http://okigyo.or.jp/information/data/1.「改正入管法に関する研修会」(H27.3.24)レジュメ.pdf)[2]
- At the Council for the Realization of Work Style Reform, issues of foreign workers are scheduled to be discussed (Expand job categories, like nursing and agriculture, by revising the current Technical Intern Training Program in the former extraordinary Diet session)

1.4 Agricultural Reforms
- Act concerning Healthy Development of Agriculture, Forestry and Fishery and Promotion of Harmonious Renewable Energy Electricity Generation. (www.maff.go.jp/j/shokusan/renewable/energy/houritu.html)
- Act on Promotion of Intermediate Management Project of Agricultural Land (www.sangiin.go.jp/japanese/joho1/kousei/gian/185/pdf/1031850141850.pdf)[3]
- Act for Partial Revision of the Act on Promotion of Strengthening of Agricultural Management Base to Promote Structural Reform of Agriculture (www.sangiin.go.jp/japanese/joho1/kousei/gian/185/pdf/t031850151850.pdf)[4]
- Act for Partial Revision of the Act on Delivery of Grants for Stable Management to Agricultural Bearers (www.sangiin.go.jp/japanese/joho1/kousei/gian/186/meisai/m18603186049.html)[5]
- Act on Promotion of Diversified Features of Agriculture (www.maff.go.jp/j/nousin/tiiki/chusankan/tamen_hou.html)
- Act on Protection of the Names of Specific Agricultural, Forestry and Fishery Products
- The fundamental agricultural program controlling the price of rice for more than 40 years will be eliminated in 2018.

1.5 Revitalization of Local Areas
- The Act for Creating Town, People and Jobs (www.kantei.go.jp/jp/singi/sousei/pdf/20141227sirvou5.pdf)[6]
- ”The law of regional future investment” (tentative name) (Capital investment tax reduction, risk money, deregulation, etc.) is under consideration, aiming to submit in the next ordinary Diet.

Appendix 1
List of laws related to the Third Arrow (as of December 2016)

2. Measures to encourage investment activity

2.1 Finance Reform
- Act for Partial Revision of the Financial Instruments and Exchange Act (www.fsa.go.jp/common/diet/186/01/setsumei.pdf)
- Expand the use of NISA
- Increasing the upper limit of annual investment in NISA (1 million yen to 1.2 million yen), establishment of reserve NISA

2.2 Innovation
- Act for Partial Revision of the National Independent Administrative Institution Science Promotion Organization Act (www.mext.go.jp/b_menu/houan/kakutei/detail/1344341.htm)
- Strengthening of the tax system for research and development (also usable in the service industry, tax reform for FY2017)

2.3 Entrepreneurship
- Basic Act for Promoting Small Enterprises (www.meti.go.jp/press/2014/10/20141003003/20141003003b.pdf)
- The Act for Partial Revision of the Act on Supporting Small Business by Commerce and Industry Association and Chamber of Commerce and Industry (www.chusho.meti.go.jp/keiei/shokibo/2014/140627shokibo.html)[7]
- Creation of global venture ecosystem
  *Strengthen the "Silicon Valley-Japan Bridge Project" and expand the program to other areas (e.g. Asia, Israel, Europe, etc.)

2.4 Special Zones
- National Strategic Special Zones Act (www.kantei.go.jp/jp/singi/tiiki/kokusentoc/dai4/sankou_kihon.pdf)
- Act for Partial Revision of the Regional Revitalization Act (www.sangiin.go.jp/japanese/johol/kousei/gian/187/meisai/ml8703187002.html)[8]
- National Strategic Special Zones (10 zones in Japan)
- Medical innovation (in Kyoto)
- Supporting venture enterprise (in Fukuoka)

2.5 PPP/PFI
- Amendment of the Law of PFI (Water supply: fully including concession in 2018)
  * Airport: Privatization of Kansai, Itami, and Sendai airport in 2016.

