Taking the lead: Establishing new channels providing investment yield, high wages and skills development in order to attract foreign resources

Mr. Kieran Hull
(U.K., age 26)

( full text )

Introduction

Increasing inward resource flows from abroad is a challenging feat for Japan. On the one hand, capital and labor linkages between Asia’s most developed economy and its foreign counterparts are highly developed. Nonetheless, Japan’s net FDI inflows compare poorly with those of similar economies. Immigration is also relatively low. The challenge is therefore to devise a strategy which not only enhances existing linkages but also creates new channels through which resources come to Japan. Success relies on analyzing the demands of foreign capital and labor – investors are looking for yield, while workers want high wages, skills development and quality of life. Policies must therefore make Japan an attractive destination for these resources. This paper asserts that growing domestic markets show investors they can make returns on their money in Japan while also providing employment opportunities. Understanding these arguments and how they can be practically applied requires one to analyze each of Japan’s industries, positioning them in both a domestic and a global context to learn of the economic viability and potential benefits of proposed policies.

Current context: Japan’s economic structure

With a Gross Domestic Product (GDP) per capita of $36,194 for 2014, 1 Japan is comfortably positioned as a highly developed economy. In gross terms, it ranks 3rd in the world. Other indicators including inequality and unemployment confirm the country’s stature. This suggests a high standard of living for the country’s residents – an attractive quality for foreign labor.

Considering the importance of each industry to the Japanese economy, the contribution to value added increases from primary to tertiary sector. As of 2013, agriculture contributed just 1.2% to value added, with manufacturing’s share 26.2% and services’ share 72.6%. These figures are roughly in-line with the average member of the Organisation for Economic Co-operation and Development (OECD). The general trend is an increasing importance of services.

1 GDP and value added figures from the World Bank 2015; “World Development Indicators”; accessed online August 2015
< http://data.worldbank.org/indicator/NY.GDP.MKTP.CD >
When constructing a roadmap for enticing foreign resources to Japan, one must be aware of this context. Policies aimed at agriculture are likely to have less economic impact than in services given the relative size of each industry. Nonetheless, for an all-encompassing plan, one must look at each sector individually to understand 1) what the current strengths and weaknesses are; 2) how Japan can attract investment and human capital from overseas; 3) which stakeholders will be involved and how they will interact and combine for implementation; and 4) projections on impact and spillovers to other industries.

**Agriculture:**

1) Agriculture in Japan is a declining sector. Value added is falling when compared with manufacturing and services, with employment numbers also dropping. Falling employment can be explained by the demographics of agricultural workers; in 2014, 49% of farmers in Japan were 70 years old or older.2 This is a problem because the number of workers leaving the sector is greater than the number entering it - between 2011 and 2014 there was a near 13% drop in the size of the agricultural labor force. Aside from the issue of labor, another key problem relates to Japan’s global competitiveness. Annual subsidies for agriculture represent over ¥2trn.3 This assistance has made agriculture a stumbling block in Trans-Pacific Partnership (TPP) negotiations.

Nonetheless, agriculture is an incredibly important industry to Japan. In terms of food security, Japan struggles due to the amount it imports. Further degradation of the agricultural industry pushes the country towards greater reliance on others: this may not be an issue currently, but it would certainly become one in the case of natural disasters, international warfare or other potential risk factors. Besides issues relating to food supply, agriculture is intrinsically linked with the country’s culture. Washoku (traditional Japanese cooking) was added to the United Nations Educational, Scientific and Cultural Organization’s (UNESCO’s) Intangible Cultural Heritage list, while Japan’s restaurants regularly rank at the top end of global food guides; success in these areas has been at least partially attributable to the quality of Japanese agricultural produce.

2) As an investment prospect, agriculture is therefore not a compelling choice. On the one hand, prices have been increasing which is positive for capital inflows. Japanese inflation data shows food prices are the fourth biggest riser since 2010 after fuel, light and water charges, energy and miscellaneous.4 Basic economics explains this through falling supply. However, while wages have remained fairly stagnant, productivity has fallen – therefore, profitability is not improving. Thus while investment into agriculture may have some

---


3 Y. Harada 2013; “Japan’s Agriculture and the TPP”; *The Tokyo Foundation*; accessed online August 2015


4 Inflation, wage and productivity data from the Statistics Bureau of Japan 2015; accessed online August 2015

attraction in that the industry is protected and can only be properly accessed through investment since tariffs are so high, there is little evidence of the sector offering strong growth prospects.

