U.S.-Japan Business Council

US JBC US-JAPAN BUSINESS COUNCIL INC

2015 Policy Statement

Hitting the Mark: Third Arrow Reforms for Dynamic and Sustainable Growth

U.S. – Japan Business Council

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1615 H Street, NW	Washington DC 20062

Introduction: Our Shared Commitment to Japan's Economic Revitalization

The U.S. – Japan Business Council (USJBC) is comprised of companies at the core of the U.S.-Japan economic relationship. Collectively, member companies account for substantially more than half of all U.S. exports to and direct investment in Japan. Moreover, USJBC companies are major contributors to the Japanese economy, employing hundreds of thousands of Japanese workers, conducting cutting-edge R&D in Japan, and providing a wide range of goods and services to Japanese corporate and household consumers. In short, many USJBC companies operate in Japan as Japanese companies and, as such, are committed partners of Japan with a direct stake in helping ensure that Prime Minister Shinzo Abe is successful in enacting ambitious and bold reforms that put Japan on a solid and sustainable growth path.

As a business association, the U.S.-Japan Business Council (USJBC) is most concerned about microeconomic policy measures that affect the business environment and the operations of U.S. companies in Japan. In that macroeconomic conditions are essential to the success of domestic or foreign companies operating in Japan, the USJBC is also mindful of the macroeconomic fundamentals and policy direction.

Accordingly, the USJBC has supported strongly Prime Minister Abe's three-pronged economic strategy known around the world as "Abenomics" since its launch in late 2012, and continues to recognize that this aggressive, comprehensive strategy represents Japan's best hope to put the economy on a sustainable growth path that will benefit Japanese citizens and the global economy.

It is in this spirit and context that the USJBC has prepared this report. The views and recommendations herein are intended as positive feedback and constructive advice from the perspective of major foreign companies operating both in Japan and globally. These views are presented with the objective of helping improve the growth dynamics and business environment in Japan in line with the Abe government's ambitious and commendable objective to make Japan one of the most "business friendly" economies in the world, and the goal to strengthen the U.S.-Japan economic partnership even further.

Abenomics: Fiscal and Monetary Stimulus Must Pave the Way to Meaningful Structural Reform

Japan's lackluster macroeconomic performance over the past two decades is well known. Broadly speaking, real GDP growth in Japan has lagged that in many other major economies, particularly those in Asia. Compounding matters is the struggle to overcome chronic deflation, coupled with the need to raise labor productivity and manage other challenges presented by an aging workforce and population.

USJBC companies recognize and share the Abe Government's strong commitment to economic revitalization in Japan and applaud Prime Minister Abe's demonstrated fortitude to tackle a broad array of interlinked challenges in a comprehensive manner. The USJBC's view, shared by many others, is that Abenomics is an intellectually sound, coherent strategy to fuel growth and revitalize the Japanese economy. The launch of Abenomics has renewed international interest in Japan's economic potential and its importance for the broader global economy. Accordingly, the USJBC continues to strongly support a bold Abenomics program as Japan's best hope for eliminating deflation, boosting productivity and stimulating investment – all essential for driving long-term growth.

To date, fiscal and monetary stimulus measures – the first two of Abenomics' so-called three arrows – have been used most extensively by the Abe government. The Abe government has also enacted a series of "third arrow" structural reforms. Bold fiscal and monetary stimulus measures have been warranted to tackle the prevailing conditions of the Japanese economy, weak domestic demand and chronic deflation. Ultimately, however, in the USJBC's view, fiscal and monetary stimulus – even if deployed aggressively – are not independently capable of boosting Japan's growth over the medium-to long term. Since December 2012, when the Abe administration took office, Japan's growth has been sluggish, and interrupted by a worse-than-expected recession and recovery following the first step in the two-stage consumption tax increase in April 2014.

Japan's Quarterly Real GDP Growth

2013				2014			
Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1.4	0.8	0.6	-0.4	1.6	-1.9	-0.6	0.4

Source: Cabinet Office

Going forward, the USJBC supports the continued use of fiscal and monetary stimulus to achieve a strong take off, but is mindful that there are ultimately limitations on how much more Japan can effectively deploy such measures to generate sustained growth, just as there are in the United States and other major economies.

- On the fiscal side, there are limits in terms of how much debt Japan can accumulate and service, even with domestic bondholders as the primary creditors. Moreover, bond prices will start to fall at some point, probably as a combination of the BOJ unwinding its quantitative easing, or QE, after achieving its goal of 2% inflation and increased pressure from bondholders who will increasingly be foreign as Japan's current account shrinks. That will mean a significant rise in borrowing costs for the government, including fiscal pressures. However, given the tenuous recovery, the USJBC urges caution in moving too quickly to tighten fiscal policy or curtail debt through the adoption of tax or other measures if such measures will have an adverse effect on growth in specific sectors that are important to overall economic growth.

- On the monetary side, the USJBC supports strongly the objective of eliminating deflation, including through aggressive monetary easing. At the same time, there is a legitimate question about how much more the Bank of Japan can expand its balance sheet before triggering concerns among bond investors.

One clear effect of monetary easing has been a corresponding depreciation of the yen. While the weaker yen has helped boost exports from large manufacturers in Japan, the USJBC underscores that a weaker yen is not the long-term solution to Japan's growth. Although the sharp decline in oil prices has mitigated this somewhat, the weaker yen has also had some negative effects on the economy through higher import prices for energy, components and raw materials, particularly for small and medium-sized enterprises (SMEs) and consumers, who must pay higher prices for food and other imported items.

Third Arrow Reforms Are the Key

For the reasons outlined above, the USJBC continues to emphasize the importance of structural reform measures that are part of the so-called Third Arrow of Abenomics as the key to achieving dynamic and sustainable growth. To its credit, the Abe government has put forward a substantial number of structural reforms that will, as they are implemented, go a long way toward boosting potential and actual growth.

In the USJBC's view, some very positive measures have been outlined under the Third Arrow, particularly in the revised package announced in June 2014. The USJBC is greatly encouraged by the vision, and urges the Abe government to redouble its resolve to challenge the status quo where necessary and enact new reforms that meet the Prime Minister's objective of making Japan one of the globe's most open business climates.