2.6 FDI
- Introduce from FY2017 a Green card system for highly skilled foreign professionals—the minimum stay required to receive permanent residency will become the shortest in the world.

2.7 TPP
- Ratification and legislation of TPP agreement & related bill in the former extraordinary Diet session.
- TPP-related Act
  - Act on Temporary Measures Concerning Customs
  - Copyright Act
  - Patent Act
  - Trademark Act
  - Law for Ensuring the Quality, Efficacy and Safety of Drugs and Medical Devices
  - Act on Prohibition of Private Monopolization and Securing of Fair Trade
  - Act Concerning the Stabilization of Price of Livestock Products
  - Act on the Agriculture and Livestock Industries Corporation, Independent Administrative Agency
  - Act on Protection of the Name of Specific Agricultural Forestry and Fishery Products and Foodstuffs
  - Act on the Provision of Information Pertaining to Declared Original Goods Based on the Agreement between Japan and Australia on Economic Cooperation

Appendix 1
List of laws related to the Third Arrow (as of December 2016)

3. Measures to improve social infrastructure

3.1 Governance and Legal Reform
- Industrial Competitive Enhancement Act
  (www.meti.go.jp/policy/jigyou_saisei/kyousouryoku_kyouka/pdf/Kommentar.pdf)
- Act for Partial Revision of the Trade Insurance Act
  (www.sangiin.go.jp/japanese/johol/kousei/gian/186/meisai/m18603186017.htm)[9]
- Act for Supporting Overseas Transportation and Urban Development Projects
  (http://law.e-gov.go.jplhtmldata/H26/H26H0024.html)[10]
- Act for Partial Revision of the Radio Act
  (www.soumu.go.jp/main content/000286304.pdf)
- Act for Partial Revision of the Act on Activation of Central Urban Area
  (www.sangiin.go.jp/japanese/johol/kousei/gian/186/meisai/m18603186026.html)[11]
- Act for Partial Revision of the Cabinet Office Establishment Act
  (www8.eao.go.jp/cstp/stsonota!settihou/1hougaiyo140519.pdf)[12]
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- Act for Partial Revision of the Act on Special Measures Concerning Urban Regeneration
  (www.mlit.go.jp/report/press/toshi07_hh_000082.html)
- Act for Partial Revision of the Independent Administrative Agency General Rule Act
  (www.sangiin.go.jp/japanese/joho1/kousei/gian/186/meisai/m1860318607.html)[14]
- Act for Partial Revision of the Companies Act
  (www.moj.go.jp/MINJI/minji07_00151.html)
- Act for Partial Revision of the Act on Temporary Measures Concerning Customs
  (www.mof.go.jp/about_mof/bills/187diet/kz20141007g.pdf)
- Act on the Provision of Information Pertaining to Declared Original Goods Based on the Agreement between Japan and Australia on Economic Cooperation
  (http://law.e-gov.go.jp/htmldata/H26/H26HO112.html)
- Requiring companies to install outside directors (the Tokyo Stock Exchange's rules/comply or explain rule)
  *Companies with one or more outside directors: 96 percent
  *Companies with two or more outside directors: 77.9 percent
  *Companies listed on the First Section of the Tokyo Stock Exchange (in June 2016)

3.2 Healthcare
- Act for Partial Revision of the Pharmaceutical Affairs Act
  (www.mhlw.go.jp/stf/seisakunitsuite/bunya/0000045726.html)
- Act on Securement of Safety of Regenerative Medicine, etc.
  (www.mh1w.go.jp/stf/seisakunitsuite/bunyalkenkou_iryou/iryou/saisei_iryou/)[15]
- Act for Partial Revision of the Pharmaceutical Affairs Act and Pharmacists Act
  (www.mhlw.go.jp/bunya/iyakuhin/ippanyou/pdf/140314-1.pdf)
- Health and Medical Strategic Promotion Act
  (www.kantei.go.jp/jp/singi/kenkouirvou/suisinlkaisai.html)[16]
- Japan Incorporated Administrative Agency Japan Medical Research and Development Organization Act
- Act on Concerning Improvement of Relevant Acts for Promoting Comprehensive Measures for Securing Regional Medical and Nursing Care
  (www.mhlw.go.jp/topics/bukyoku/soumu/houritu/186.html)
- Faster authorization of regenerative medicine
- The assessment lag of the Pharmaceuticals: a month (FY2011) > 0 (FY2014)
- The assessment lag of medical devices: two months (FY2011) > 0 (FY2014)