To revolutionize, the sector needs reforms. Encouraging larger scale farming over individual agricultural venues is often cited as a potential driver for productivity. Furthermore, while completion of the TPP would be painful in the short term owing to increased competition, it could help to consolidate and improve efficiency in Japanese agriculture. However, policies in this area will take time. The current state of agriculture can be explained by various historical factors, meaning immediate change is unrealistic. Therefore, while this paper recognizes the importance of implementing reforms, it also seeks to bring new ideas. Indeed, even if the TPP is finally implemented, it is unclear whether resulting efficiency gains would be enough to counteract downward price pressures coming from an open market, and stimulate foreign resource flows.

However, if productivity gains could be achieved in conjunction with lower wages then perhaps there is a case for agriculture as a venue for capital and labor from abroad. This paper asserts that foreign workers have the potential to make the industry more efficient and in turn attract investment from abroad. Given the demographic challenges the industry faces, bringing in young workers is particularly important for easing the burden of more labor-intensive tasks. Two channels can achieve this target.

First, agritourism in Japan is an underdeveloped area. The idea is to bring in workers from abroad to help on farms and at other agricultural venues, with payment being mainly in the form of accommodation and a percentage of the food harvested. Many of these workers may come for relatively short stays. However, it is the workers who can stay beyond the normal vacation length that can make a particularly big difference in helping where Japan’s agriculture really struggles in terms of productivity - seasonal goods such as fruit, vegetables, rice and so on. The ‘gap year’ market, where young people take a year off between school and university to travel the world, is one area which could be targeted.

However, while younger workers may hold a productivity advantage when it comes to agriculture on account of greater physical endurance, this is unlikely to be realized in agritourists without any farming experience. The second channel is therefore to twin agricultural venues with agricultural colleges within the country, thus involving increasingly skilled workers. Given the importance of education on productivity for agriculture, offering courses with summer or year-long internships at farms can boost efficiency gains without severely impacting costs. Such courses should be available to both Japanese and foreign students – the latter can be encouraged to come to Japan through scholarships and more classes taught in English.

Through these channels, investment becomes more attractive. However, potential capital inflows must be facilitated too. For foreign investors looking to invest directly, improving the business environment is important, given how Japan’s lags behind many developed contemporaries in this area (particularly on starting a business,
dealing with construction permits and registering new property). Indeed, such an argument applies to industry and services too. Away from FDI, an exchange traded fund (ETF) comprised of agricultural assets could also give investors outside of Japan the opportunity to get involved in the sector.

3) The government must be behind such a plan. Importantly, visa rules may currently be prohibiting the inflow of workers from abroad: change here would therefore be required. The government would also need to work in conjunction with agricultural bodies and educational institutions to understand how policies should best be constructed to ensure successful implementation. Marketing at both public and private sector levels would mean a more coordinated thus effective approach.

Given the economic benefits associated with essentially free workers in the form of agritourists and interns, the financial burden for scholarships and development of the agritourism business in Japan should fall mainly on the private sector. Mandatory substitution imposed by the government away from subsidies to the described policies could be a way of enforcing implementation. The agricultural sector should work with NGOs with expertise in tourism and student welfare so they are ready to attract and accommodate human capital which may not be accustomed to Japanese living. Finally, securitization of agricultural assets would be the responsibility of the financial sector; securities firms and asset managers have experience in constructing ETFs etc.

4) Measuring the expected impact of such policies is difficult given the youth of agritourism as a global industry. Studies on the U.S. and Canada highlight that although schemes tend to have a loyal tourist base which contributes meaningfully to the profitability of host venues, it is not a well-defined space and more work has to be done. Therefore, the budget for these schemes must take into account these uncertainties, as well as the size of agriculture and the existing support provided to the sector by the government. Initiatives should be implemented in conjunction with studies to better understand agritourism in order to optimize policies.

