



Navigating a New World Order

Tokyo, 20-21 July 2017

Executive Summary

A NEW WORLD ORDER : WHAT IT MEANS FOR JAPAN

Trump is a symptom

The US does not want to be the policeman of the World anymore and some portion of the American middle class is fed up with globalization, which has left them worse off. This led to the anti-establishment movement and in some ways to Trump's election. However, some fundamentals remain the same despite Trump.

In terms of some of this administration's orientations, "we have seen this movie before" but the new factor is Trump's psychology, unpredictability and style. The US President seeks validation. He wants wins, respect, is focused on reciprocity and has a certain understanding of the notion of face. This has profound implications for his relationship with Asia. Trump is anti-elite, anti-globalist and a populist. He is reactive, he has a non-systematic approach of how the world works and no vision about the US global strategic role. He has an outdated view of economics and a disdain for the multilateral approach and alliances.

The good relationship between Prime Minister Shinzo Abe and Donald Trump is nice but it does not provide all the answers that Japan needs to a complex situation. If there is a long-term decline of US power, or decline of will to use its power, will China fill the leadership vacuum? This will be detrimental for Japan.



Hiroyuki Akita, Rui Matsukawa, Brad Glosserman, Thierry Porté

Growing assertiveness and expanding economic and geopolitical footprint of China

Xi Jinping has been considerably expanding his power and a key question is how he will use this stronger position in Beijing's relation with countries such as the US and Japan. The development of the One Belt, One Road (OBOR) initiative under his direct leadership is an illustration of China's increasing ambition.



Minhao Yu, Sujan R. Chinoy, Yasushi Akahoshi, Claude Smadja, Zongze Ruan, Yul Sohn

Sharp increase of the North Korean threat

The development of Pyongyang ballistic missile program is creating a new dimension. It might be wrong to think that this could change US/Japan relations. However, Trump's unpredictability makes Japan nervous. In addition, if things go from bad to worse, Japan is not ready for the possible influx of refugees from the Korean Peninsula.

Japan's strategic options are:

- ✓ Increasing defense capabilities: Boosting the defense budget over JPY 5 trillion, focusing on developing intelligence capabilities and possible nuclear deterrence power to respond to the Korean Peninsula issue and to the changing strategic balance in North East Asia
- ✓ Constitutional Reform
- ✓ Tightening and strengthening the relationship with:
 - a. Russia: while Abe knows that Russia will not relinquish the four islands he will continue to hold summit meetings with President Putin.
 - b. China: While there are strategic issues with China, the government should continue to look for opportunities of improvement with Beijing (forthcoming invitation to Xi Jinping to come to Japan, Japan delegation at the OBOR summit in Beijing last May and receptiveness to Japan's involvement in the OBOR initiative).
 - c. India: on the economic as well as the maritime navigation security
 - d. Australia and other ASEAN countries
- ✓ Trying to salvage TPP: Even if the US stays out, too much effort and political capital has been invested in TPP by Abe to just let it go. Japan is also working towards making Trump reconsider his decision using the forthcoming APEC meeting in November. If the US stays out, the idea would be to create a successful framework with 11 members ("Ocean's 11").

The uncertainties created by the Trump administration and some of the policies that it wants to initiate create an opportunity for Japan to take a more forward-looking and activist approach in areas where Japan has strong assets such as in technology, next generation computing, AI, robotics, energy and global infrastructure.



Rui Matsukawa



Tomohiko Taniguchi



Glen S. Fukushima



Hiroyuki Akita



Mead Treadwell

ABENOMICS, CONTINUED...

The global economy has recovered. It is expected to grow by 3.5% this year. In this context, while Japan's situation has improved, with a forecasted growth of 1.5% riding mostly on the back of strong exports, the country's economy continues to show weaknesses: in spite of low interest rates, business fixed investment is still lagging. While interest rates need to remain low, they risk at the same time to create complacency as this encourages companies to avoid restructuring. This moral hazard risk cannot be underestimated.

The continuous low level of interest rates is linked to the difficulties that the BOJ is facing in trying to get back to a more "normal" monetary policy. Governor Kuroda has had to repeatedly postpone the target date for achieving the 2% inflation target. At the same time, the US has come off Quantitative Easing and the expectations are that the ECB will be either coming out of monetary easing by the end of this year, or at least will reduce its monthly buying of securities.



Sadanori Ito, Hiroko Ota,
Munetomo Ando

The poor performance of the economy is linked to low productivity, the overall rigidity of the labor market and the aging of the population. Cash is not moving, households and companies, as well as banks, are sitting on a pile of cash, thus getting mediocre returns, or even no return at all. In this context, Japan has the opportunity of turning the tables and becoming an active global investor.



