

Strategic Special Zones for Growth Strategy

Drilling into the Bedrock

By Japan SPOTLIGHT Editorial Section

Tatsuo Hatta, president of Asian Growth Research Institute, a distinguished economist and a key advisor on deregulation programs to the administration of Prime Minister Shinzo Abe, is the chairman of the Strategic Special Zones Working Group, where experimental regulatory reforms will be discussed. This is truly a core part of the third arrow of “Abenomics”. Japan SPOTLIGHT introduces this reform, in particular what benefits it may create for business people outside Japan, based upon Prof. Hatta’s public lecture at The Tokyo Foundation last November and his supplementary remarks in our interview with him in February, 2015.

Introduction

If left to the competitive market, resources will flow in the direction of higher productivity, where the rewards are higher. Hence markets allocate resources efficiently.

When some sectors grow in a competitive economy, some other sectors must accordingly decline. For example, cotton flower production was completely wiped out in 10 years after Japan opened its ports in 1859. Liberalization of oil imports also reduced coal production to less than 10% of the peak level in the post-World War II period in Japan. Yet Japan achieved historically high growth and economic development on both occasions.

As the economy grows, however, industries that have accumulated vested interests tend to set up entry regulations to prevent new firms and industries from starting businesses. Then the natural flow of resources faces obstacles set up by incumbent firms to protect their vested interests, and the economy will stop growing.

Therefore, in order to enhance economic growth, we need to remove the obstacles that hamper the natural flow of resources. Such reforms are called Structural Reforms. Drastic deregulation, however, could provoke political resistance. Thus we can take advantage of Strategic Special Zones by introducing there such drastic deregulation programs experimentally to see if they could work well to enhance economic efficiency and assure people concerned about the utility of the programs. Among possible regulatory reforms, we should give priority to the ones which immediately stimulate the domestic economy.



Tatsuo Hatta, President of Asian Growth Research Institute

Six Strategic Special Zones

We have had other types of special zones in the past, but the current system of Strategic Special Zones makes a clear distinction from the two main predecessors.

First, the Comprehensive Special Zones adopted by the government of the Democratic Party of Japan were chosen from among applicants to promote the respective region’s growth and welfare, and not the whole nation’s growth. Strategic Special Zones, on the other hand, are approved by the government for a national growth strategy as the engines of major regulatory reforms. Thus, they are the laboratory for reforms of “bedrock” regulations.

Second, the Structural Reform Special Zones adopted by the administration of Prime Minister Junichiro Koizumi early in the 2000s were also selected from among applicants keen on promoting regulatory reform in various regions. Though this was also aimed at expanding regulatory reform nationwide, it was initiated by the regions, whereas the current policy is led by the nation.

Another key distinction from the Koizumi reforms is who negotiates with the regulatory offices of the relevant ministries. In the case of the Koizumi reforms, Chief Cabinet Office officials were engaged in such negotiations. But it has often been difficult to achieve real reforms through negotiations involving only government officials. In the current reform, the Strategic Special Zones Working Group consisting of private business people and academics will negotiate with the regulatory authorities. The Working Group members are independent from any government bureau and have no

vested interest in any government activity. When negotiations between the two get deadlocked, the Council on Strategic Special Zones, the supervisory body of this Working Group, of which Abe himself is a member, will be responsible for resolving any possible conflicts with the regulatory offices. Thus it will be difficult for a regulatory office to insist upon preserving its regulations under such political pressure.

Such a decision-making process, significantly different from that of the Koizumi reforms, could make it possible to achieve more drastic regulatory reform in a short period.

In March 2014, the national government chose the six strategic zones. Tokyo and Osaka were selected, since the Strategic Special Zones initiative was originally intended to turn Japan into a country where globally-oriented business people prefer to work and these big cities could be the most business-friendly venues. Considering the need to achieve a balanced growth between the big cities and the regions, Yabu city in Hyogo Prefecture and Niigata city in Niigata Prefecture were selected for reform of the agriculture sector, the former for reform of small or medium-scale agriculture and the latter for large-scale agriculture. Fukuoka city in Fukuoka Prefecture was selected as a venue for labor market reform, since its population growth rate is the highest in Japan and the number of new business enterprises is the second-largest after Tokyo. The merits of labor market reform there would be enormous in enabling these new companies to employ workers more easily. The last zone is Okinawa Prefecture, a politically important place for the Japanese government in the light of national security. It was chosen as a venue for encouraging international tourism.

How Can These Zones Attract FDI from Around the World?

Abe said in Davos last year, “I’m willing to break through the solid rock of vested interests over the next two years.” With this commitment, these six zones will take the initiative in drilling into the bedrock of vested interests protected by regulations. Elimination of vested interests will increase new entries into the market, not only Japanese ones but also non-Japanese ones from overseas.