3.3 Energy
- Act on the Partial Revision of the Electricity Business Act
  (www.meti.go.jp/press/2014/03/201503 03001120150303001.html)[17]
- Act on the Partial Revision of Electricity Business Act
  (www.enecho.meti.go.jp/category/electricity_and_gas/electric/system_reform004/pdf/20140611_03.pdf)
- Electric Power Sector Reform (1st and 2nd stages are already done. 3rd stage—the separation of generation, transmission and retail sector—will be done by Apr. 1, 2020)
  *Establishment of nation-wide grid system (amendment of the Power Generation Business Law (1) (Apr. 2015)
- Full deregulation of the retail market amendment of the Power Generation Business Law (2) (Apr. 2016)

3.4 Education

- Act on the Partial Revision of the School Education Act and National University Governance Act (www.mext.go.jp/b_menu/shingi/chousa/koutou/059/gijiroku/_icsFiles/afieldfile/2014/07/2811350318_5.pdf)[17]
- National University Governance Reforms (Separation of management and education)
  *Formulation of national university reform plan (Nov. 2013)
  Formulation of the "Business plan of national universities" (Jun. 2015)
- The law of certain national research-related agencies (giving global rewards to excellent human resources domestically and internationally by the National Institute of Advanced Industrial Science and Technology,
- Institute of Physical and Chemical Research, and National Institute for Materials Science, assigned in Oct. 2010) Amendment of national university corporation (making the site for National university lendable to an outsider, effective from Apr. 2017)

3.5 Social Security

- My Number System (personal number system in Japan) (From Jan., 2016)
- Introducing ID in the field of medical services
  **Report by the Study Group concerning Utilization of the ID Number System in Fields of Medical Services, etc*. was summarized on Dec. 10, 2015)

3.6 Transportation and Tourism

- Act for Partial Revision of the Ports and Harbors Act (www.mlit.go.jp/kowan/kowan_tk2_000003.html)
- Act for Partial Revision of Act on the Regional Public Traffic Activation and Rehabilitation (www.mlit.go.jp/sogoseisaku/transport/sosei_transport_tk_000055.html)
- Act for Partial Revision of the Road Act etc. (www.mlit.go.jp/report/press/road01_hh_000426.html)
- The Linear Chuo Shinkansen (scheduled to start its operation by 2037—brought forward by eight years due to economic measures—and will run between Tokyo and Osaka within 67 minutes)
- Relaxation of visa requirements (foreign visitors to Japan exceeded 20 million in 2016. Aim to exceed 40 million by 2020)

3.7 Taxation

- Act for Partial Revision of the Local Tax Act, etc. (www.soumu.go.jp/main_content/000283837.pdf)
- Act for Partial Revision of the Income Tax Act etc. (www.nta.go.jp/shiraberu/ippanjoho/pamph/shotoku/h26kaisei.pdf)
- Corporate tax cuts to date: 7.03 percent in 3 years—29.97 percent in FY2016, 29.74 percent in (FY2018) (Postponed consumption tax increase to 10 percent until Oct. 2019)

