

Farewell to the Old Growth Strategy of Japan

By Naoyuki Haraoka

Why Is Economic Growth Necessary?

Business cycle synchronization is a key phrase in describing global economic landscapes today. Most of the major economic powers in the world were strongly affected by the collapse of Lehman Brothers and the shrinking global demand that followed it and they are still struggling to find a way out of the recession. Through the increasingly close interdependency of nations achieved by trade and investment, the economic situations in developed as well as developing nations have become more interlinked and thus their economic performances have become more synchronized. In particular, the major developed nations or areas, such as the United States, European Union and Japan, share the same economic policy goals in facing a similar macroeconomic climate, that is to achieve economic growth without using fiscal and monetary policy. This is because, on the monetary side, repeated quantitative easing under current extremely low interest rates has put them into a so-called liquidity trap and made monetary policy ineffective, while on the fiscal side their cumulative budget deficits have also constrained them in spending more on fiscal stimulus. Before looking in detail at their growth strategies that do not use traditional macropolicy measures, we should consider the relevance of economic growth as a policy goal.

In mature economies, the goal of economic policy is different from that pursued by developing ones, for which growth is an urgent need to achieve the ultimate goal of economic development. Equal income distribution in their rapidly aging societies, with enriched social welfare programs, could be a relevant economic policy goal corresponding to the needs of such mature nations. But to achieve this goal they would still need sufficient growth, under a virtuous cycle in which economic growth would enable firms to raise their employees' salaries and subsequent increases in tax revenues would enable the government to enhance social welfare programs.

Mature economies, in most cases, have no option but to raise their productivity levels to boost economic growth, since their overall demand growth is saturated and only technological progress maintained by continuous entrepreneurship can achieve this. Thus, innovation is key to promoting growth in these economies and innovation policy is considered a crucial growth strategy.

Measures to achieve higher economic growth generally lead to attracting foreign direct investment (FDI) from around the world. Considering that nations today are competing with each other to

attract FDI as a locomotive to drive their wealth, growth strategy is a key to winning such competition. The key question concerns the contents of growth strategies. What kind of strategy would be most effective in improving each nation's economic performance and enhancing its productivity and growth?




Strengthening Individual Capacity with 3rd Arrow of “Abenomics”

The recently announced Japanese growth strategy, the third arrow of Abenomics, a revised version of the one announced last year, is supposed to create an engine for the economic growth of Japan. Although it covers a wide range of issues and fails to show explicitly the priority of policies, it has still revealed to the public the critical points to be emphasized among a variety of policy measures and how specifically these policies would be implemented. Even a detailed schedule for their implementation was revealed. This strategy is, I believe, a crucial advance from the original one announced last year.

The philosophy behind the strategy, if I understand it correctly, is to raise individual competitiveness by enhancing the level of competition. First of all, this growth strategy endorses and promotes free trade and investment systems. The Trans-Pacific Partnership (TPP), a mega-regional free trade agreement (FTA), is a goal the government is pursuing not only in the interests of foreign policy but also from an economic policy perspective, in the belief that strengthening competition through significant reductions in tariff and non-tariff trade barriers could stimulate the economy and eventually enhance its competitiveness. To take full advantage of such trade liberalization, we would need structural reforms in the sectors possibly affected by the conclusion of such FTAs, such as agriculture. The growth strategy highlights such efforts as reforming the existing agricultural associations in local areas from agencies advocating protectionist policies into ones that promote competition in agriculture.

Assuming that diversity among economic players is an engine for growth in a mature economy, the growth strategy encourages women and overseas business to be key players in the Japanese economy. A Japanese company is now obliged to reveal to the public the percentage of its female board members and raise its percentage continuously under peer pressure. FDI into Japan has been low in spite of the Japan External Trade Organization's (JETRO) laborious



efforts to attract more. Its ratio to Japanese GDP is still around 3-4%. We need to enhance this figure towards the level of other developed nations, that is around 20%. Such an increase in diversity as a target of economic policy would lead to more competition among individuals and companies, strengthening their respective competence.

Japanese corporate governance has been a stakeholder-oriented one, especially in terms of caring for employees' interests. But this growth strategy clearly pursues a reform of Japanese corporate governance from stakeholder-oriented to shareholder-oriented, meaning return on equity (ROE) would be considered the most important goal for management. To enhance ROE, a Japanese firm would need to encourage each employee's creativity to raise the added value of their product or service rather than merely maintaining job security, regardless of the quality of job. More creative people contributing to enhancing added value would mean a higher evaluation of a company.

The growth strategy also ventures into the sensitive area of labor practices. It will modify a regulation on working hours and introduce a system determining salaries based upon the competence or performance of each employee, instead of determining salaries merely on the basis of hours worked. This clearly encourages more creative workers to join a workforce. Human resources development is important in enhancing the level of an employee's competence. With the introduction of more equal treatment between permanent and non-permanent workers in terms of wages and other working conditions, as well as such enrichment of human resources development, labor market mobility will be enhanced.

