

JAPAN TRANSFORMATION

JANE 10th Anniversary Policy Proposal

December 28, 2022

Depopulation Low Growth Inward-looking society and economy Globally high tax rates Delay in digital readiness Lacking diversity in society Inflexible government



JAPAN TRANSFORMATION Change Japan Fundamentally

Make Japan a country where "people, knowledge, and money" gather from all over the world

There is no future for this country unless we change Japan toward a new era with the power of entrepreneurs

✓ Important measures for realization of JAPAN TRANSFORMATION(JX)

1

Give more authority to the private sector

- The role of the government should be shaped according to this core principle
- Forster a **philanthropic ecosystem** centered on private sector

2

Reduce globally high tax rates

- Countries with high taxes will inevitably decline
- **Prerequisite for any reform** necessary for JX

3

Promote and use of "New Combination"

- "New combination" of all the connections that are fluidized by digitalization
- **Create new value and improve productivity** through "new combination"

Important Policy ① Give more authority to the private sector

Free economic activities by the private sector efficiently allocate resources and realize “greatest happiness for the greatest number”

Give more authority to the private sector

The role of the government should be shaped according to this core principle

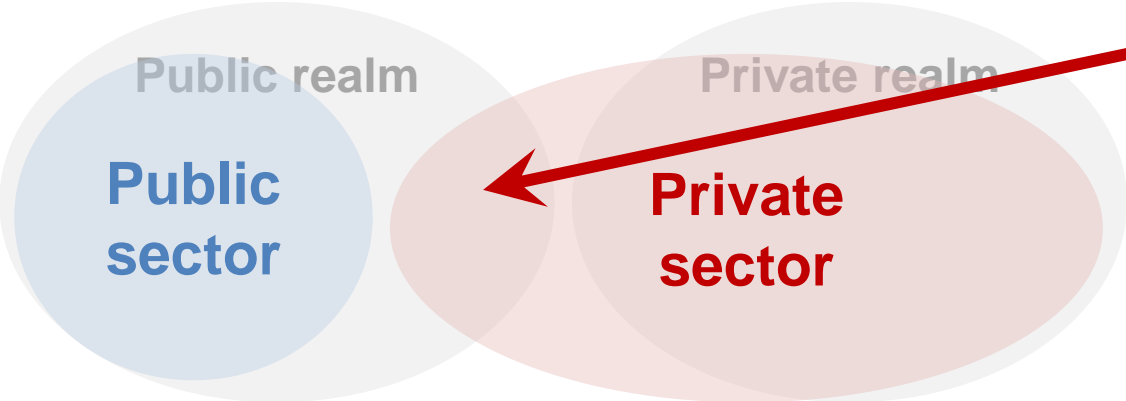
- ① effective functioning of the market
- ② complementing “market failure”
- ③ redistribution of wealth

In Japan, the issue is that capitalism is not thoroughly implemented in the first place, and structural reform is necessary even before “new capitalism”.



Public realm = Public sector
Private realm = Private sector

Even in the public realm, there are areas where the private sector can take charge, or where the private sector can be more efficient and effective.



(e.g.) Venture Philanthropy

A model that attempts to solve social issues by encouraging business growth through non-profit organizations and social enterprises. It has a wealth redistribution function.

Foster a philanthropic ecosystem and create new money flow

Important Policy ② Reduce tax rate that are high by global standards

Japan has a high tax rate on income for both individuals and corporations




Japan

55%
Including Local tax

29.74%




Singapore



India

30%
Surcharge of max 37% to large income earner



U.S.

Federal **37%**
States **0.0-13.3%**



U.K.

45%
max 46% in Scotland



Russia

15%

Tax rate on personal income
(maximum tax rate)

Tax rate on corporate income

(sources) OECD, JETRO Website tax system, MOF Website
Tax on personal income is based on progressive taxation
Data of corporate income tax rate is as of 2022 for Japan, US and UK, 2021 for other countries

Countries with high tax rate will inevitably decline

(e.g.) The exodus of companies and people from California to Texas in the US

From perspective of unleashing the power of the private sector, reducing the extraordinarily high tax rate and minimizing regulatory and administrative cost is necessary

<Reference> The relationship between tax rate and the economy

Lower tax rates do not necessarily lead to lower revenues because they are also a factor in economic growth (e.g., increased investment).