For example, in the pharmaceutical sector, it has taken much longer in Japan to get administrative approval for selling new medical devices or prescriptions in the market compared with other countries. The Strategic Special Zones Working Group is planning to simplify this approval process as much as possible.

More specifically, for a product to be prescribed for patients on public health insurance, it is currently necessary to prove its effectiveness in expensive and time-consuming clinical trials even after its safety has been demonstrated.

The Working Group is proposing to test the effectiveness of a product on the patients treated on public health insurance in selected hospitals in the Strategic Special Zones, as long as its safety has been demonstrated. If they prove to be non-effective while being tested in the selected hospitals, they will not be approved. If they prove to be effective for the patients in the testing hospitals, they will

be given final approval and will be used on public health insurance all over the country. This testing procedure would be much less expensive than now.

It is expected that many medical device companies will then come to Japan to start business with this reform put into practice.

There are also three major regulatory reform issues which would completely change the business environment in favor of foreign-affiliated companies, as in the case of Germany, which now enjoys the quickest approval process and is successful in attracting many medical device companies from all over the world.

First, non-Japanese companies find Japanese employment customs a serious barrier to entry into the Japanese market. The life employment and seniority system that has been observed as a dominant rule for a Japanese company in employing its workforce has tended to make dismissals difficult. Business corporations outside Japan would therefore find it difficult to enter the Japanese market with such a rule of employment discouraging dismissal and labor mobility, since they are not in accordance with their own employment customs.

There is certainly a statutory rule of dismissal formulated in Article 16 of the Labor Contract Law in Japan shown as below.

Article 16 of the Labor Contract Law:

“A dismissal shall, where it lacks objectively reasonable grounds and is not considered to be appropriate in general societal terms, be regarded as a misuse of the right and therefore be renounced.”

However, this is too vague and it causes a lack of predictability, and both private companies and employees cannot tell whether an individual dismissal is valid or not until they go to the courts. This leads to non-Japanese private companies’ hesitation in hiring employees.

An Employment Guideline was agreed in advance between the Cabinet Office and the Ministry of Health, Labour and Welfare, clarifying the conditions under which an employment contract will enable dismissals. In formulating this Guideline, foreign law firms’ views were taken into account. It was then decided that each Strategic Special Zones can set up an Employment Center, and a foreign corporation engaged in business in Japan can ask the lawyers of the center to check free-of-charge whether their particular labor contract is in accordance with the Guideline.

Second, concerning housing circumstances in big cities, in particular Tokyo, that have been considered a major impediment for non-Japanese businessmen to come and work in Japan, it would be possible for them to live in a high-rise apartment close to their offices in the central part of Tokyo by the deregulation of floor-area ratio restrictions in residential buildings.

With the existing rigorous floor-area ratio regulations, urban developers find it easy to earn money by building offices rather than residential apartments. But with the modification of this rule, they would start building high-rise apartments that business people coming from abroad would find very helpful. All major city developers in Tokyo have now announced plans to build residential buildings in the central areas of Tokyo. These plans could be realized by the year 2020 when the Olympics and Paralympics will be held in Tokyo.

CHART 1
National Strategic Special Zones

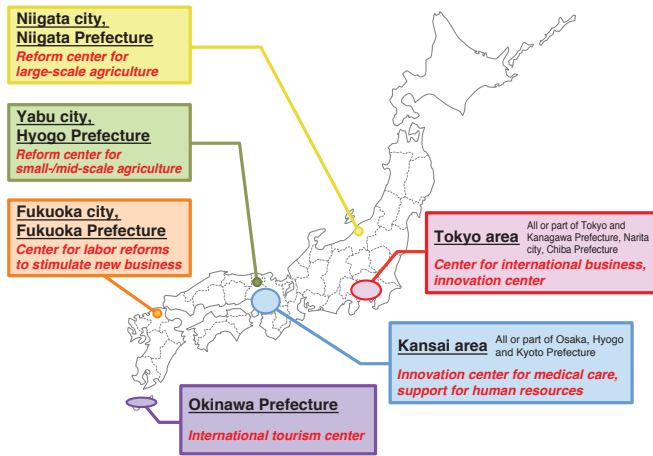


CHART 2
Tokyo area (reform center for creating global city)