Potential spillovers to other industries are significant. As mentioned, tourism services, education services and financial services would all benefit. Furthermore, given the current rural-urban divide within Japan and the issues relating to ‘brain-drain’, such a policy could also give welcome relief to struggling areas in the countryside. Finally, any knowledge transfers from experienced elderly farmers to the younger generation of both domestic and foreign workers can help to secure the food supply in the future for Japan and other countries. Such international relationships can help strengthen Japanese agriculture in the global value chain and promote

5 World Bank 2015; “Doing Business 2015”; accessed online August 2015  
<http://www.doingbusiness.org/data/exploreeconomies/japan>


7 C. Barbieri 2010; An Importance-Performance Analysis Of the Motivations Behind Agritourism and Other Farm Enterprise Developments in Canada; p1-20 : Journal of Rural and Community Development : Volume 5 : No.1
the various high quality products made within the country, which are generally underrepresented in Japanese export figures.

**Manufacturing:**

1) The second area to consider is manufacturing, a sector which has historically been very strong, but weaker as of late. In some markets, Japanese manufacturing is healthy: for example, in automobiles Toyota, Nissan and Honda remain global leaders. Their success has in part been due to their ability to adapt with the times, illustrated by their currently strong position in ecofriendly and hybrid cars.

However, other areas provide cause for concern. In electronics, Sharp was effectively bailed out in May 2015 by Mizuho and MUFI, while the troubles of Toshiba, Sony and many others show the country’s previously dominant position in the field has been greatly eroded. Criticism of such firms often relates to corporate governance, and the inability to identify (or even desire to acknowledge) loss-making parts of the business and eliminate them.

2) This paper asserts that attracting foreign resources must therefore follow a binary strategy in acknowledgement of these differences within the market. The arguments here focus more on investment than labor. First, the areas in manufacturing which are currently succeeding such as automobiles already attract foreign resources to some extent – the key is to ensure these flows continue. Policies must therefore focus on keeping Japanese firms at the top. Such a mandate requires one to have some idea of the future of the industry – a challenging task. Nonetheless, ensuring that technological development is at the forefront of company mindsets is one area which will always be important.

Historically, Japan has been successful in taking existing technologies and improving them. The current status of global manufacturing may provide similar opportunities. For example, Germany has been developing ‘Industry 4.0’, a so-called fourth industrial revolution involving ‘individualized production, end-to-end engineering in a virtual process chain and production networks.’ Studies on the potential gains resulting from the imposition of such technologies make a resounding case. Admittedly, it is unlikely that implementation would have a positive effect on foreign labor inflows – part of the premise of ‘Industry 4.0’ for example is that machines and computers can communicate with each other thus reducing the need for human input. Such technologies can however push productivity thus profitability – a massive driver for foreign investment. Specifically, the initiative

---

8 Sharp 2015; “Notice regarding the issuance of Class Shares by third party allotment, revision of a part of articles of incorporation, decreases in capital and capital reserve, and appropriation of surplus”; accessed online August 2015


seeks to create a new way in which products are made, not new products per se. Because the area is relatively untested and global standards are yet to be set, there is an opportunity for Japan to establish itself as one of the leaders of the movement. This is a realistic proposal given the existing strength of intermediate goods production within the country. Looking at the world’s top companies, it is clear that innovators attract capital. If Japan’s manufacturing companies can push global innovation, investment will follow.

However, implementing industrial change can only be successful if it is backed up by supportive management systems. Evidence from the ailing areas of manufacturing suggests Japan struggles in this respect. For example, the recent troubles of the electronics sector highlight how the separation of areas which do and do not make money in a global context is not being achieved. Of course, not all business divisions are unprofitable – Sharp, for example, has seen positive conditions in its health and environmental equipment and business solutions product lines. However, these divisions are undermined by other parts of the business which are no longer competitive in the international market. This relates to corporate governance, because such unprofitable areas are being propped up instead of exited. The result is zombie firms, a problem seemingly unique to Japan.