Notes

1 The link is best accessed through the home page of the ministry (www.mhlw.go.jp)
2 Best accessed through the parliamentary home page (www.sangiin.go.jp)
3 Ibid.
4 Ibid.
5 Best accessed through the Cabinet's home page (www.kantei.go.jp/index.html)
6 Best accessed through the agency's home page (www.chusho.meti.go.jp)
7 Best accessed through the home page
8 Ibid.
9 Can be accessed by searching on (http://law.e-gov.go.jp/cgi-bin/idxsearch.cgi)
10 Best accessed via the parliament's home page
11 Ibid.
12 Ibid.
13 Ibid.
14 The link is best accessed through the home page of the ministry (www.mhlw.go.jp)
15 Best accessed through the Cabinet's home page
16 Best accessed through the ministry's home page (www.meti.go.jp)
17 Best accessed through the ministry's home page (www.mext.go.jp)

Task Force Members

Richard Dyck has spent his career in the semiconductor industry, mostly in Japan. He is the owner and president of TGK-Japan, a company that specializes in semiconductor testing. From 1982 to 1999, Mr. Dyck was vice president of Teradyne, a Boston-based manufacturer of semiconductor capital equipment, where he was responsible for Asia operations. He left Teradyne when he led a management buy-out of the company's Asia-based high-speed connection system business. Dyck is a director and investor in Japan Industrial Partners, a Japan-based private equity firm that specializes in carve-outs of businesses from major Japanese corporations. He serves on the board of Hitachi Chemical and the Semiconductor Portal, a company jointly owned by Dyck and Japan's main semiconductor equipment, materials and device manufacturers. He has served on the boards of the Japan External Trade Organization (JETRO), the Tokyo Philharmonic, Nishimachi International School, the Sasagawa Peace Foundation, the Japan–US Friendship Commission, and various industrial trade organizations and government advisory committees. In 1999, he was cited by the Japanese Prime Minister for his contribution to Japan's international trade. He supports several projects in Cambodia, including schools, orphanages, and regional hospitals. Mr. Dyck received his PhD and Master of Arts, from Harvard University.

Barry Hirschfeld, Jr. co-founded AIP-Japan in 1998 and currently serves as its president and CEO. Mr. Hirschfeld has worked and lived in Japan over the past 20 years and brings with him more than 15 years of experience in the Japanese real estate private equity market, including leading the firm's initial healthcare-related investments since 2001. Since then, AIP has come to be viewed as a pioneer and leading company in the Japanese healthcare real estate investment space. AIP has been involved with advising the Japanese government on the creation of the first healthcare real estate investment trust in Japan.

Previously, Mr. Hirschfeld was a Panasonic associate at Matsushita Electric Industrial Co, Ltd. based in Osaka, Japan from 1993 to 1996. Mr. Hirschfeld is also active in the community. Hirschfeld has worked closely over the past decade with Denver mayors to promote the establishment of a non-stop flight between Denver and Japan, and served as the Japan chair of Denver International Airport's Ascent to Asia Committee. Furthermore, Mr. Hirschfeld is one of the founding members of the Colorado Governor's Tourism and Trade Ambassador Program (TTAP) and currently serves as the Japan Group chair. He was appointed by Governor Hickenlooper to be a member of the board of the Colorado State Department of Education's Study Colorado. Hirschfeld is also a member of the National Association of Japan America Societies, the ULI Japan Executive Committee, and the University of Denver Bridge Project.

Mr. Hirschfeld is fluent in Japanese and Spanish, and conducts business in both languages and cultures. Mr. Hirschfeld graduated with honors from Harvard College with a Bachelor of Arts in East Asian Studies in 1993, and the Harvard Graduate School of Business with a Master's degree in Business Administration (MBA) in 1998. He is also a member of the ACCJ Board of Governors.

Seiji Inada is the Head of External Communications, AVP, for MetLife Insurance K.K.

Prior to joining the private sector, Mr. Inada was a career diplomat working at the Ministry of Foreign Affairs of Japan, playing a key role in various trade negotiations and national security issues. He was posted to the Japanese Embassy in France and the Japanese Mission to the European Union in Belgium. In 2011, he was appointed as a deputy counsellor of the Cabinet Secretariat (Prime Minister's Office) in charge of national security and crisis management. After these services at the Japanese government, he joined PwC in 2013 as a manager providing policy and strategic advice to both the public and private sectors. He then joined MetLife in July 2014.