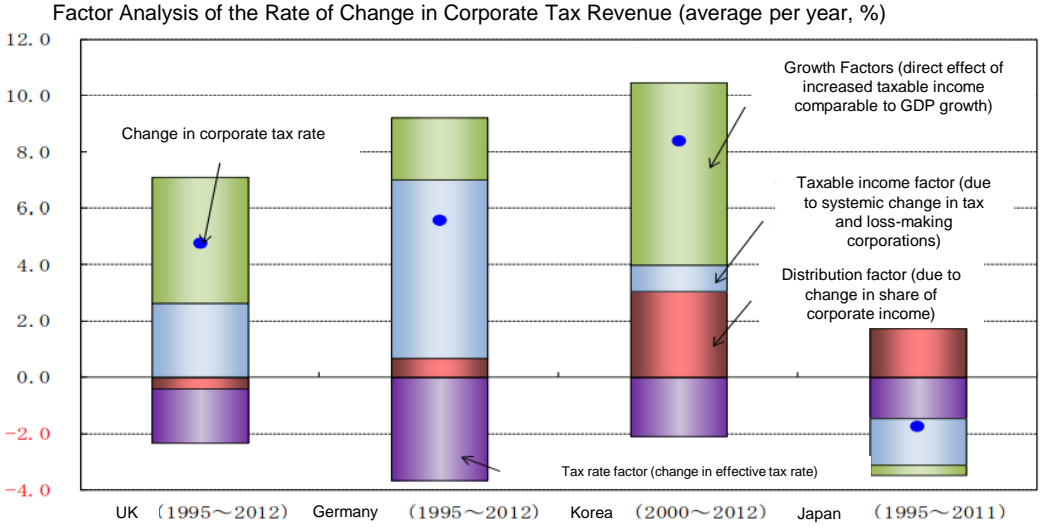
Background analysis of countries where tax revenues increased despite reductions in corporate tax rates

U.K.: Contribution from growth factors and expansion of tax base due to systemic reforms, etc.
 Korea: Growth factors contributed significantly. Rising corporate income ratio also contributed.

	UK	Germany	Korea	Japan
Tax revenue change	4.8%	5.6%	8.4%	▲1.7%
GDP change	4.5%	2.2%	6.5%	▲0.4%
Tax rate change	▲9.0%pt	▲24.9%pt	▲6.6%pt	▲10.4%

Estimated paths through which tax rates affect the economy (Reduction in corporate tax rate)

- ① **Increase in investment**
 ⇒ Mainly capital investment* and R&D investment
- ② **Consumption expansion**
 ⇒ Increase in employee wages, employment growth, and shareholder dividends due to increase in corporate CF
- ③ **Expansion of consumption demand**
 ⇒ Lower prices of goods and services due to reduced public burdens
- ④ **Promotion of inward investment**
 ⇒ Increase in attractiveness of corporate locations (see next page)



(Note) 1. Compiled by OECD National Accounts, OECD Tax Data Base, Cabinet Office "National Accounts", and Ministry of Finance Policy Research Institute, "Monthly Report on Fiscal and Financial Statistics". Periods covered by factor decompositions differ due to data constraints and are indicated next to the name of each country.
 2. The decomposition formula is: corporate tax rate = effective tax rate x (taxable income/corporate income) x (corporate income/GDP) x GDP; the same formula is log-transformed and decomposed from the factorial difference to the contribution to the average annual rate of change. Note that taxable income is calculated by dividing tax revenue by the effective tax rate. Corporate income is defined as the difference between operating surplus and property income of financial and nonfinancial corporations.
 3. Examples of changes in distributional factors include a shift from self-employment surplus and employer compensation subject to income tax to corporate income subject to corporate tax, and a shift from dividends received by households to retained earnings.