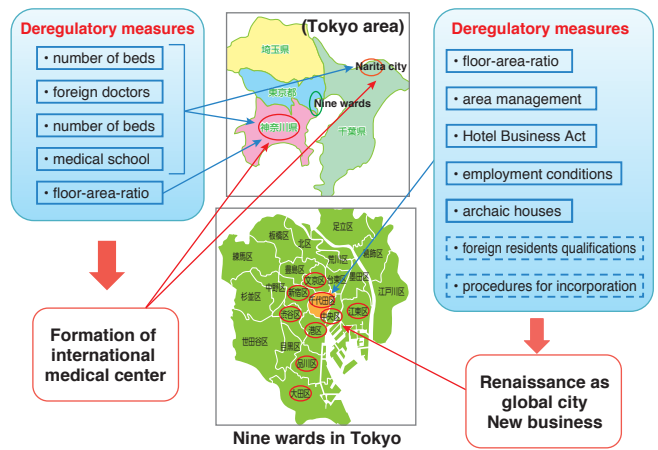


CHART 3
Kansai area (reform center for creating global innovation center)

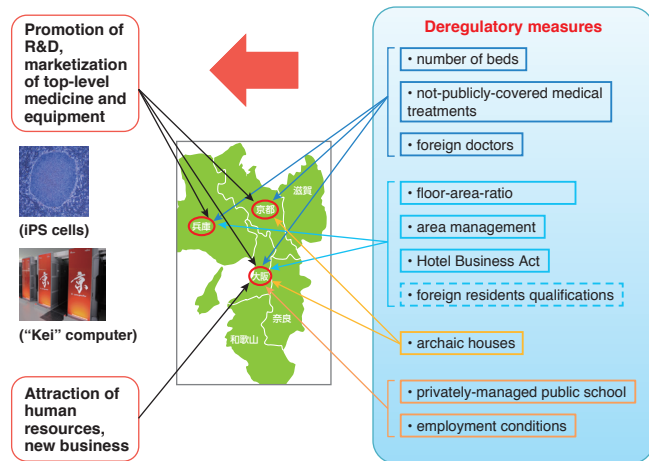


CHART 4
Fukuoka city (center for labor reform & new business)

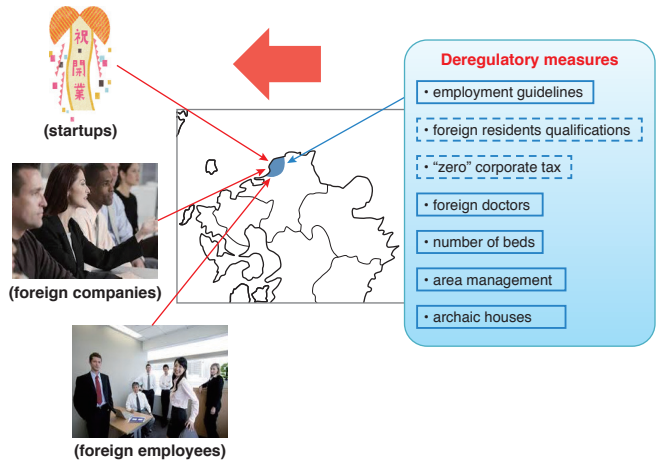


CHART 5
Niigata city (reform center for agriculture & labor)

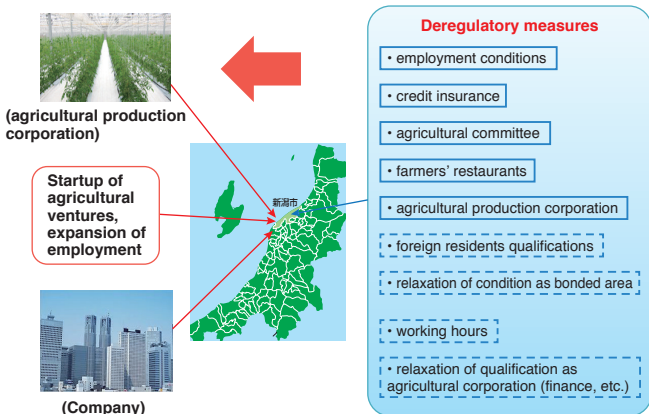
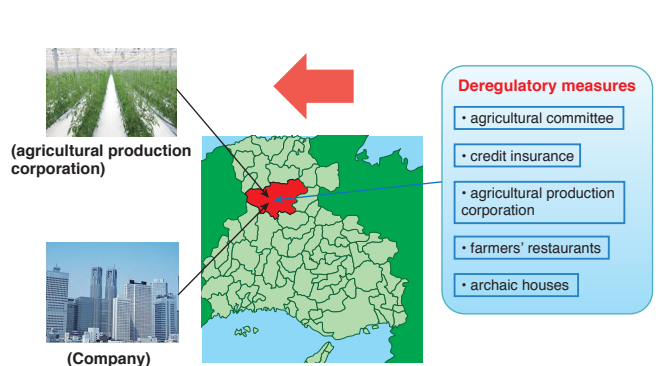


CHART 6
Yabu city (reform center for small & mid-size agriculture)