Mr. Inada holds an Master of Arts in Public Administration from the Catholic University of Leuven, Belgium and a Bachelor of Arts in Economics from Waseda University, Japan. In 2012, he was appointed as a working group member for the National Strategic Council of the Cabinet Secretariat.

Natsumi "Nat" Ishino currently works for Sumitomo Corporation Global Research as a senior analyst with a specialty in Sub-Saharan Africa and Western Europe. Prior to Sumitomo, she held managerial positions at Savills Japan and GR Japan. Nat has extensive educational and work experience in both Japan and England, where she has a Master's in Economic History and Economics with Reference to Africa from the London School of Economics and Political Science (LSE) and the School of Oriental and African Studies (SOAS), respectively. Nat speaks fluent Japanese and English.

Christopher J. LaFleur is senior director for Japan at McLarty Associates, an advisory firm—headquartered in Washington, D.C. and represented in 18 countries—that helps clients assess global challenges and opportunities and execute strategies to achieve their international objectives.

Ambassador LaFleur serves concurrently as Chairman of the Depository Trust and Clearing Corporation's Data Repository Japan, as a director of the Tsuneishi Holdings Corporation, and as president of LM Associates. He is a member of the board of directors of the Maureen and Mike Mansfield Foundation, the Japan Center for International Exchange, and the International Student Conference, and is an advisor to Ashoka, the pioneer in global social entrepreneurship.

During his prior US government career, Ambassador LaFleur became one of the US State Department's leading Japan experts, eventually serving as minister and deputy chief of mission at the US Embassy in Tokyo. He also dealt with a wide variety of issues elsewhere in the Asia–Pacific region as US ambassador to Malaysia, principal deputy assistant secretary of state for East Asian and Pacific Affairs, negotiator on the future of the US alliance with the Republic of Korea, deputy director of the American Institute in Taiwan, and director of the State Department's Office of Vietnam, Laos, and Cambodia. His diplomatic postings also included the US Embassy in Paris and the US Mission to the United Nations in New York.

Ambassador LaFleur, a New Yorker, studied at Oberlin College and Princeton University's Woodrow Wilson School. He is currently serving his second one-year term as president of the ACCJ.

Arthur M. Mitchell has over forty-two years of experience, much of it in Asia, and is one of the leading American lawyers specializing in investment and financing transactions around the world.

Prior to joining White & Case in September 2007, Mr. Mitchell was General Counsel of the Asian Development Bank (ADB). He became General Counsel of the ADB in 2003 and supervised all aspects of legal advice given with respect to documentation of public sector and private sector loan transactions, equity investments, political risk guarantees, and bond financings. Mr. Mitchell managed an office comprising 42 attorneys from 18 countries and was responsible for compliance with bank policies and procedures. He advised the president and the board of directors on corporate governance, institutional and administrative matters, and all litigation involving the bank.

Throughout his career, he has had considerable experience in: cross border M&A transactions, project financing of large infrastructure projects (including manufacturing plants and real estate), negotiating the formation of incorporated and unincorporated joint ventures, investments in and for private equity and other funds, structuring cutting-edge financial products, corporate governance initiatives, and investigations and disputes before government agencies

Mr. Mitchell is the author of numerous articles on legal developments in Asia and beyond. He is a member of the Council on Foreign Relations and serves as an independent director on the board of the Sumitomo Mitsui Financial Group, Inc. He is also a member of the ACCJ Board of Governors.

Tomonobu Noguchi is the executive director and secretary general at Silicone Industry Association. He previously held the position of global marketing director & public affairs director at Dow Corning Toray. Mr. Noguchi graduated from Waseda University's School of Political Science and Economics in 1982, and received an MBA from George Washington University in 1990.