The results in the Lower House elections last December provide Prime Minister Abe and the LDP-led coalition government a rare opportunity to deliver bold, long-lasting structural economic reforms that increase productivity, improve living standards, and make Japan a more competitive and attractive place for all companies - domestic and foreign alike – to invest and do business. This requires the right focus and determination to approve and implement a host of tax, trade, regulatory and other measures that make it easier and less costly to do business in Japan. While some of these measures are sensitive to specific political constituencies in Japan, it is important that reforms prioritize openness and opportunity as well as the economic or social welfare of Japanese citizens as a whole. In short, now is the time for Japan to move forward with bold economic reforms that change both the underlying conditions of the economy and the perceptions of Japan as a place to do business.

Correspondingly, the USJBC has identified a range of measures below that, if fully implemented, will both significantly contribute to economic growth and also have important "signaling effects" for the domestic and foreign business communities that reform is real. Action on these issues will raise confidence that Abenomics can achieve its goals, including Japan's transformation into a new global center for sustainable growth and opportunity.

Improving the Trade and Investment Environment

Trade Policy – the Importance of TPP

Japan's economy, contrary to stereotype, is not especially export dependent. Exports as a share of GDP are, in fact, lower than in all other OECD countries except the United States, standing at 16.15% in 2013. Notably, this ratio was lower in 2013 than in 2007 (16.15% vs 17.75%) but substantially above the 12.7% level reached at the heart of the global financial crisis in 2009. Measures that prioritize expansion of domestic demand and consumption, therefore, remain as essential as ever to bring about the greatest exponential growth impact from Abenomics.

At the same time, new exports also provide another route to add further to Japan's growth potential. Compared to the move among Japanese companies in the automotive, electronics, chemical and other manufacturing industries to globalize their production and supply chains over the past two decades, Japanese trade policy continues to play catch-up. Relative to Japan's major competitors in Asia, less than 20% of Japan's regional and global trade occurs under its bilateral and regional FTAs currently in force.

To its credit, the Abe government has set an ambitious target to bring the ratio of Japan's trade covered by bilateral, plurilateral or multilateral trade agreements from the current 19% to 70% of total Japanese trade by 2018. This is a commendable goal. The key for improving Japan's growth potential through FTAs is not only global coverage but also ensuring these trade agreements are both comprehensive and ambitious in scope. This means establishing the highest standards for rules governing trade and investment as well as agreement on the comprehensive elimination of tariff and non-tariff measures that restrict trade in manufactured and agricultural goods and services.

The USJBC underscores one fundamental point: Trade is a reciprocal process, and good trade agreements require that Japan must commit to opening its economy to imports in order to gain new market access for its exports. In spite of Japan's low average tariff on manufactured goods, the penetration ratio of foreign-branded manufactured goods in

Japan nonetheless remains low relative to OECD norms, particularly in sectors that are primary export sectors for Japan such as autos, electronics, and machinery. Of particular concern is the need for the removal of numerous "behind the border" non-tariff measures such as regulations, unique product standards, lengthy product approvals, and other measures that make it unnecessarily costly and difficult for foreign companies to export to or conduct business in Japan.

Although Japan imports agricultural products and food in large volumes, continued protection through high or prohibitive tariffs, government-controlled import mechanisms, unique Sanitary and Phyotosanitary (SPS) rules out of step with international standards or norms, and other technical barriers to trade have dramatically limited the extent to which U.S. and other foreign suppliers could sell high quality, lower cost food in Japan.

For these and other reasons, Japan's readiness to remove these various barriers and conclude an ambitious, high-standard and comprehensive Trans-Pacific Partnership (TPP) agreement is a critical aspect of the success of Prime Minister Abe's "Third Arrow." Indeed, in the USJBC's view, concluding a successful TPP agreement that removes tariff and non-tariff barriers alike is the most important Third Arrow step Japan can take.

Successfully concluding a strong TPP agreement will have an important signaling effect for international investors, sending the unmistakable message that Japan is open for business and truly welcomes unimpeded trade and investment.