Source (CHART 1 - 6): Compiled by Prof. Tatsuo Hatta

The third regulatory reform in favor of the new non-Japanese entrants concerns the regulations related to starting up a business in Japan. Under existing regulations, if you try to start up a business in Japan you need approvals from many government offices, such as one on the services of a notary office from the Ministry of Justice, on tax from the Ministry of Finance, on labor issues from the welfare ministry, and so on. In the Strategic Special Zones, a one-stop application center for establishing a new company has been established and all administrative approval procedures can be completed at this center. The most difficult part of this reform concerned the notary services that must be done only by a notary office and not by such a one-stop center, according to the existing law. With the revised law, it is also now possible to do this at such a one-stop application center. Non-Japanese business entrepreneurs will now find it much easier to start up a company in Japan.

Under existing regulations, foreign entrepreneurs can obtain a visa by proving that they have 5 million yen in their bank account. However, in order to have a bank account in a Japanese bank, you must have an address in Japan, and you need a visa in order to have an address. This means non-Japanese entrepreneurs will not be able to start a business in Japan unless they already have a visa for entrepreneurs. Thus it has been almost impossible for non-Japanese entrepreneurs to start businesses in Japan up to now.

After the reform, they will not need to have 5 million yen in a bank deposit in order to be qualified for a visa for entrepreneurs. Instead, they will have to prepare 5 million yen within a few months of their acquisition of the visa, and if they cannot do so they will lose their visa status.

This reform could create a more business friendly environment for non-Japanese entrepreneurs in the Japanese market, which would encourage new entrants from overseas and stimulate higher efficiency in the economy through activated competition.

Dealing with Other Major Bedrock Regulations

Deregulation programs initiated by the Strategic Special Zones would of course have a positive impact on the nation itself, not only on people from outside Japan. There are several examples of bedrock regulations closely related to the people's daily life in the nation.

(1) The number of hospital beds in large cities is currently restricted, which means the vested interests of currently working medical doctors are preserved. Relaxation of this restriction has already been approved in Kobe where an additional 40-bed increase was permitted for eye surgery using regenerative medicine initiated by Dr. Masayo Takahashi.

(2) In the area of medical services, billing for mixed medical care services in the public insurance system will be allowed in selected hospitals in Strategic Special Zones under more flexible conditions with this regulatory reform.

Currently, once a new medicine or medical device which has not been covered by public insurance is used in your treatment, you have to pay all the medical costs including the part originally covered

by the insurance. After the reform, you would pay for only the part of the treatment which is not covered yet by public insurance and the rest would be paid by public insurance. This is called the "mixed treatment" of the new medicine or medical device.

In this reform initiative, new medicines and medical devices approved in the United States or United Kingdom, for example, would be automatically permitted for mixed treatment in the selected hospitals in the Strategic Special Zones in Japan within three months of their approval in their country of origin.

(3) Another example of drastic reform affecting the people's life overall is nationwide liberalization of contract terms for professionals with fixed contract terms. Currently, after the termination of their five-year contracts, professionals have no choice over the length of their next fixed-term employment contract. But after the reform, professionals whose annual income exceeds about \$100,000 would be able to choose the length of a fixed-term employment contract during the next 10 years. This would enhance labor mobility and facilitate market competition.

(4) Lastly, reform of agriculture will have a significant impact upon national life. After the reform, the credit insurance system will be applied for loans to agricultural business. Corporations, including banks, are banned from owning farm land and because of this they cannot lend money to farmers using their farm land as security. Even if the farmers offer their farmland as security, the bank cannot take over ownership of the farm land if that farmer goes bankrupt. The bank cannot easily sell such mortgaged land, since the local agricultural committee would not usually allow any outsiders to buy the farm land. Currently, only Agricultural Corporative Banks can monopolistically lend money to farmers.

Banks can extend loans to a customer without their taking a mortgage if their customer takes advantage of the credit insurance system. With this system, even without holding a mortgage, if a farmer pays the credit insurance fee, the credit insurance association would ensure that they could secure credit even if the farmer goes bankrupt. This credit system is applied to all sectors other than agriculture, but the reform will see that farming is also encompassed in the Strategic Special Zones. This is a symbolic reform that will eliminate the monopolistic power of Agriculture Cooperative Banks.

Conclusion

Drastic deregulation in the Strategic Special Zones is a major part of the third arrow – a growth strategy – of "Abenomics". This is based on the principle that narrowing the productivity gaps among different sectors by deregulation would promote growth. Abe's commitment to drilling into the bedrock is shown by these deregulation programs, which cut deeply into vested interests. They will be instrumental in attracting a large amount of foreign business in terms of both money and people.

People visiting Japan for the Olympics and Paralympics in Tokyo in 2020 may discover a new country amazingly revitalized. 