Munetomo Ando, Hiroko Ota, Katsunobu Kato, Akira Matsumoto, Nobuhiko Sasaki, Masayuki Makino

Agriculture and other food related industries

Japan has the sixth longest shorelines in the world, which provides tremendous opportunities for fishery industry development.

The Central Union of Agricultural Cooperatives (JA) needs to be reformed. JAs are handling too many domains such as distribution, insurance, finance and they cannot cope efficiently with these many tasks. The efficient segments help maintain other inefficient activities. Regional JAs need to be allowed to compete among themselves. Japan has acquired a reputation for high quality agricultural products and has some of the best freezing technology in the world. It should use these competitive advantages to increase its exports.

We are still half way through in terms of the reforms needed in the agricultural sector.

Governance

There needs to be a reform leading to devolving more responsibilities to the local governments to generate efficiency gains. This goes with instilling a sense of financial responsibility to local civil servants. Overall, Japan does not have more civil servants than any other country of the same size but the issue is to increase their efficiency, productivity and accountability rather than reducing their number.



Shigeru Ishiba, Robert A. Feldman

There needs to be more transparency and communication to the public on Japan's financial sustainability. The Consumption Tax has to be raised even though deeper discussions are needed as people must have confidence in order to consume more.

Deregulation

Deregulation is still a priority and a pre-requisite to improve corporate efficiency. There remain too many bureaucratic layers and companies still need to go to 5-6 ministries on certain issues. These are the kind of obstacles that continue to make it difficult for foreign SMEs to enter Japan.

The overarching weaknesses in Japan are: lack of innovation, low productivity and deterioration of competitiveness.

TOKYO AS A GLOBAL FINANCIAL CENTER

While Japan is the second largest economy in Asia, it is the third financial market coming after Hong Kong and Singapore. Why has Tokyo lost its first place from the 80s when it represented about 50% of global market cap against currently 8%? Some key reasons are:

- ✓ Recognition gap/communication deficit
- ✓ Cultural barrier (language)
- ✓ Not enough innovative players – especially in terms of financial products (mainly due to lack of risk appetite)
- ✓ Underutilization of savings
- ✓ The corporate structure of asset management firms in Japan is not conducive to good performance. Mistakes are harshly punished while high returns are not rewarded – promotions are based on experience and age contrasting with the US and EU where asset management is extremely meritocratic.



Yuriko Koike

What would help Tokyo becoming again a global financial center would be reforms regarding white collar jobs in the sector that would create more flexibility to adjust to times of crisis. In the same way, there needs to be an exemption to the working hour limit. Linked to the issue of Tokyo as a financial center is the question of the internationalization of the Yen on which the debate is still unresolved.

Now that the law on special economic zones has been passed in the context of Abenomics, Tokyo stands a bigger chance to build on its unique economic attributes which are currently under-optimized such the attractiveness of the city in terms of quality of life, the very strong regulatory framework provided and a committed governor.

Let's make Tokyo great again!

LABOR REFORM

Overall productivity in Japan's service industry is a quarter of that in the United States and the working population is declining sharply. The employment system "Japan style" has many elements that are no longer sustainable, among them:



- Unspecified work description leading to long working hours (Karoshi, i.e. death from overwork), this eliminates many women from the labor market
- The employment system (for large Japanese companies) is like a membership club: those who are out of the club – the non-regular workers - have scant chances to get into the club and benefit from its advantages.
- The skills presently required by the system are getting obsolete more rapidly than ever before and new skills are not being developed fast enough.

Assessing the workstyle reform launched in March 2017

Among the reform elements:

- ✓ Equal pay for equal work
- ✓ Limiting overtime
- ✓ Support for career shift
- ✓ Work/life balance

The questions that remain to be answered:

- ✓ The elimination of ultra-long hours
- ✓ Reduction of the work conditions gap between regular and irregular workers
- ✓ Enhancement of mobility
- ✓ Whether restructuring will be easier
- ✓ Increasing women participation in the workforce

The present reform comes short on:

- ✓ Restructuring modalities including severance
- ✓ Public support for training and labor mobility
- ✓ How can the application of this reform be extended to non-unionized SMEs employees and non-regulars?
- ✓ Retirement age revision



Izumi Kobayashi

The key challenge is to ensure that the labor reforms translates into much needed productivity gains.

Productivity can be improved though:

- ✓ Efficient leveraging of ICT
- ✓ Improved individual productivity through education revolution
- ✓ Human Resources Development (HRD) revolution and mobility (from low to high productivity sectors)

In practice, companies need to:

- ✓ Break down the tasks
- ✓ Evaluate according to performance and not seniority
- ✓ Review their modus operandi which currently forces employees to spend too much time compiling documents and explaining what they do to their superiors
- ✓ Actively promote tele-working
- ✓ Promote diversity in the workplace (women and foreigners)

The work style reform challenges the Japanese society as a whole but unless the issues involved in the reform are solved productivity cannot be improved.