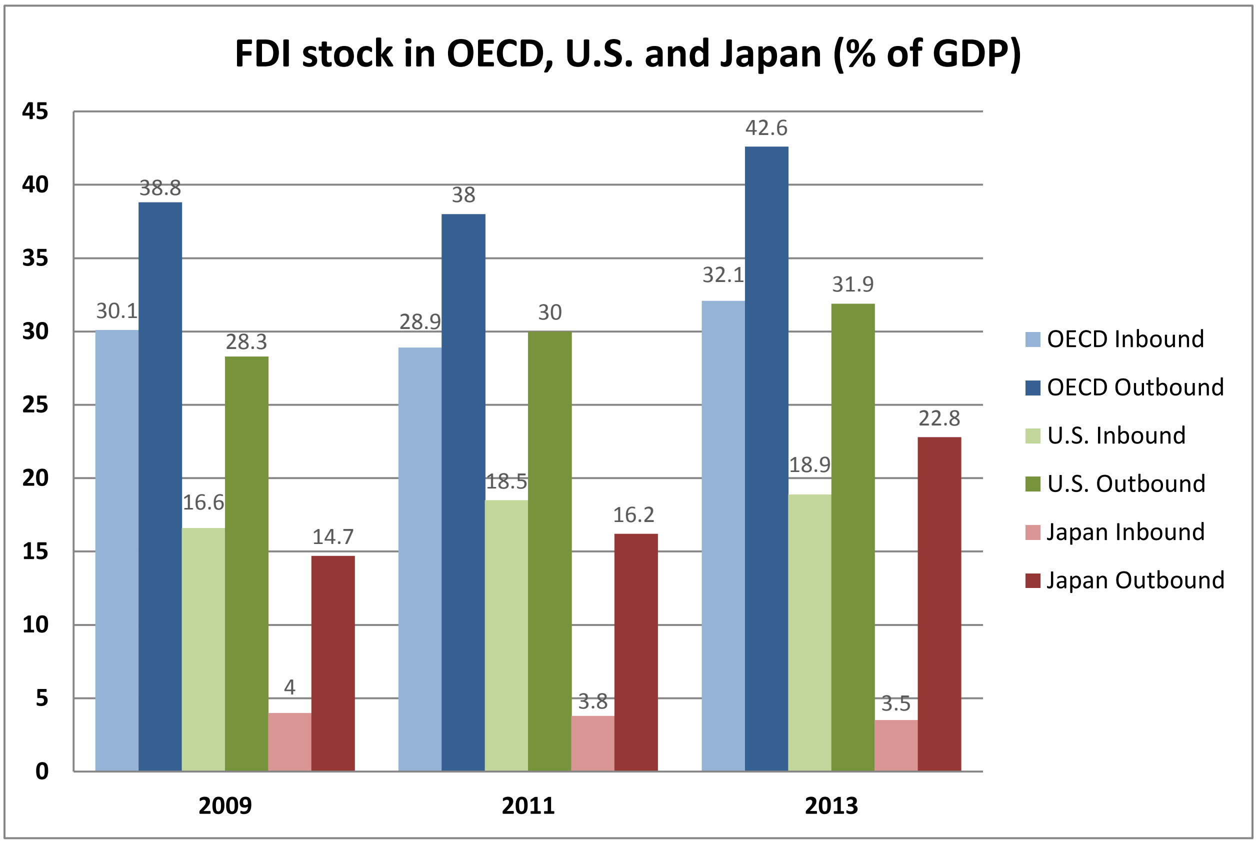
This is particularly true in the agricultural sector, where agreement to phase out tariff protection of agricultural goods has both symbolic significance as well as the potential to generate important overall welfare benefits for Japanese consumers and the economy. Given that subsidies provided by the Government of Japan account for almost 50% of the value of agricultural output according to OECD data – far higher than in any other OECD economy – the current system is inefficient and costly for domestic consumers. Moreover, consumers are hit again by the high tariffs imposed on many food items that Japan does import. At a time when the consumption tax is rising and incomes remain relatively flat, this imposes unnecessary hardship on consumers. Lowering tariffs on imported agricultural products, in contrast, should help compensate for higher prices imposed with the consumption tax increase.

The TPP will also establish important rules throughout the markets of TPP partners that will benefit many of Japan's key export products and services, including better IP protection, supply chain connectivity, digital trade, customs and trade facilitation, transparency and procedural fairness with respect to drugs and medical devices, and regulatory transparency overall.

Lastly and most importantly, it will go a long way to usher in a new era of competition and innovation in Japan that will benefit consumers and the overall economy.

Promoting Inward FDI

The USJBC applauds the Abe government's goal to double inward FDI by 2020. Japan is a notable outlier on virtually all measures of inward FDI. In terms of annual inflows, Japan ranked below Greece in 2013, with inbound FDI of only $2.3 billion compared to $2.6 billion for Greece. Japan's total stock of inbound FDI (historical value) measured only 3.5% of GDP in 2013, last in the OECD. Japan's outbound FDI, while substantially greater, also lags relative to the G-7, G20 and OECD economies. It is highly unlikely that Japan can come close to the G7 or OECD averages in the near term, but setting a more ambitious goal that brings Japan's abnormally low level of inward FDI much closer to the OECD average is a welcome step. Backing up the goal with concrete measures to improve the investment climate will give a boost to growth and employment, and help make the economy more dynamic as new technologies, services and methods are introduced.

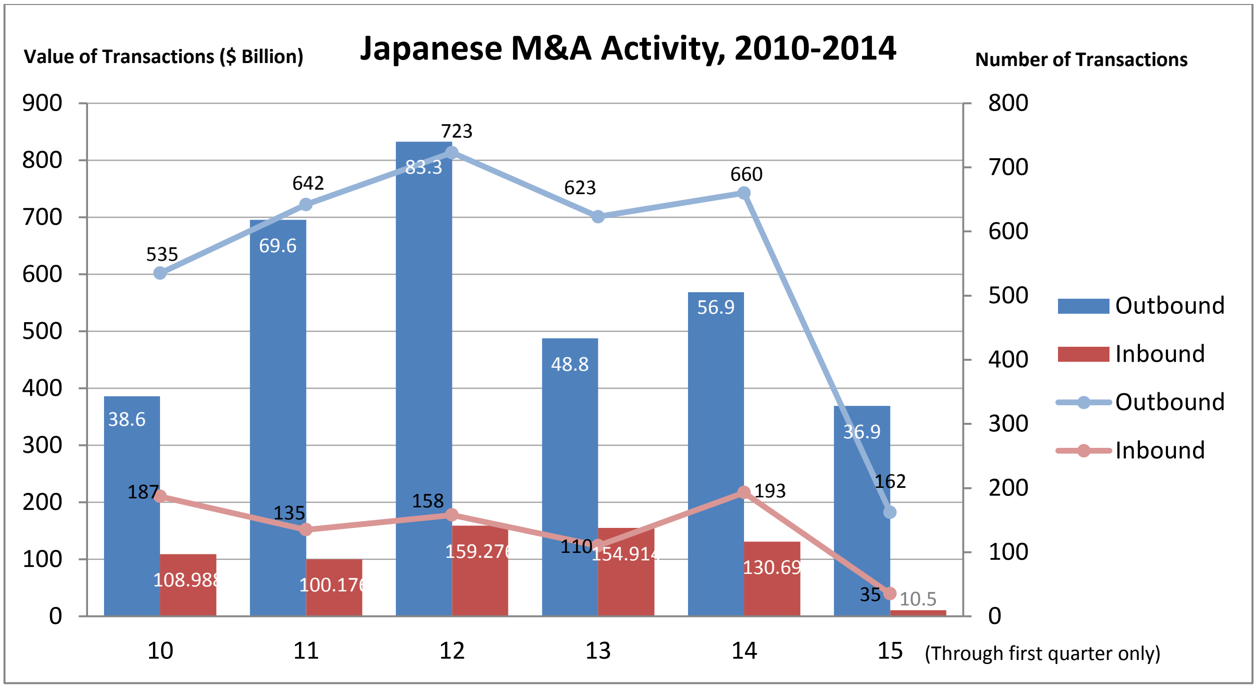


The good news is that Japan is an affluent market with much potential – a point continually illustrated by the country's high ranking in UNCTAD's World Investment Report, the World Economic Forum's annual competitiveness and innovation reports, and the World Bank's annual Doing Business reports. With its technology, educated workforce, and globally competitive companies, Japan has many unique advantages. Policies that help square the potential with actual performance is the key, in light of Japan's low scores on the UNCTAD FDI performance indicators and near-bottom ranking in the OECD for overall inward FDI.