Jay Ponazecki is the chairman of the ACCJ and served as ACCJ President in 2014 and 2015. Until December 2015, Ms. Ponazecki was a partner at Morrison & Foerster's Tokyo Office. Ms. Ponazecki represented multinational businesses in a wide array of industry sectors in a variety of cross-border legal transactions, including tender offers, privatizations, mergers and acquisitions, joint ventures, and strategic alliances. Ms. Ponazecki also represented financial sector firms and asset management companies, assisting them with their portfolio investments, regulatory compliance matters, commercial arrangements, and investor and operational issues. She also advised clients on the adoption of global corporate compliance, trade secret, privacy, and data protection policies, as well as inbound clients on how to best launch or expand their business operations in Japan and other key strategic issues associated with doing business in Japan. Ms. Ponazecki graduated from Columbia University (Barnard College) and NYU Law School, and was an exchange student to Japan. Over the past six years, she has helped lead more than 25 Hands On Tokyo volunteer groups to work in the Tohoku area in the aftermath of the Great East Japan Earthquake and Tsunami of 2011.

Yoshitaka Sugihara is an ACCJ governor, a chair of the Internet Economy Task Force and a vice chair of the Government Relations Committee. A graduate from Doshisha University with a Bachelor's in Law, he received a Master's degree from the University of Pennsylvania. After graduation, Mr. Sugihara started his career at the Liberal Democratic Party headquarters. During this time, he was awarded a research grant to study trade policy from the European Commission and received a Master's of Science from the London School of Economics. He served as premier secretary for the Nagano governor and was senior vice president of the Metropolitan Software Association and Metropolitan Computer Engineer Association.

Prior to his current position at Google Japan G.K., Mr. Sugihara served as government and corporate affairs manager at Intel K.K. Outside Google Japan G.K. and the ACCJ, Mr. Sugihara also contributes his time to various non-profit organizations. He has been serving as president of the Institute of Regional Information and Communication Development for the past six years.

Tsugu Watanabe's practice focuses on financing matters, with particular emphasis on project finance and infrastructure transactions; leveraged and asset-based lending financings, including aircraft financings; loan trading; and loan restructurings and refinancings, including in a bankruptcy context. Mr. Watanabe currently serves as the managing partner of Morgan Lewis's Tokyo Office.

Mr. Watanabe counsels clients in real estate, mergers and acquisitions, and general corporate matters, including employment issues involving Japanese affiliates of multinational companies. He also assists Japanese clients in international arbitration proceedings and US litigation, and he advises both Japanese and non-Japanese clients on cross-border transactions originating from inside and outside Japan. Over the past few years, Mr. Watanabe has been a team member in providing pro bono assistance for three successful applications for refugee status in Japan.

Project Director and Deputy Project Director

Peter Langan has worked as a journalist in Asia for 30 years, including a term at the *Nikkei* newspaper group, and 18 years at *Bloomberg News,* where he served as Tokyo Bureau Chief, global Managing Editor covering energy, and an editor-at-large. (Not all at the same time.) He led the *Bloomberg News* team that won two Society of Publishers in Asia (SOPA) awards for coverage of the Fukushima disaster.

Yuriy Humber is an award-winning journalist, who spent more than a decade working at media giants such as *Bloomberg News* covering the rise of Vladimir Putin and the oligarchs in Russia, the nuclear disaster in Fukushima, and the commodity boom and bust across the world. After more than 14 years in journalism, in 2016 Yuriy decided on a fresh start. He founded Yuri Invest Research Ltd. to specialize in financial research for overseas clients interested in Japan, as well as providing copywriting and editing services for Japanese companies looking abroad. Yuriy is also co-author of the Tokyo guidebook published by Wundor Editions (UK) in 2016.

A graduate of the University of Cambridge, Yuriy has worked in Japan, Russia, China, and Ireland. Fluent in Russian and English, Yuriy has professional-level Japanese and a high proficiency in French. He has lived in Tokyo since November 2010.

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