

Summary

- The LDP-led government will probably push for constitutional revision by 2020, while continuing to pursue economic stimulus measures in Japan
- Policy-making is heavily influenced by Japan's ruling coalition, business interest-groups, and bureaucracy
- Japan's political opposition remains fractured and relatively weak

Risk scores

Overall

1.0 ↗

MODERATE

Political	1.2	Moderate	↔
Economic	0.3	Low	↗
Legal	0.6	Low	↔
Tax	2.2	Elevated	↗
Operational	1.1	Moderate	↗
Security	0.7	Low	↗
Individuals	0.5	Low	↔
Cargo and transport	1.3	Moderate	↗

Note: 0.1 = minimum risk, 10.0 = maximum risk.



Structure and calculations

Analysts determine scores based on qualitative guidance. Each score represents the average expected level of risk over the coming year, and each outlook represents the projected direction of risk trends after that 12-month period. Overall risk scores are calculated as equally weighted averages of the six aggregate categories – Political, Economic, Legal, Taxation, Operational and Security. Risk is scored on a 0.1-10 scale. The scale is logarithmic, with intervals of 0.1 magnitude. This range is split into seven bands, ranging from Low to Extreme risk.

Business environment - strengths and weaknesses

Strengths	Weaknesses
Japan has a well-developed and transparent tax system.	Japan's corporate tax burden is moderately high compared with other East Asian countries.
The government is democratic and stable, particularly because of the dominance of Prime Minister Shinzō Abe and his Liberal Democratic Party.	Exclusive political and business networks (linking the “sougoushousha” conglomerates with the central government) can hinder foreign investment and disadvantage overseas companies in competition for contracts.
Japan’s policy on foreign investment is liberal; there are few formal restrictions to FDI.	A high overall cost structure makes market entry and expansion expensive for foreign investors.
Japan has an advanced and non-discriminatory legal system.	Japan is at high risk of natural disasters, including earthquakes and tsunamis.

Country risk - overall statement

Japan benefits from a strong rule of law and independent judiciary. Commercial law is applied consistently, with no evidence of bias against foreign companies. Policy priorities and implementation have remained consistent if plagued by predictable delays since Shinzō Abe became prime minister again in December 2012. Despite delays in labor-market reform, policy implementation will probably remain strong relative to previous administrations. Challenges include Japan’s high tax rate compared with its regional neighbors, insular commercial business culture, linguistic and cultural barriers, as well as heavy government regulation in various sectors. Japan faces the structural problem of a rapidly ageing population, which puts pressure on government finances and limits the size of its workforce. The most immediate security threat to Japan is North Korea’s ballistic missiles, although war remains unlikely.

Detailed Analysis

The LDP-led government will probably push for constitutional revision by 2020, while continuing to pursue economic stimulus measures in Japan

Prime Minister Shinzō Abe's term since December 2012 has been a period of relative stability for Japanese politics. Despite a landslide defeat in the indicative Tokyo metropolitan assembly election in July 2017, the Liberal Democratic Party (LDP) and Komei Party alliance remains relatively strong. Following the October 2017 lower-house and July 2016 upper-house elections, the ruling coalition has a super-majority in both houses. Importantly, pro-revisionist members also hold a super-majority, meaning a proposal to amend the constitution will probably pass. However, a victory in the subsequent referendum is less probable. In May 2017, Abe stated that he aimed to amend the constitution by 2020, a main aim of which is to clarify the legal status of the Self-Defense Forces. A proposal is most likely before LDP presidential elections in September 2018, or in 2019 before the Tokyo Olympics and Paralympics in 2020.

Abe came to power on a platform of economic reform policies dubbed “Abenomics”. These successfully brought Japan out of two decades of deflation and low inflation in January 2014. Specifically, progress was made on the first two “arrows” of Abenomics – monetary easing and fiscal stimulus. However, progress on the third “arrow” – structural reform – will probably remain more challenging. Importantly, measures to make the labor market more

flexible have been minimal, only incrementally changing visa laws for foreigners, legislation supporting women before and after maternity leave, and the substantial discrepancy between “regular” and “irregular” employees. Japan's economy is vulnerable to territorial disputes, notably with China. For example, in September 2012, escalation of the Senkaku/Diaoyu islands dispute saw Japanese exports to China fall by 14.5% between June and November.