To achieve or surpass its goal, the government must ensure that economic fundamentals and business conditions are attractive to foreign investors. Global companies such as USJBC member companies have choices and multiple opportunities to invest around the world, particularly in Asia, but limited capital for expansion. Special FDI promotion programs, incentives and advisory services are welcome and needed supplementary measures that can help make Japan a more inviting investment location. But if Japan cannot match the matrix of solid macroeconomic conditions, a supportive business environment, and business opportunities available in other markets, companies will choose to invest elsewhere.

The signal that Prime Minister Abe has sent in his Third Arrow reforms supporting foreign investment is highly welcome. So is his stated intention to drive reform to address some of Japan's deep-seated economic challenges, including excessive regulation, lack of transparency, high tax rates, unpredictability, high energy costs and inflexible labor markets – all of which dampen investor enthusiasm. However, in short, the most effective thing the Abe government can do to make Japan a more attractive destination for foreign companies is to achieve full implementation of Prime Minister Abe's Third Arrow reforms that foster restructuring of the Japanese economy.

Effective FDI promotion must also take into account the methods through which large companies – the major global investors – conduct FDI around the world, but particularly in mature markets like Japan, the United States, and Europe. While "greenfield" investment does occur in these markets, the overwhelming share of FDI occurs through Mergers & Acquisitions. M&A often can be the only practical means of entering or expanding business in highly developed, high-cost markets such as Japan. Here, too, Japan lags the norms for major economies in terms of the inbound M&A flows. Japanese companies are increasingly aggressive acquirers of companies across a wide range of service, technology, energy and manufacturing industries in the United States, Europe, Asia, etc., but foreign investors do not find nearly the same degree of openness or receptivity to foreign acquisition of Japanese companies.



Source: Thomson-Reuters

Absent a more welcoming M&A environment, it is likely that new and higher levels of FDI, and the innovations and ideas that it brings, will continue to bypass Japan. Closing the large discrepancy between Japan's outbound versus inbound M&A activity can be facilitated through new, focused measures, and recognition by Japanese corporations and their shareholders that it is often as much a value proposition and strategic opportunity for them as it is for foreign companies seeking to invest in Japan.

<u>Specific Recommendations</u>

- Government recognition that raising the level of M&A activity to G-7 norms of balance between inbound and outbound M&A is perhaps the most important step that could be taken to achieve ambitious FDI goals. To this end, government messaging establishing that inbound M&A is a critical part of Japan's FDI solution would be a helpful start.

- Commitment by the Abe government to explore and enact concrete policy or legal changes such as improved tax treatment and authorization of direct stock-for-stock cross-border stock swaps, as an alternative to the much more convoluted triangular merger mechanism currently in place, could have a positive impact on FDI in Japan by supporting new interest in opportunities for individual transactions.

- Opening new areas of the economy through legal or regulatory changes can create new opportunities for foreign companies. Promising areas include health care (hospital services), digital services linked to cloud and mobile technology, and travel and tourism. U.S. Integrated Resorts operators, for example, which are the largest and most successful in the world, are prepared to make major multi-billion dollar investments in Japan once the enabling legislation for IRs is approved in the Diet.

- Improving tax treatment as applied to net operating losses is another priority, as Japan has the shortest Net Operating Loss carry-forward period of any major developed country. The USJBC urges the Government of Japan to extend the carry-forward period to at least twenty years – the OECD average – and allow it to be applied to existing as well as new losses. Such treatment will be particularly vital for small, innovative companies to make the decision to invest in Japan in the start-up phase, as these companies often incur operating losses as they build their business, allowing them to carry forward net operating losses for long periods is thus important to make Japan an attractive destination for their technologies and investment.

  The USJBC applauds the positive move by the Government of Japan to introduce a new Corporate Governance Code. The Government should continue to encourage changes in corporate governance, including more independent and diverse board directors, more focus on shareholder return, and greater openness to M&A. The creation of the JPX-Nikkei Index 400 is a good example of the kind of further actions that are needed.

Cross-cutting Measures for a Dynamic Economy

Energy and Environment

The USJBC supports strongly and commends the Abe government for its efforts to implement an "all of the above" energy mix – nuclear, renewables, efficiency, and oil/LNG. An affordable and predictable electricity supply is critical for long-term growth. Without it, Japan will not be able to increase FDI to the scale desired, and will be uncompetitive as a manufacturing base. Moreover, efforts to promote growth in other sectors, whether health care, travel and tourism, or information technology, will be more difficult without stable and affordable electricity.

Specific Recommendations:

- Nuclear energy should continue to be a critical part of the energy mix and the USJBC commends the Abe government for moving forward in a clear and deliberate way to re-establish nuclear power with enhanced safety as a means of ensuring affordable and predictable base load electricity and reducing greenhouse gas emissions. The USJBC will continue to work with our Japanese private sector counterparts and both governments on measures to support the restart of nuclear plants with the requisite levels of enhanced safety, as well as broader public and political messaging about its importance to the Japanese economy.

- LNG is an increasingly important part of Japan's base-load electricity supply that can serve the dual purpose of providing stable electricity with lower GHG emissions than coal. The USJBC supports Japan's continued development of a diversified, balanced portfolio approach to LNG import sources, including from the United States, as a complement to Japan's traditional Australian and Middle East sources. To this end, the USJBC will continue to work with both the Japanese and U.S. governments and the private sectors through our ongoing energy dialogue to address the financial, logistical, commercial and policy issues involved in bringing U.S. LNG to Japan.