INNOVATION

The number of Japanese companies which can be labelled as “global champions” has shrunk dramatically over the last twenty years. The paradox is that compared to other countries, Japan fares rather well in the education system until high school. However, the system creates a uniform mindset which was extremely efficient in the Industrial age but is an obstacle to innovative thinking in the new economy. This uniform mindset leads to a lack of dreams, prevalent among Japanese corporations, a hindrance to innovation.



Yuii Ukai

Japanese companies are not very good at catching and capturing social needs and aspirations. They lack the very important factor of “playfulness” and thus they are lagging behind in many aspects for providing the products and services that will respond to the fast changing aspirations of the public. Moreover, innovators are not rewarded in most corporate structures and the majority of those involved in corporate research are male coming from the same few universities, hence this monolithic culture preventing innovation.

In the last few years Japan has increased its GDP growth and is at full employment level but today the way to get to the next level is only through AI, advanced Robotics and IoT.

The “Society 5.0” program is about launching a number of new R&D initiatives based on the collaboration between the private, public and academic sectors. It targets 11 domains such as autonomous driving technology, smart agriculture, AI, IoT and robotics.

Tokyo 2020 will help send a strong message worldwide on innovation made in Japan. Society 5.0 aims at boosting R&D investment. Whatever the concept (Singularity/ Society 5.0 etc) they all mean the same thing and refer to a much accelerated Moore’s Law, where output gets doubled every year and price gets halved.

Japan has been suffering from confusing invention with innovation, where invention is taking a lot of money and making ideas and innovation is making ideas into money. Obviously, education, in creating the right skills and fostering talents, will have to be a key component of Society 5.0. However, the lack of Venture capital remains a major weakness: It is worth noting that the venture capital industry is bigger in Korea despite the fact that it is one third of the Japanese market. In other countries like the US (CALPERS) and Korea pension money is invested into venture capital, which is not the case in Japan.

The 4th industrial revolution maps the digital work into the physical world (thru robotics).

The term CAMBRIC was coined by William Saito referring to the convergence among all these disruptive technologies:

Cloud

AI

Mobility

Big Data

Robotics

IoT

All wrapped up in a secured fashion **C**ybersecurity.



William H. Saito

The government is now committed to raise awareness about cybersecurity, which is closely related to national security. Unfortunately, most of the research is done in the United States and Japan has been left behind. Japan needs its own R&D in cybersecurity. The technology is changing extremely fast, cyberattacks are targeted and can generate profit. Conventional technology is not sufficient anymore to counter cybersecurity attacks. Anti-virus software is not cutting it anymore which means tremendous opportunities in the cybersecurity field for Japan.

For companies, it is crucial to identify the Megatrends and to bet on the right ones. For instance, Nokia missed the fact that it was not phones becoming smart but computing becoming mobile and it took time for the company to overcome this strategic overlook. What makes a difference is the combination of the various technologies.

Ten years ago, the top 5 global companies by market capitalization were from the petroleum or petroleum-based industry, now the top 5 market capitalization companies are data companies. For instance, Tesla is valued at US\$ 50 billion, more than GM with a production which is 1/100 of GM's. Unfortunately, Japan leads when "it makes", it loses when it switches to software and the business models are now based on networks. Not a single Japanese company is network based. A lot of countries are missing out on this. The few companies that have started on this model in Japan have left as cooperation is lacking and other companies are not taking the risk to buy from these ventures.



Oki Matsumoto, Danny Risberg, Sayuri Shirai, Motoshige Ito

MINDSET CHANGE IS A KEY TO CHANGE

Spanning the discussions of this year's Roundtable Japan, was a concern and at the same time a priority which emerged as a unifying threat: the need for Japan to achieve a change of mindsets. There is no energy in the young generation to aim for a better life. The country is run for old people rather than for the young. Japan is all about risk aversion and risk evasion. Too many regulations are constraining people even if they want to take risk. Japanese people were trained to be quiet and it is very difficult to change. This prevailing mindset of risk avoidance and putting a premium on status quo, plays a role in the fact that Japan ends up not having a strong voice on global affairs.

If one cannot expect to change the group culture, then people aiming for a change should just take the best of it and make this culture more agile. Japan has money, talent, markets and global trading capabilities to play a larger role. The world needs the quality and reliability of Japanese partners.

One positive element is that things are changing, some of the young people are now willing to take risks. Young entrepreneurs want to start in Japan but immediately think about expanding outside of Japan too. One foreign participant summarized the overall thrust of the discussion: "We wish Japan was more ambitious!"