Thus the major components of the strategy will work in favor of creative and competent individuals through increased competition.

Achieving Its Goals

The Japanese government's growth strategy has been pursuing a high economic growth rate, an industrial structure producing high added value, and increased trade benefits through improved terms of trade. The latest strategy announced last year highlighted some potential leading sectors such as the green industry or healthcare industry where prosperity can be promoted, given growing concerns over the global environment or healthcare facilities for the aging population. Hitherto, some specific sectors have been the targets of Japanese growth strategy, but this new one, for the first time in Japan, focuses on raising an individual person's competence as an engine for economic growth.

To achieve this, Abenomics boldly attempts to implement a large-scale regulatory reform that includes the reforms of working practices and labor market, agricultural competitiveness, and rules concerning corporate governance. It also includes reforms in the healthcare and medical industries to enhance the quality of their services against the backdrop of the aging society. The government is very concerned about overcoming the challenges facing the Japanese economy, believing such an in-depth structural reform is inevitable. The third arrow of Abenomics hopes that by creating a business environment more friendly for the venture spirit it will spur a rise in entrepreneurship — not only in starting new businesses but also in raising each individual's productivity no matter where he or she may work — and that this will be the most crucial factor in promoting growth.

However, I believe that government policy is not enough to achieve a rise in entrepreneurship. It can bring a horse to the water, but it cannot force him to drink. The next question to be asked is from what culture does such entrepreneurship creating innovation-oriented growth come? I believe it largely comes from the individualism at the root of Western society's capitalism and democracy. It is very difficult to define the nature of Japanese society in comparison to Western individualism. But it is probably relevant to say that Japanese society is a mixture of Asian collectivism and Western individualism, and certainly evolving towards a new society distinct from either of them.

A Westerner probably notes that collective action is still dominant in Japan, observing, for example, how the "cool biz" fad prompted all businessmen to take off their ties from June 1 until Sept. 30 during the hot and humid summer as if it were a law once it had been officially perceived by the government as a "custom". I am not saying that Japanese are less creative than Westerners but it may be true that most Japanese businessmen, in particular, prefer to do what the majority would do and do not highly value being different from others.

I believe that entrepreneurship will be born in a culture where people are proud of being different from each other. Given that this latest Japanese strategy embraces each individual's innovation or creativity as the most crucial factor in achieving growth, will it be possible to achieve this goal easily in Japanese culture? It is up to people themselves whether the goal is realized or not, since the government can only create an accommodative environment for innovation; whether people can raise their creativity or not by utilizing this opportunity is another question.

On a different note, we may also need to have a capacity to

evaluate each individual's creativity. Otherwise, we may fail to provide people with the incentive to be creative. At this moment, in Silicon Valley, there are a number of Japanese ventures with invented technologies pursuing collaboration with Silicon Valley ventures, since they cannot find business partners in Japan. The majority of Japanese business firms, in particular the large ones, prefer to collaborate with large and well-known firms, since their criteria for evaluating new technologies are simply whether they come from large and well-known companies that can always be trusted.

It is not only Japanese business firms but also parents who highly value the size of a firm as a criterion of trust. Thus they prefer their children to get a job in large companies rather than start a small business. In such a culture in Japan, would it be easy to enhance entrepreneurship? How can the Japanese take full advantage of the opportunity for change of the business environment provided by the third arrow of Abenomics and become more competitive and creative individuals? The key to achieving the goal of Abenomics is whether or not the Japanese can change their culture in responding to the current government's courageous initiatives to reform the country to strengthen its competitiveness.

History tells us that culture can be changed by the introduction of diversity among important players in social evolution. In the 6th century in Japan, it was Chinese and Koreans, who had moved to Japan and were naturalized in Japan, who made a substantive contribution to the unity of the nation, and in the 10th and 11th centuries it was women like Lady Murasaki, author of *The Tale of Genji*, who spearheaded the creation of a national indigenous culture after having digested the strong cultural influence of China. Following such historical precedents, it may be that non-Japanese and women could again help lead the nation towards an authentic reform. Diversity would again encourage the transformation of Japanese culture into one more friendly to creative individuals.

A Business Environment in Favor of Women & Non-Japanese

There are many competent young women in Japanese firms today complaining about the old men who are reluctant to retire and thus prevent hard-working and intelligent women from being promoted. Although these women believe the old men are inefficient in their work and a mere nuisance to them, the old men believe they should maintain the significant positions in a company

and that women should work under their guidance. Given that such a male-dominated culture is deeply rooted all over Japan, the third arrow of Abenomics obliges Japanese firms to note the percentage of female executives among their board members in their reports to shareholders and encourages the central as well as regional governments and the private sector to adopt a numerical target, such as 30%, for the leading posts in their organizations to be taken by women. This could be the most effective way to break down a male-dominated culture, not simply ensuring secure working conditions for working mothers by expanding daycare facilities and the like.