- Energy efficiency is a reliable, low-cost source of low-carbon power. While Japan has achieved notable efficiency gains in various parts of the economy over the years, more can be done to achieve broader efficiency gains. Energy efficiency is the "first fuel" – the cleanest and cheapest fuel, and there are a range of energy efficiency technologies that can be deployed to the meet this goal.

- The USJBC supports deregulation of the electricity sector in Japan, and specifically the separation of distribution from generation. As Japan moves forward with reforms, it is important that measures to expand capacity in the various regional utilities are put in place quickly in order to handle base loads and additional generation from solar and wind sources.

- The USJBC supports continued efforts to promote renewable energy in Japan. A robust target for wind energy usage as part of the new energy mix policy would be welcomed.

- The USJBC urges the Japanese government to work with the U.S. and other governments to update and streamline regulatory requirements by standardizing regulations across countries, where applicable.

    - For example, the United States has proposed hydrofluorocarbon (HFC) reduction regulations for certain end uses. Other countries are considering adopting similar regulations as well. This will help drive adoption of low global warming potential alternatives. The widespread adoption of these types of products could have a transformative effect on greenhouse gas emissions, especially when the increased use of these products is considered over the coming decades.

    - In addition, to ensure consistency and reduce unnecessary impediments and barriers, the Japanese government should standardize international testing methodologies in Japan. For instance, a new low-global-warming-potential product, HFO-1234ze, can be used as a near drop-in replacement for many high-global-warming-potential hydrofluorocarbons (HFCs). Although leading manufacturers around the world are adopting HFO-1234ze, it is not available to many companies and consumers in Japan because of Japan's unique flammability classification methodology. Japan should adopt the internationally-recognized ISO and ASTM standards to ensure global consistency in flammability classification. This would provide Japanese users with a wider range of safe and readily-available HFC alternatives.

Regulatory Reform

The USJBC is encouraged by Prime Minister Abe's strong commitment and progress to date to reduce the regulatory burden confronting businesses operating in Japan. The USJBC has long noted the high costs, administrative hurdles and uncertainty in how some regulations are administered as major problems in doing business in Japan – a view frequently echoed by the OECD, WTO and many Japanese business organizations. A sustained and concerted effort by the Abe government to reduce or eliminate regulation and improve further the transparency and predictability of the regulatory system is wholly welcomed and supported by the USJBC.

In broad terms, objectives for regulatory reform should be aimed at increasing regulatory predictability and transparency; easing business entry/exit; lowering compliance time and costs associated with administrative requirements; and improving further the public comment process for proposed new regulations.

<u>Specific Recommendations</u>:

- The USJBC urges the quick and full implementation of the National Strategic Special Zones policy as a means of starting the ongoing process needed to achieve Prime Minister Abe's deregulation initiatives. Most importantly, the USJBC stresses the importance of having dedicated officials within key ministries, the Diet and Cabinet Office tasked with ensuring specific measures are adopted as intended, and on a timely basis.

- The USJBC urges the Abe government, in consultation with local governments, to establish specific measures and pathways that will enable successful Special Zone deregulation efforts to be adopted quickly in other parts of Japan.

- To maximize chances for success, the USJBC urges active engagement by Japanese ministries and the Cabinet Office, taking into account views of domestic and foreign businesses, in order to develop ideas making the Special Zones as attractive and effective as possible.

Tax Policy

The USJBC welcomes the Abe government's effort to lower the corporate tax rate in Japan and concurs that taking the rate closer to the OECD average of 25% over the next few years represents an important step to improve the business environment.

<u>Specific Recommendations</u>:

There are additional positive tax measures that would also support new investment:

- Improving tax treatment as applied to net operating losses would be especially helpful for start-up companies. It is disappointing that the tax bill approved by the Government and now before the Diet does little to address Japan's outlier status as having the shortest Net Operating Loss Carry-forward periods of major developed countries. The USJBC urges the Government of Japan to extend the carry-forward period to at least twenty years – the OECD average -- and allow it to be applied to existing as well as new losses.

- Making permanent the R&D tax credit would provide certainty for companies over the longer term.

Labor Policy

The USJBC welcomes and applauds the Abe government's focus on labor market issues. From the perspective of foreign companies with large work forces in Japan, the top priorities for labor policy should be to expand the number of educated, skilled workers available while establishing more flexibility in the labor market.

The Abe government has correctly identified the most immediate means of expanding the labor pool -- bringing more women into the workforce and leadership positions. Among other benefits, increasing the participation rate of female workers not only will fill important gaps in the Japanese labor market as the work force ages but also is essential for bringing new talent and important new perspectives into corporate management. Evidence from Japan and other major economies suggests that financial performance is best in those companies in which woman hold board and leadership positions.

In addition, Japan needs to find concrete ways to increase substantially the number of both skilled and less skilled workers to fill particular needs, including technical professions, health care workers, construction workers and other categories. Without adequate labor, the economy will continue to fall short of its potential.

Measures to introduce more flexibility into the labor system are also essential, as this will enable domestic and foreign companies alike to hire more permanent workers, thus contributing to higher overall wages.

<u>Specific Recommendations</u>:

- The Abe government's recent proposal to ease the white collar exemption for certain categories of workers such as securities traders is a positive step that will help increase flexibility in some areas. To have a major impact, however, this approach should be broadened to include other non-financial professions in which highly-skilled office workers play a critical part in the company operations and management.

- The USJBC urges the Abe government to introduce a new voluntary labor contract that would fix in advance the severance to be paid if the company restructures or otherwise terminates the employment. This could be a first step to reforms that make it easier to hire more employees full time.

- The USJBC urges the Abe government to enact broad new measures to encourage greater women's participation in the workforce, including at higher levels of seniority, such as the establishment of more day care centers, more protections to ensure job security upon return from maternity leave, and more flexibility for professional households to sponsor household assistants from overseas.