Some of the highest-profile policy changes during the past two years have increased the central government's powers relative to civil society – for example, the Special Secrecy Law enacted in December 2014 and the “conspiracy bill” discussed in the Diet [Japanese parliament] in May 2017. Such legislation will probably continue as long as North Korea continues to threaten Japan with its ballistic missile tests, requiring intelligence sharing and co-operation with the US military, and as long as terrorist attacks internationally pose a threat to events such as the 2020 Tokyo Olympics and Paralympics.

Policy-making is heavily influenced by Japan's ruling coalition, business interest-groups, and bureaucracy

Policy-making in Japan is a bargaining process between politicians and bureaucrats. New legislation is proposed in the parliament, the Diet, and discussed in a transparent fashion. However, in practice, most of the legislation is crafted in the ministries away from public view. Special-interest or issue-specific parliamentary groups also tend to finalize bills before they are even discussed in the Diet. The Liberal Democratic Party (LDP) – cabinet ministers, the prime minister, and party-faction leaders – dominates a power triangle with the bureaucracy and the interest-group associations of business and labor leaders. Generally, government policy is made through a bargaining process between these groups. In particular, public policy decision-making is heavily influenced by a bureaucracy that has developed a closely intertwined apparatus of agencies and committees with the LDP.

In April 2016, the corporate tax rate was reduced from 23.9% to 23.4%, and a further reduction to 23.2% is planned for 2018. However, after the consumption tax increase from 5% to 8% in April 2014 and an economic decline, the second planned increase to 10% has been delayed to October 2015, April 2017, and now to the second half of 2018. It will be essential for this increase to go ahead if the LDP is to adhere to its promises while campaigning for the October 2017 general election to fund free pre-school education and child-care with the revenue. Nonetheless, the government still faces a substantial and growing need to increase revenue to finance rising social welfare costs and pension outlays because of Japan's declining and ageing population.

Continued progress is also probable on energy policy to secure a cheap and stable supply – namely including Nuclear Power Plant (NPP) restarts. Although Japan's Basic Energy Plan states that Japan will seek to reduce its reliance on nuclear power following the meltdown of reactor one at the Fukushima power plant in March 2011, it reaffirms the importance of NPP electricity supply for resource-poor Japan. Japan is highly unlikely to abandon nuclear power; instead, more NPPs that meet the Nuclear Regulation Authority (NRA)'s revised guidelines will probably be restarted. Japan's vibrant, non-violent grassroots movement will probably demonstrate against these restarts outside local authorities and in Chiyoda Ward, Tokyo.

Japan's political opposition remains fractured and relatively weak

On 28 September 2017, the main opposition Democratic Party (DP) dissolved. One Upper House parliamentarian and 16 Lower House parliamentarians formed the Constitutional Democratic Party (CDP). Many other former DP members instead ran in the 22 October 2017 as candidates for the Hope Party (HP), founded in September 2017 by Tokyo Governor Yuriko Koike. Koike defected from the LDP and ran as an independent in the July 2016 Tokyo gubernatorial election.

Although the split into the liberal CDP and conservative HP means the larger opposition parties are now more ideologically unified internally, the HP and even the CDP only differ substantially from the conservative ruling Liberal Democratic Party (LDP) in a few key areas: the LDP's promise to revise the constitution, phasing out of nuclear power, and perceived over-reliance on monetary easing to boost Japan's economy. More importantly, the parties remain

relatively weak: the only time the LDP was overthrown was in August 2009 when the Democratic Party of Japan (DPJ) won an election and ended 50 years of LDP rule. However, the DPJ only ruled briefly from September 2009 to December 2012. The DPJ had worked hard to rehabilitate its legitimacy in the public eye in the run-up to the 2009 general election (the LDP remained in power in 1955–2009, except for 11 months from 1993 to 1994), with former DPJ prime minister Yukio Hatoyama promising fundamental change. However, their policy program was not considerably different to that of the LDP; this is in part because of long-term electoral rules and voter trends in Japan that have facilitated a convergence of the two parties' positions. Dogged by internal fragmentation, this paved the way for the LDP's relatively swift return to power.

In short, Japan's political opposition remains weak and fractured. Although unlikely to pose a substantial threat to the LDP-Komei Party coalition in the one-year outlook, the CDP's ability to mobilize grassroots activists and social media publicity will probably facilitate its challenges to policy, notably a proposed amendment to the constitution.