The government has already noted this, with corporate governance reform in motion. Logically speaking, better corporate governance should have a positive impact on investment, by contributing to greater transparency and providing capital holders with a voice. On employment, there are also channels where better management leads to labor attraction. Considering the board as an agent, with multiple principals including not only shareholders but also employees, governance structures which allow employees to participate can empower workers and provide job security. Balancing these two areas is a challenge. However, there is potential for reforms to have a positive impact on both capital and labor.

More specifically, reforms can target foreign resources. One of the discussions is to force listed Japanese firms to have at least one outsider on the board of directors – however, this could be amended to encourage diversity on a broader scale by including foreigners and females. Japan lags the rest of the developed world in this area – only 3.4% (40 people in total) of current board members for Topix 100 companies are foreign, while the figure is just 2.1% (52 people in total) for the constituents of Japan’s larger stock exchange – the Nikkei 225. These figures are lower than the U.S. (where foreign board members make up 8% of the total board), and are way behind European counterparts such as the U.K., France and Germany (which all have at least 19% foreign national board representation). If there was 1 foreign member on each of the boards for all Nikkei 225 and Topix 100 companies, then foreign board members would be around 9%, just above the US but still well below European levels. Nonetheless, evidence from Scandinavia suggests that even a single foreign national member per board

11 Spencer Stuart 2015; “Japan Board Index 2014”; p13
could help entice foreign investors by demonstrating a ‘commitment to shareholder rights’. Making moves in the right direction here is therefore the key.

There is also a case for greater internationalization having knock-on effects for employment. Although the area is not well covered in literature on the subject, foreign board members may encourage a more diverse employee base, with staff seeing management as a representation of the firm culture. Whether more foreign management encourages an increasingly foreign workforce or vice versa is not clear: encouraging studies on the relationship and the causality would help to understand this area better and therefore contribute to better policymaking.

3) In foreign countries, the public sector has typically played a large role in pushing initiatives like ‘Industry 4.0’. Developing action plans and working closely with the private sector to implement legislation which supports industrial change are areas which the Japanese government should also look at. Nonetheless, the responsibility for initiatives lies mainly in the hands of private sector manufacturing firms. Development can come domestically from research and development departments or as a result of knowledge transfers from foreign-based subsidiaries.

On corporate governance, changes to the rules are already being assessed by the government. However, as noted, even enforcing a rule that at least one board member be a foreign national would only just put Japan above the U.S. but still well behind Europe in comparison. Thus bolder ideas from the public sector to be implemented in cooperation with Japan’s stock exchanges can ensure meaningful changes occur. For example, there is already the Nikkei-400 Index where constituents must demonstrate good corporate governance to be admitted; such an index is a step in the right direction, but it does not go far enough with the goal of foreign resource attraction in mind.

4) There has been some work on measuring the effects of industrial change. For example, one paper suggests that a small firm implementing some of the practices of ‘Industry 4.0’ would see a rise in profitability of 30% and a reduction in missing parts of 80%. Quantifying the effects of improvements in corporate governance is less straightforward – on employment for example, there would be a very small direct effect from an increased number of foreign board members. However, the policy’s success would be based more on the indirect and spillover effects, the magnitude of which are more difficult to estimate.

**Services**

1) In terms of valued added, services is Japan’s biggest sector by far. Within the various subsections of the industry, Japanese firms often compete with the world’s best. For example, financial services and insurance

---


13 McKinsey and Company, VDMA 2014; “The future of German mechanical engineering”; p65
companies are well-established and have performed strongly in recent crises: in 2008 Nomura and MUFJ picked up U.S. bank assets in the wake of the global financial crisis. The security of Japan’s more settled services providers is complemented by a number of nascent areas such as tourism, which although small has consistently broken records in recent years and is growing. Japan’s highly skilled workforce has contributed to success within services – the country ranks 5th in the world as per the World Economic Forum Human Capital Index. Given the size and quality of the services industry, policies aimed at attracting foreign resources in this section of the Japanese economy can perhaps have the most success.

2) Japan’s services industry already makes a strong case in providing investors with yield and workers with job opportunities. Japan must therefore be innovative in attracting further resources and think outside of the domestic space – the country can leverage its expertise to develop services in foreign countries. As a leader in the sector within Asia, this paper suggests Japan should become an incubator for the services industries of developing economies looking to benefit from established infrastructure and knowledge transfers. In physical infrastructure for example, Japanese firms often invest under a ‘build-operate-transfer’ model in the domicile of Asia’s younger economies. However, because services are less restricted by geography, such soft infrastructure creation can happen within Japan.