Corporate Governance

The USJBC applauds the government's efforts to improve corporate governance and increase Return on Equity (ROE) in Japanese corporations. Japan's trading partners have for years called on Japan to encourage its corporate managers to better serve the interests of shareholders. To its credit, the Abe government understands that government policies and structural reforms that create the conditions for long-term growth cannot succeed without better performance from Japanese companies. To its further credit, the Abe government is addressing these calls with a series of moves that will incentivize corporate managers to deliver better returns shareholders. Together, these changes amount to perhaps the most successful element to date of the Third Arrow reforms.

The measures initiated so far include the introduction of a UK-style Stewardship Code, now endorsed by 183 pensions and other fund managers, which will require shareholders to engage in the management and strategies of the corporations in which they invest. The government has also revised Japan's Corporate Law and introduced a Corporate Governance Code, changes that include requirements whereby corporations either hire more independent directors or, if not, publicly explain why.

Perhaps the most impactful change, at least for the near term, has been the introduction by the Tokyo Stock Exchange and the Financial Services Agency (FSA) of the JPX-Nikkei 400 index, which requires corporations to meet tough standards of profitability and Return on Equity. Any company that fails to be included in the index is now publicly branded as an underperformer.

As a result of these moves, Japanese corporations are now beginning to return to shareholders the large quantities of excess cash on corporate balance sheets after years of grappling with deflationary pressures. Dividend payouts and particularly share buybacks – which improve return on equity – are surging to levels in 2014 that are nearly double what they were in 2009.

Japan's cross shareholding arrangements continue to be unwound, and are now at the lowest levels in decades. Corporations, meanwhile, are also conducting searches for qualified outside directors – including, in response to Abe government initiatives, more women – whose participation in management has a proven track record of improving performance.

The USJBC supports these moves, which together have already contributed to the strong performance of the Japanese equity market. That, in turn, creates investment options for the financial institutions – banks, brokerages, asset managers, pensions and insurers – who will be charged with allocating the capital needed to finance the retirement needs of Japan's rapidly aging population.

Specific Recommendations:

- The USJBC encourages continued movement to improve corporate governance along the lines established so far. Ensuring full implementation of these measures drives structural change and adds dynamism to the economy.

Sector-specific Recommendations for New Growth

Agriculture and Food

The USJBC applauds the efforts being made to reform Japan's agricultural sector. To its credit, the Abe government recognizes that the current system requires historic reforms given the combination of demographic and structural factors that inhibit higher productivity in the sector. The USJBC recognizes the sizable political complexities involved in agricultural reform, but is encouraged by a growing recognition by the Abe government and across Japan that major changes are unavoidable.

In broad terms, reforms are urgently needed that increase the scale of production through land consolidation, boost productivity through the introduction of new methods and technologies and, most importantly, bring new entrants into the sector through legal or regulatory changes that allow corporate entities to own and farm land. To its credit, the Abe government is developing and initiating reform policies that can, if sufficiently ambitious and implemented fully, help achieve these objectives over time.

Coupled with agricultural reforms, opening the Japanese agricultural market under the Trans-Pacific Partnership (TPP) agreement is an important opportunity to help Japan meet its food needs more efficiently while gradually shifting Japan's agriculture production to agriculture and food products that maximize its own comparative advantage. By placing greater emphasis on measures that facilitate the production and export of greater high-value products in areas such as protein (eg. wagyu beef) and produce, rather than maintaining support for inefficient staple commodity production, Japanese farmers can be more successful in domestic and international markets.

Continuing to subsidize and protect inefficient agriculture sectors not only misallocates public tax money but also imposes higher prices on Japanese consumers for those items. At the same time, opening the market to efficient, low-cost producers from the TPP countries can substantially meet Japan's demand for protein, grains, and other products.

Smart agriculture reform, coupled with trade liberalization, holds the prospect of lowering costs, introducing new efficiencies and incentives, and transforming a larger percentage of Japanese agriculture into the high-value, Grown-In-Japan food products that are in high demand both domestically and, increasingly, in overseas markets. This is, ultimately, an enhanced partnership opportunity in the agricultural sector that should create win-win solutions and opportunities for greater collaboration in this sector between Japan and the various major agricultural exporters in the TPP.

Specific Recommendations:

- Accelerate as quickly as possible measures such as reforms of taxes on land and zoning regulations to increase the scale of production through land consolidation.

- Approve as quickly as possible an ambitious and comprehensive TPP agreement in order to provide high-quality, safe, and lower-cost food to Japanese consumers through enhanced trading relationships with trusted agricultural suppliers such as the United States. TPP will, in the USJBC's view, actually help increase Japan's food security.

Digital Economy and Innovation (mobile, cloud, media/entertainment, Internet of Things)

Today, every business relies on the Internet and technology in some capacity, whether it is ensuring efficiency of a global supply chain or providing consumers worldwide with the best possible products and services. In fact, the "digital economy" is now essentially synonymous with the economy as a whole. Therefore, it is important that Japan ensures its companies, consumers and government have access to the best available technology and avoid adding new restrictions to cross—border data transfers or by implementing one-size fits all approaches to data privacy that add new burdens without adding an improved level of protection.

Despite strong broadband networks, Japan needs further expansion of its digital infrastructure to spur growth in the digital economy in areas such as mobile platforms, services and applications; cloud-based technologies and services for corporations; broadcast and internet-based media and entertainment; and the burgeoning area known as the "Internet of Things."

In particular, more wireless spectrum is needed to avert capacity constraints for new digital products and services linked to cloud, Internet of Things, and other mobile technologies. Improvements in the wireless auction system can generate new revenue, and increase investment and innovation in the wireless and broadcast industries.

An updated regulatory structure and practices that support further expansion in mobile services, broadcasting, and content generation (including for export) should also be a priority.

<u>Specific Recommendations</u>:

- The privacy bill recently passed by the Diet creates new requirements that will impede the movement of data in ways that cut off Japanese business and consumers from the global economy and hinders modern business models without providing greater data privacy or additional security. Best practices, such as the APEC Cross-Border Privacy Rules, which Japan recently joined, call for privacy rules that enable the seamless flow of data while accommodating different risk levels and uses of data. The USJBC looks forward to working with the government and private sector to craft privacy rules that both enhance privacy protections and facilitate innovation and growth.