*If the decrease in tax revenues increases the budget deficit, it could have the negative effect of restraining capital investment through higher interest rates.

<Reference> Corporate relocation/population growth due to tax reduction (U.S. Texas)

Relocation of HQ to Texas

No. of relocated companies in 2021: 62 (Highest ever. 25 are relocated from CA)
 E.g.: Oracle, HPE*, Tesla, Caterpillar (planned), Toyota USA

Main reason of relocation

- 1 Transportation hub: Logistics hub not only within the U.S., but also with North and South America and Asia
- 2 **Low tax burden: 0% corporate and personal income tax**
- 3 Affordable living environment: Easy living with low cost of living, including prices and rent

Major tax system

	corp. tax	personal income tax	sales tax	fixed property tax
Texas	0%*	0%	8.20%	1.60%
California	8.84%	13.3%**	8.82%	0.70%

*franchise tax ** highest tax rate
 As of July, 2022
 (Jan 2022 for personal income tax, 2019 for fixed property tax)

Data

Number of projects expanded* (state, 2021)

- First rank in 10 consecutive years for number of PJs expanded
- Tesla released to spend 10 billion USD for investment to a new factory.

Texas	1,123
Ohio	507
Illinois	480
California	301

(Source: Site Selection magazine HP)

*Businesses that generate more than \$1 million or more than 20 jobs or more than 20,000 sq. ft. of new space

Population growth rate (compared to 2010)

Entity	Growth Rate (%)
Texas	+16.5%
US	+6.6%
California	+5.5%

Issues with increasing Financial Income Taxation

- Punitive tax increases on those with high incomes as financial income taxation is a strong negative message in attracting "people, knowledge, and money" from around the world, and is a major problem.
- Taxation on capital gains and dividends is double taxation.
- Financial assets are a major asset of Japan. However, asset owners will flee Japan to other countries if punitive tax increases, and it will be also difficult for attracting asset owners to come to Japan. This will have a negative impact on stock prices, and investors will also leave the Japanese market.
- The "brain drain" and deterioration of life in California, where taxes are high is a lesson for Japan.
- Japan's personal income tax is already higher than in the U.K., U.S., and other countries currently showing development.
- The effect of increasing national tax revenues is limited even if taxation on financial income of high-income earners is strengthened. Review of spending and a more balanced budget are needed.

Important Policy③ Promote and utilize "New Combination" opening the country and accept immigrants

Progress of globalization

Does not mean homogenization of the world or loss of originality of country

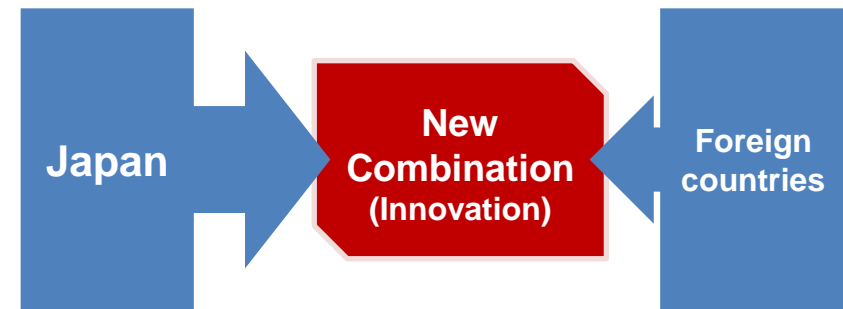
Encountering uniqueness of other countries brings in **new perspectives**

By "opening the country",
create new value through "new
combination" of Japanese originality
and foreign perspectives

**Actively promote acceptance of
foreign people including immigrants**

If Japan does not try to actively engaged in building relationship with foreign countries, Japan will be simply disregarded (Japan passing), and nothing valuable will be created.

Japan will not be able to keep up the country with **Galapagos-thinking** "of Japanese, by Japanese, for Japanese".