There have been some small steps in this area. For example, the Japan Exchange Group announced in April 2015 it would assist Myanmar in setting up its stock exchange. While Asia’s developing countries have high growth prospects, they also face significant hurdles in achieving their potentials. By helping the likes of Myanmar overcome their issues, Japan can in turn attract investment domestically to help fund the projects. In the case of Myanmar’s stock exchange, it can attract local experts to Japan to help in the construction of the exchange and learn about the good practices which contribute to robust financial market systems. Typically, initiatives to assist in the development of low and middle income countries result in outbound resource flows rather than inbound; indeed, in this case there are certainly obvious channels through which capital would leave Japan. However, given that infrastructure development would happen within Japan, there would also be new inbound channels to offset outbound flows. For example, development of exchanges within Japan would provide foreign investors with the opportunity to gain exposure to emerging Asia, but in a more transparent environment under the Japanese umbrella.

Stock exchanges is just one of many areas which can be targeted. Another example would be small and medium-sized enterprises (SMEs): the same model can be applied to the development and financing of the sector. Japan provides a very supportive environment for SMEs, largely because of the systems it has constructed which help to eliminate market failures. For example, the country’s Credit Risk Database (CRD)

14 World Economic Forum 2015; “Human Capital Index”; accessed online August 2015

15 Japan Exchange Group; “Establishment of Yangon Stock Exchange Business Setup Unit”; accessed online August 2015
helps to overcome asymmetric information on a company’s creditworthiness by providing lenders with both financial and non-financial data on firms. SMEs account for a substantial part of Asia’s economy, thus making sure the market they operate in is transparent and fair in allocating resources is crucial. Japan should encourage those tasked with developing SME infrastructure in emerging Asia to come to Japan, collaborate with Japan’s existing companies and learn how to create credit databases and so on in their own countries.

3) The key stakeholders involved would be the employees of Japan’s stock exchanges, CRD and other services which can be used as yardsticks for developing Asia. These companies would need to work with legal services to understand and overcome the cross-border related barriers associated with such schemes. Given the fact these members of the private sector may have little to no experience working with developing countries, they should twin with development think tanks which focus on the problems facing emerging Asia and are likely to have a greater understanding of the potential roadblocks.

4) The impact on human capital flows depends on the number of different areas the overall scheme would encompass. Rigorous cost-benefit studies would be required on a case-by-case basis – the size of capital and labor flows would depend on the partner-country. On stock exchanges, one would have to look at the number and size of companies looking to join, comparing the findings with countries of a similar nature at more advanced stages of development. Similar exercises would be necessary in analyzing schemes for SMEs and other potential avenues.

While direct flows may not be overwhelmingly positive for resource attraction, the spillover effects could be enormous. Schemes like this can help poorer countries to develop, with positive implications for poverty reduction, health and education in Asia. Relationships built with companies in these countries could also lead to underwriting and initial public offering business for Japan’s securities firms, who can connect investors with companies looking to be listed. These listings could also transfer to Japan’s exchanges as dual listings or depositary receipts (DRs). For example, $5.5bn was raised through DRs for Asia Pacific in H1 2014; Japan must look to take this market from the U.S., where the majority of the underwriting currently occurs.

**Conclusion:**

Through this three-pronged approach, Japan can attract foreign resources. For agriculture, policies need to be innovative to stimulate the industry. For manufacturing, Japan needs to ensure it continues forward momentum by implementing cutting-edge technologies and strategies. When businesses fail, they cannot be allowed to continue acting as a drag on growth. For services, Japan can utilize its strength to benefit the younger economies of the continent and, in the process, itself. Judging the extent to which these policies can be effective requires

---


further investigation and work. It is noted throughout that a number of themes discussed lack an existing body of literature. It is because of this that the recommended policies present new and exciting opportunities. Japan has the academic resources and policy analytics necessary to understand how these proposals can be best implemented and reestablish itself as a global trendsetter.