- The USJBC recommends that the Government of Japan implement a market - based mechanism to allocate and trade radio spectrum utilized by private firms as well as public entities. Introducing an auction and a spectrum sharing system will enable more efficient use of spectrum, and it will set a level playing field equal to that in the United States and other OECD nations for further technology development and deployment.

- To ensure continued growth in the broadcasting industry, the USJBC recommends that the Government of Japan encourage the adoption of international best practices for television audience measurement (TAM) in order to bring Japanese practice in line with current best practices for TAM used in major markets around the world.

- Securing open and fair markets for trade in digital products is important to the current and future prosperity of the Digital Economy. The USJBC looks forward to working closely and collaboratively with the Government of Japan to develop and maintain trade policies that support greater inclusiveness and open, duty-free cross-border trade in digital products via the TPP, Trade in Services Agreement, and other agreements under negotiation at present or in the future.

Financial Markets and Services

The USJBC welcomes Japan's recognition of the importance of financial services as a source of growth and productivity enhancement. To that end, the USJBC applauds the efforts of the Japanese and Tokyo Metropolitan governments to realize the "Tokyo Global Financial Center" project to make Japan a financial hub of Asia, and encourages further efforts on the necessary regulatory reforms that are imperative for realizing the project.

The resource reallocation in the Government Pension Investment Fund (GPIF) is a positive step that can help meet Japan's financial needs. But without underlying corporate performance improvements, this step alone is not likely to translate into higher sustained valuations of the Nikkei.

Regulatory transparency and practice by the FSA has improved significantly in recent years, and we encourage continued efforts to fully modernize the capital markets as a means of increasing liquidity and investment capital in the economy.

The USJBC underscores that a level playing field is a key regulatory principle for strengthening financial and capital markets and avoiding market inefficiencies and competitive distortions in the markets. That is, there should be like regulatory treatment for like products and services, such as those provided by mutual aid cooperatives (*kyosai*), government-affiliated companies such as Japan Post entities and FSA-regulated private competitors.

<u>Specific Recommendations</u>:

- It is important to establish a level playing field, in terms of regulatory and tax treatment, between mutual aid cooperatives (*kyosai*) and FSA regulated private sector financial service providers.

- The Postal Privatization Law (PPL) requires Japan Post Holdings (JPH) to sell all its shares in Japan Post Bank (JPB) and Japan Post Insurance (JPI) "as promptly as possible" (PPL Article 7) and that "necessary restrictions shall apply to the operations of [Japan Post group companies] to ensure equivalent conditions of competition with businesses engaged in like business operations, and these restrictions shall be eased in accordance with the circumstances of postal privatization" (PPL Article 8).

  During the privatization process, the law requires that any easing of these restrictions (i.e., approval of new business) follow a process that includes review by the Postal Services Privatization Commission and authorization by the Prime Minister and Minister of Internal Affairs and Communications (PPL Articles 19, 110, 138, et al). This process shall remain in place regarding until such time that JPH has respectively sold at least half its shares in JPB and JPI (PPL Articles 110-2, 138-2). The Diet resolution that accompanied the Law further stipulates that even after 50% of JP is sold the Administration and the Privatization Commission must still review the competitive impact new business notified by JP would have on the private sector.

  In light of these requirements of the law and the Government of Japan's decision to move forward with privatization, Japan Post's decision to sell a portion of its shares via an initial public offering on a public stock exchange is an important step towards introducing market discipline, promoting transparency and good governance, and bringing about a level playing field.

  As the privatization process moves forward and as market discipline is increasingly introduced to the Japan Post entities, it is important to ensure the process is managed in a manner that results in equivalent conditions of competition with the private sector and allows the Japan Post entities to operate independently of each other, including permitting the post office to be a distribution channel for private company products, which would also maximize the economic value the Government derives from the IPO.

- Faster and more flexible product approvals for insurance products and services would help promote more competition and innovation in the insurance sector for the benefit of Japanese consumers.

- To relieve fiscal pressure due to unsustainable increases in health care and social welfare spending, which now accounts for more than half of the annual budget, the Government should consider measures to support and complement the national health care system by facilitating the introduction of retirement income solutions to give Japanese citizens more choice and flexibility. Examples of measures include expanding the amount of tax deferral for private pension plans and expanded tax incentives for health insurance.

Health Care Innovation

The USJBC applauds the Abe government's strong focus on developing a robust, innovative and competitive life-science industry. Japan is vitally important to the global pharmaceutical and medical technology industries, while these industries are also critical to the Japanese economy and people.

Health Care as an Investment

The USJBC recognizes that there are unprecedented budget challenges facing Japan given the aging population and workforce. However, the USJBC underscores that it is important to think of healthcare as not just a budgetary cost, but as an investment in people, the economy, and future of Japan. Sustaining a healthy and productive workforce as it ages is critical for Japan's economic growth going forward.

In this context, drug and medical device expenditures should be evaluated as an investment, not just as a cost. In the USJBC's view, reductions in reimbursement rates as a means to reduce overall health care spending is shortsighted, and must be balanced with an understanding of the huge benefits that come from early detection and treatment with drugs and devices to improve health, support healthy aging, and promote economic growth.

For example, the U.S. pharmaceutical industry published a recent study title and reference on the value of innovative medicines recently that demonstrates an overall financial benefit to the Japanese economy of 1.5 trillion yen from the introduction of just five new drugs. This value includes both the savings in treatment costs because of use of more innovative drugs as well as the productivity benefits to the economy. Similarly, numerous recent studies in the United States and Europe demonstrate the enormous benefits derived from medical devices (e.g. implantable cardioverter defibrillators, total joint replacements, insulin pump therapy, etc.), including adding years to life expectancy, improving quality of life and generating efficiencies and cost savings in the economy.

Essential Elements for an Innovative Industry

R&D is the lifeblood of innovative pharmaceutical and medical technology companies. To this end, the USJBC supports the Abe government's establishment of the AMED (Japan Agency for Medical Research and Development) to accelerate R&D in the sector.