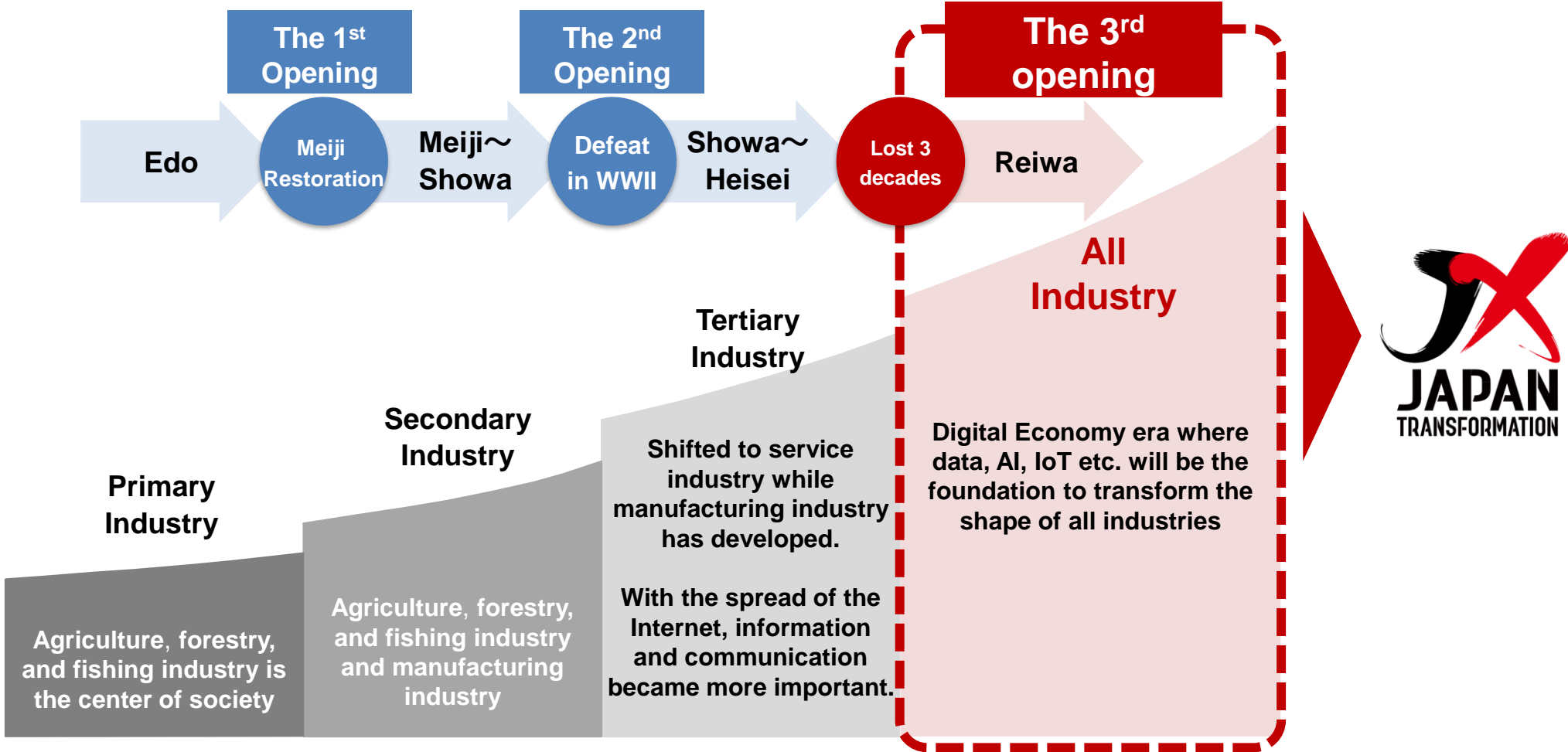
Originality of a country (culture, sense of values, philosophy) can be a vital factor of "metagame" of business

No future for a country with a declining population

It is important from perspective of coping with population decline

Necessity of the "Third opening of Japan"

- **Globalization** is an inevitable phenomenon that is accompanied by digitalization, which enables activities that transcend constraints of time, place and scale. **"The Third Opening of Country"** based on structural change of industry is necessary.