Subsidiaries of non-Japanese companies still play a limited role in Japan. The third arrow determines to adopt a new numerical target for FDI in Japan — that is, to double the existing total of FDI by 2020. National Strategic Special Zones designated by the government are expected to attract FDI by providing attractive business environments, by such measures as low taxes and more international schools for the children of employees at non-Japanese subsidiaries.

In addition to this attempt to expand business opportunities for non-Japanese firms, the third arrow aims to realize a society where non-Japanese can find many good working opportunities. Technical training systems for non-Japanese workers would be widened to cover a greater scope of professions, and the period of training expanded from three years to five.

In the National Strategic Special Zones, the government will enable



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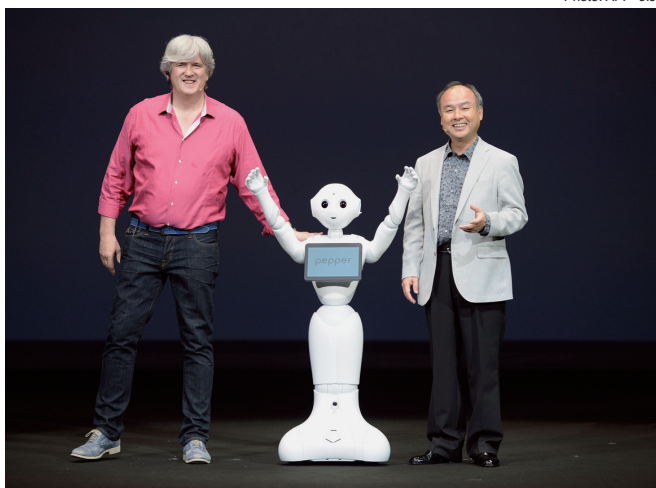


Photo: JJI

Japanese Prime Minister Shinzo Abe (center) visiting a licensed daycare facility run by a business corporation



Photo: AFP=JJI



Masayoshi Son (right), president of Japanese mobile carrier SoftBank, and Bruno Maissoner, CEO of French robot maker Aldebaran, introduce their jointly developed humanoid robot "Pepper", equipped with an emotion engine, in Tokyo on June 5, 2014. SoftBank will release the robot next February with a price tag of \$1,980.

residents there to employ non-Japanese housework staff, and will also support non-Japanese students becoming qualified as caregivers in Japan to help them find jobs by extending their working visas. The entry of non-Japanese business firms will also be encouraged by a wide range of deregulations, in areas like the medical and healthcare business and robotics, which is touted as the driving force of a new industrial revolution in the 21st century.

Overall, such measures could expand the diversity of working people in Japan. In addition, the 2020 Tokyo Olympics could be an opportunity to increase significantly the number of tourists visiting Japan, which might ultimately lead to an increase in the number of businessmen interested in starting up a business in Japan.

Success of 3rd Arrow Up to People

Abenomics, in particular the third arrow, is a product of policy entrepreneurs. First of all, I would like to explicitly state my personal respect for such an audacious political initiative. This is certainly a venture that challenges a number of difficulties that have been impediments to the economic growth of Japan, not only agriculture, inflexible rules in the labor market, and a rigid healthcare system, but also other aspects of conventionally inflexible Japanese culture. The third arrow will prepare a good environment for growth opportunities and even cultural change that could initiate further innovation. It will then be up to us to let it hit the target. This is a time to think about

what we can contribute to our nation and not about what the government can do for our own interests.

The current administration has also decided to lower the corporate tax rate to less than 30% and this is expected to stimulate private investment, an important engine of growth. However, this tax cut could end up in increasing firms' internal savings and not lead to increasing investment. It will be up to companies facing the need to increase their ROE under new corporate governance principles to decide whether private investment will increase or not.

Likewise, it will also partly be up to women whether we can achieve the numerical target of having 30% of the leading roles in organizations occupied by women. While many women are keen on pursuing leading roles in Japan, it is also true that many are still reluctant to take any responsible role in the workplace. Some would still be more than happy to choose a working life in which they can earn some money from less important jobs without taking any responsibility in spite of their excellent academic career. I think this would be waste of human resources and they should at least know the implication of their choice in the context of the third arrow, even though their choice should be respected as personal one.

Finally, I would like to tell our readers from all over the world that now is the best time to start a business in Japan. You would be given a variety of business opportunities not only in the National Strategic Special Zones but also regional towns, since the third arrow also targets them as centers of growth. If you ask how serious the Japanese government is in realizing a business-friendly environment for non-Japanese firms, I would say, very serious. Without achieving this goal, Japan could fall into permanent decline because of its predicted fall in population due to its aging society. There is no other choice and this will be the last chance to avoid it. That is why the government has decided to engage in unprecedentedly revolutionary reforms, in spite of significant political resistance. It expects non-Japanese firms and workers not only to make active contributions to the economic growth of Japan but also to change our culture and society. This is a fundamental difference from any preceding growth plan devised by the Japanese government.

Japan SPOTLIGHT, in our coming issues, will follow the progress of the third arrow and highlight its consequences. **JS**

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