R&D is critical, though insufficient, for the development of an innovative and globally competitive life science industry. Innovation also thrives where pricing, product approval and other basic policies support it.

Specific Recommendations:

- Product Approval: Japan has made great progress in recent years in reducing product approval times for both pharmaceutical and medical device products. Simultaneous global product development continues to be a goal of the industry, and an area in which industry and government can work together.

- Pricing: The USJBC applauds the introduction of the pricing pilot program to motivate development of innovative drugs, but believes strongly that this program for innovative drugs should be made permanent. Most importantly, the recent proposal to move to annual or *ad hoc* pricing revisions would negate much of the recent progress and would make the life sciences sector less competitive. In fact, any such signals, including a possible 2017 pricing revision, would negatively impact the industry's assessment of predictability in Japan. The USJBC also urges the Government of Japan to provide incentives that encourage investment and export growth in the medical device sector and repeal policies that detract from these goals. This includes elimination of the Foreign Average Price rule for medical devices, which acts as a disincentive for innovation and negatively impacts competitiveness of both domestic and foreign manufacturers.

Prevention and Vaccines
The USJBC urges Japanese policymakers to attach stronger importance to preventive health care and, especially, the vital role that vaccines play in public health and managing long-term healthcare costs.

Specific Recommendations:

- The USJBC urges the Abe government to move forward to restart the public vaccination program, and pledges to work closely with the government to address public concerns.

Travel & Tourism

The USJBC applauds the Abe government's initiative to boost the Travel & Tourism (T&T) sector as a major contributor to economic growth and job creation. The Travel & Tourism (T&T) industry is a major contributor to economic growth globally, representing a significant share of GDP and employment in most major economies. T&T is a major contributor to Japan's GDP and employment in absolute terms. Relative to other major economies, and some smaller economies in Asia, however, the contribution of the T&T industry is not as substantial.

In many respects, Japan is not fulfilling its potential as a Travel & Tourism destination for global business and leisure travelers. Japan has many characteristics needed for a robust and dynamic T&T sector, including rich cultural resources; a strong air and ground transport and ICT infrastructure; great geographic beauty and diversity that includes cosmopolitan cities, beautiful mountains and beaches; leadership in the areas of education and training and a modern financial system; and a strong customer and service-oriented culture and work force.

However, relative to other major global and regional economies, Japan's tourism industry ranks low in some critical areas, including tourism infrastructure, price competitiveness, availability of electronic payments networks, availability of qualified labor, and relatively high prices for accommodations and other amenities necessary for a strong tourism sector.

To its credit, the Abe government recognizes that a more robust T&T industry can contribute significantly to Japan's overall growth and employment. The convergence of three major developments – the overall reform and revitalization of the Japanese economy under "Abenomics," the Abe government's specific efforts and programs to increase T&T, and the 2020 Olympics in Tokyo – provide an enormous opportunity for accelerated growth in Japan's T&T sector if appropriate steps are taken to improve areas in the T&T industry in which Japan lags global and regional competitors.

Recent trends in the number of inbound tourists from overseas are very encouraging, but even with a record 13.4 million tourists entering Japan in 2014, inbound tourism in Japan still continues to lag major markets, and even smaller economies in Asia such as Singapore. Still, it is very encouraging that the Abe government is making a concerted effort to develop this important industry further, and is taking specific steps to facilitate greater expansion.

To improve the travel and tourism environment in the run-up to the 2020 Olympics, the USJBC urges the Government of Japan to address the following issues.

Specific recommendations:

- Airport Infrastructure and Service: In order to handle more tourists and improve access to major business and tourism centers, expansion of the number of slots available at Haneda airport, in particular, as well as at Narita airport for international flights during main hours is essential, as is increasing availability at outlying airports.

- Customs and Immigration: Efforts to improve customs and immigration at major airports are needed in order to reduce processing time for arriving visitors.

- Electronic Payments Networks and Accessibility: In the interest of convenience, safety and the security of visitors to Japan, it is vital to improve the electronic payment environment, in particular the network of acceptance. According to the Tourism Agency's 2011 survey on acceptance for inbound visitors, issues relating to credit card use were high on the list of inconveniences experienced by visitors during their stays in Japan. Many pointed out the limited number of ATMs accepting overseas-issued credit cards.

- Hotel Capacity: As the number of tourists increases in line with the Abe government goals, more hotels across a broader range of categories and price points will be needed to accommodate them, both in major cities and regional centers.

- Labor: To provide support for construction of new facilities, as well as permanent staffing of completed projects, more skilled and unskilled workers are needed to ensure capacity needs are met. This will be tied to broader labor policy changes and debates about expanding immigration, but the USJBC underscores the importance of factoring in T&T growth when considering overall workforce needs.

Long-Term Vision Beyond 2020: The Importance of MICE and Integrated Resorts
To fully develop its travel and tourism economy, Japan needs a long-term vision and drivers to sustain travel and tourism growth beyond 2020. Among the various proposals currently under consideration, development of Integrated Resorts offers the greatest potential to increase tourism beyond 2020. While Japan can leverage its many cultural and natural attractions to increase travel and tourism, Integrated Resorts will provide the kind of "destination tourism" attractions that will attract international tourists year-round in large numbers.

U.S. Integrated Resort operators are the most successful in the world, and are prepared to invest *billions of dollars* in new Integrated Resorts in Japan once the enabling legislation is approved. Investment on this level will not only sustain the growth in tourism beyond 2020, but will provide thousands of well-paying jobs across a range of professions in both the construction and operating phases, generate needed tax revenue, and provide major opportunities for business expansion for various Japanese suppliers of goods and services.

By focusing on MICE – Meetings, Incentives, Conventions and Exposition – business, which Integrated Resorts are equipped to accommodate, Japan can also expand the number of global business travelers who come to Japan on a regular basis.

Specific Recommendations:

- The USJBC appreciates the government's support for the proposed Integrated Resorts enabling bill, and urges it to make its approval a priority in the current ordinary session. Without approval of the basic legislation, Integrated Resort operators will continue to be in limbo regarding prospects for Japan, further delaying the project approval process and start-up work.