Need to build systems to meet global standards

Globalization as an inevitable consequence of the digital economy

Digitalization eliminate location constraints.
In the digital economy, market expands beyond country borders

Necessity of international system harmonization

A system in one economy influences behaviors and systems in another economy

Participation in global system making

The "**interdependence**" of national systems is evolving, and **active engagement** is required to enjoy the fruits.

Rather than simply accepting the agenda set by other countries, Japan needs to be actively involved in the making of internationally required system.

Ensuring global equal footing of systems

Japanese companies could not compete in global market when they need to comply with Japan original restrictions and obligations

Apply and enforce existing domestic systems (tax and regulation) to foreign companies operating in Japan

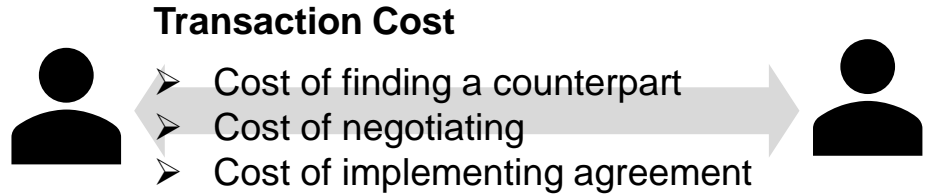


Change domestic systems to comply with global standard

Promote and utilize “New Combination” – flexible policy and rule

The essence of digitalization

More than just efficiency improvement, **create new value** by bringing the **change** in people’s **transaction cost**



In the **digital economy**, the **forms of and relationship** between **individuals, companies and governments** becomes **fluid**

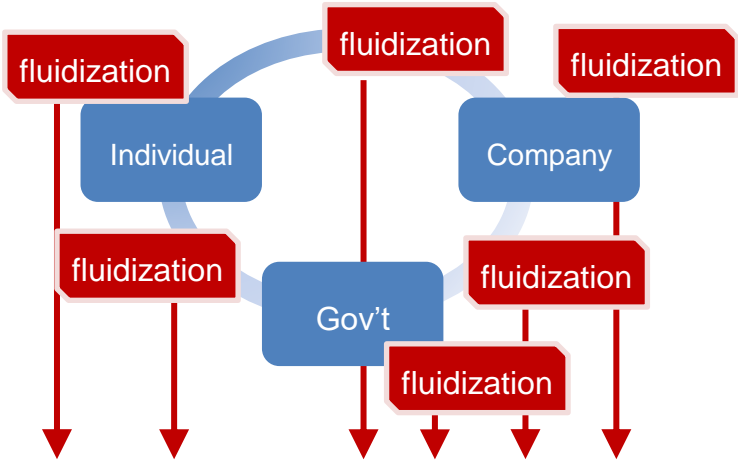
New connections among various entities will enable **productivity increase** through the **creation of new value**

- Organizations, such as companies are one form of connection between individuals, and so **form of organizations are required to change**
- Make a **smooth transfer to new type of jobs** from jobs that are **disappearing by digitalization**, and increase total volume of employment is necessary to realize **through digitalization**

Enables new business models that were not cost-effective in the analog economy

- Expand market to the far locations
- Business in niche markets (long tail)
- Sharing Economy

Digital Disruption



“New Combination” to create new value and improve productivity

Flexible policies and rules to create “new combination” (Innovation) are needed

Comprehensive reform, not partial reform

Complex interrelated structural issues

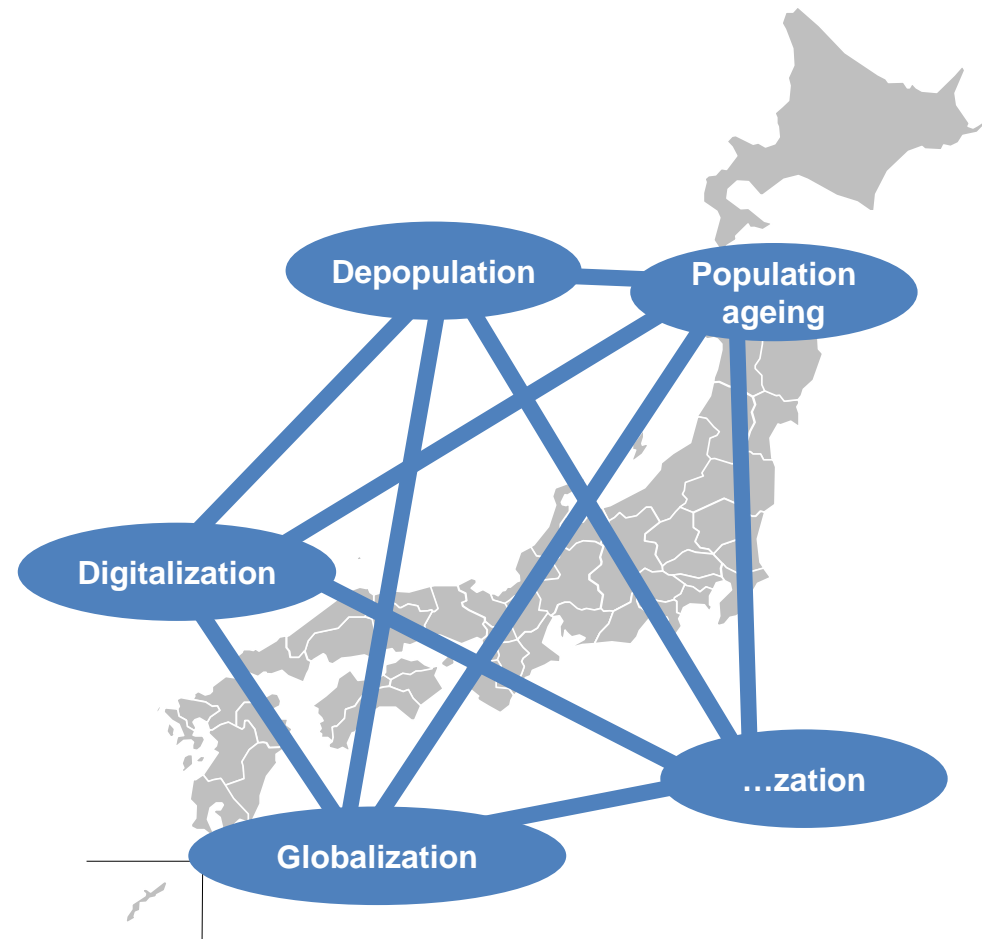
Structural changes are the source of various issues.
Because of this, issues are interrelated.

Partial reform addressed **only some of the issues** may end up with followings:

- policy implementation **not producing the intended results**
- **adverse effect** such as **double cost** due to coexistence of old and new systems, and produce people who bear the pain of **losing jobs due to digitalization**

Reform needs **social consensus** but tackling only a few issue will lead it in a **wrong way**.

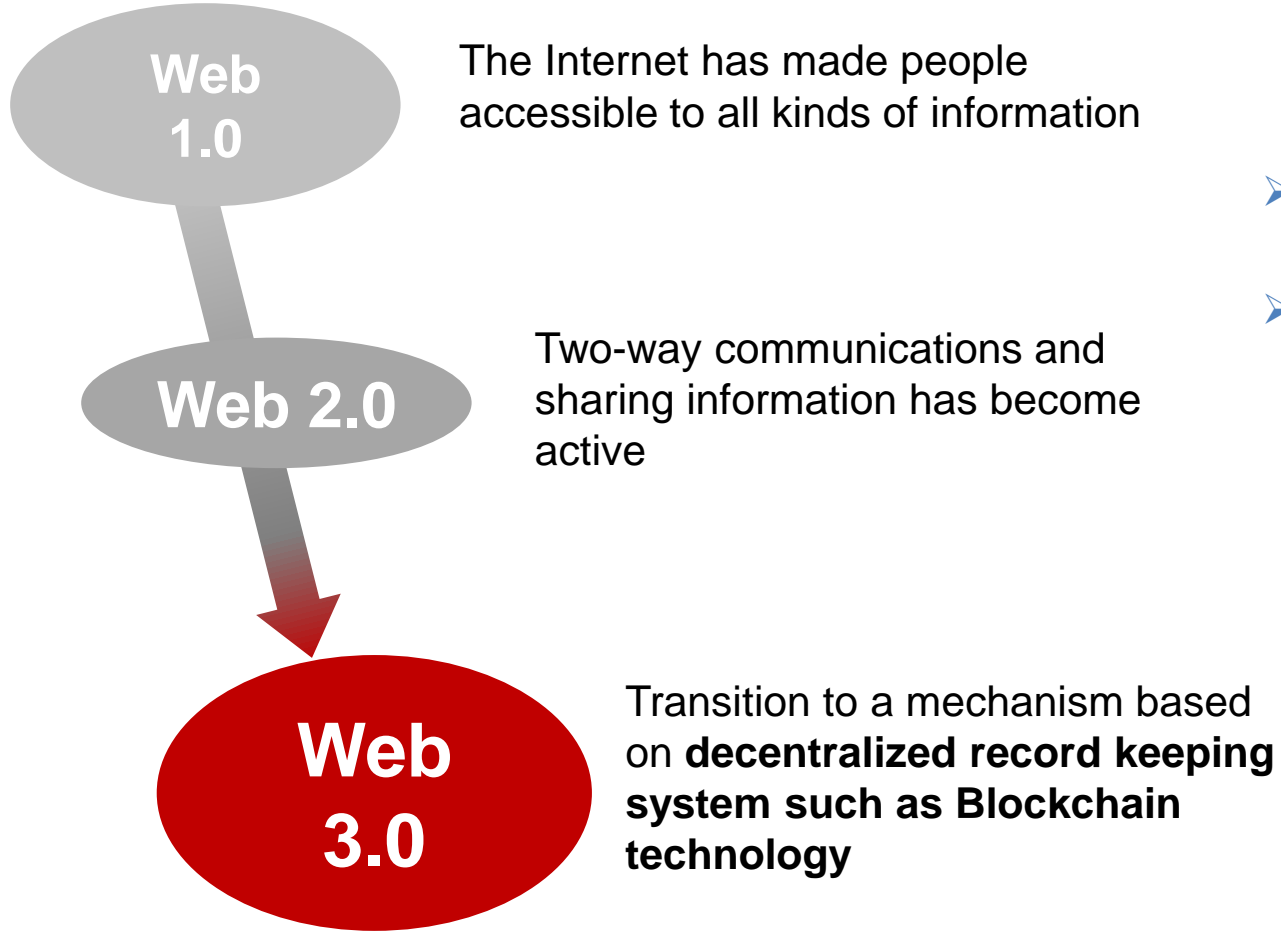
- “Neoliberalism” which may conceived to be negative



Need to carry out comprehensive reform, not partial reform, with strong political will and persistent persuasion.

Need to respond to the Web 3.0 era

- In the short span of time since the Internet first appeared in the Heisei era, **the Internet world is evolving into Web 3.0**. This is an **opportunity to break the "digital defeat" up to Web 2.0**, when the advantages of digital technology were not well utilized and foreign businesses were allowed to dominate the market, and to embark on a **new challenge**.



Digital defeat

- Japan has **failed to take advantage of digital technology**
- **Foreign players called "Mega platformers" dominated even in the domestic Japan market**

New opportunity

Directions for action towards “New Combination”

What is necessary in Japan now

To achieve **prosperity** by **increasing productivity** through **creation of new value** (\neq cost cutting) by ensuring **innovation/entrepreneurship/globalization** in the **digital economy**.

Impossible to achieve with various issues unsolved

- Cannot compete internationally due to high tax
- Difficult to do business due to regulatory constraints
- Cannot hire due to high "recruitment costs"
- Inability to reform with inventive ideas at local level
- Government is unable to address issues quickly
- Redistribution cannot proceed efficiently
- Low birthrates make it difficult to envision the future
- Unable to acquire necessary skills in education
- Foreigners and women are unable to demonstrate their abilities

Creation and development of business freely and flexibly

- Tax reform to reduce high taxes and create International competitiveness
- Regulatory reforms that do not hamper business in the digital age
- Labor policies that enable active employment and utilization of human resources

Pro-reform and efficient political and administrative systems

- Reform of the government system to encourage competition among local governments
- Central government reform to realize pro-business administration
- Redistribution and social policies that leverage the power of “private” sector

Mechanism to make the best use of people with “the right person, in the right place, at the right time”

- Education policy to develop human resources for the digital economy
- Immigration policy to actively accept human resources from overseas
- Labor policies that enable everyone to exercise their abilities in the jobs they want

Policy Action Item

① Drastic reduction in tax rates and elimination of Galapagos regulations in funding and business.

- In order to compete for global talent acquisition and attraction of company locations, drastic reduction of individual/corporate income taxation and inherit tax (e.g., maximum individual income tax rate from current 55% to 40%) and revision of departure tax
- Revision to book value assessment taxation of tokens, including those held by third parties, and separate taxation of profits from crypto asset transactions
- Removal of restrictions on the listing of class shares
- Elimination of Galapagos regulations such as those that hinder inbound tourism (e.g., restrictions on heli-skiing and water cottages)
- Elimination of restrictions on C2C businesses such as ride-sharing and minpaku stays
- Conduct a collective review of the necessity and effectiveness of all the individual "business laws"

👉 **Companies can create and develop global businesses on a level playing field**

② Enact a "Basic Immigration Act" and establish an employment system of attracting people from the world.

- Clarification of the principles for accepting foreign nationals by enactment of the Basic Immigration Act and abolition of the technical internship system
- Introduction and thorough enforcement of rules for starting and ending employment based on job descriptions, which is normal outside of Japan
- Abolition of systems based on the "breadwinner of the family," such as the spousal deduction
- Establishment of a social insurance/labor system that facilitates freelance and other forms of work other than "employment".

👉 **Individuals can get opportunities of new job, job change, and job assignment of their choice and demonstrate their abilities in jobs required in the digital age**

👉 **Companies are able to utilize diverse and highly engaged human resources in the right place and at the right time**

Policy Action Item (Continued)

③ Promote reform competition among local governments and foster a philanthropic ecosystem

- Establishment of a government system that promotes reform and competition among local governments with the *doshu* system as one option, and thorough national standardization of data infrastructure
- Drastic tax reduce and social security spending reform, reform of the public interest corporation system and the donation tax system in an integrated manner, and creation of new money flow through the "private" sector playing a "public" role (e.g., venture philanthropy)
- Recruitment and assignment of highly specialized human resources, and legalization of the EBPM principle in the government
- Abolishing the lifetime employment system for each ministry, which leads to bureaucrats becoming a resistant force tied to vested interests
- Adopting the common law approach and avoiding "pre-emptive regulations" through codification

☞ **Enables efficient government for evidence-based, pro-business responses in an agile manner**

④ Break away from an educational style that accumulates individual knowledge and strengthen "LEEDF" education on a broad base

- L: Leadership / E: Education / E: Entrepreneurs / D: Digital / F: Financial education—strengthen those in elementary, secondary, and higher education
- Expanding the number of faculty members with business experience, increasing the students in information related departments and curriculum reform in the university to respond to the digital age

☞ **Enables individuals to acquire the ability to think for themselves and live in the digital age**

⑤ Regulatory and taxation systems reforms to ensure digitalization in preparation for the Web3 era

- Enactment of the "Comprehensive Act for the Promotion of the Formation of Web3 Society" to collectively reform regulations and taxation systems that hinder the development and spread of blockchain/NFT
- Revision of the "Basic Act for the Formation of a Digital Society" to clearly state the principles of complete digitization of all procedures in the public and private sectors, realization of a "zero-cash society" by 2030, and opening of APIs.
- Introduction of regulations prohibiting acts that impede competition and fee regulations focused on OS/applications stores

☞ **Enabling "new combination" of connections throughout society that creates new value, not mere efficiency**