



Implementing Structural Reforms in Abenomics: How to Reduce the Cost of Doing Business in Japan

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Motivation

- Improving the business environment is part of the growth strategy of Abenomics
 - The growth strategy is not a new invention, but a new development is the introduction of KPIs
- Abe Administration aims to improve Japan's rank in the World Bank Doing Business (DB) Ranking from the #15 (as of 2013) among high-income OECD countries to one of the top 3
 - Does it matter for economic growth? Yes (Haidar, 2012 and Hoshi and Kashyap, 2012)
- This paper
 - identifies specific reforms that Japan can implement to improve the ranking
 - discuss how difficult/easy the reforms will be

Japan in WB Doing Business Ranking

Japan's ranking and top 5 OECD economies in terms of ease of doing business

	Japan's ranking		Ranking of the top 3 countries
	World	OECD	In OECD (from first to third)
Starting a Business	83	27	New Zealand, Canada, Australia
Dealing w/ Construction Permits	83	19	Denmark, Germany, Korea
Getting Electricity	28	9	Korea, Germany, Switzerland
Registering Property	73	23	New Zealand, Denmark, Norway
Getting Credit	71	22	New Zealand, United States, Australia
Protecting Minority Investors	35	17	New Zealand, United States, Ireland
Paying Taxes	122	30	Ireland, Canada, Denmark
Trading Across Borders	20	14	Korea, Sweden, Ireland
Enforcing Contracts	26	16	Luxembourg, Iceland, Korea
Resolving Insolvency	2	2	Finland, Japan, Germany
Ease of Doing Business	29	19	New Zealand, Denmark, Korea

Note: The source of this information is the World Bank 2015 Doing Business Database.

What would it take for Japan to be in Top Three?

- We identify 32 reforms that Japan can carry out

Classification of reform		Political Resistance	
		Low	High
Legal Change	Not Necessary	Group I (15 reforms)	Group III (2)
	Necessary	Group II (2)	Group IV (13)

- Group I reforms would improve Japan's ranking to #15
- Groups I and II would improve Japan's ranking to #13
- Groups I, II, and III would improve Japan's ranking to #11
- Only by implementing most of Group IV reforms in addition to Groups I, II, and III, Japan would make the top three
- Even this may not be sufficient because the other countries do not stand still

Starting a business (rank: 27th)

- In Japan, it costs 7.5% of GDP per capita, takes 8 procedures, and requires 11 days to start a business
 - In New Zealand, an entrepreneur can start a business by just paying 0.3% of GDP per capita, taking one procedure, and spending a half day.
- How can Japan improve?
 - *Eliminate the requirement for a company seal*
 - *Make business registration administrative rather than judicial*
 - *Create one-stop shop for business registration*
 - *Cut registration fees*

Starting a business (reforms)

- ***Eliminate the requirement for a company seal (A-L)***
 - Entrepreneur is required to make a company seal and register it. These two procedures take about 4 days.
 - Requirement per Article 20 of the Commercial Registration Act.
 - ¥10,000 for machine-carved seal or ¥20,000 for hand-carved seal.
 - Company representative must register the company seal and obtain a certificate of seal registration from the Ward office in person. The certificate then must be submitted to the Legal Affairs Bureau at the Ministry of Justice. About ¥400 per certificate of seal registration but varies from ward to ward.

Starting a business (reforms)

- ***Business registration administrative (not judicial) (A-L)***
 - Entrepreneur submits a completed application to the Legal Affairs Bureau headquarter or any of its branch offices in major cities. Once the application is approved, the company applies for a company registration certificate. The process takes four days.
 - 2004 reform has allowed online applications, but this has not shorten the time.
 - Japan can reduce the time for business registration by making it a simple administrative process rather than judicial process.
 - This changeover is straightforward and has been done in many countries less developed than Japan, including Serbia, Uganda, Bulgaria, and Honduras.

Starting a business (reforms)

- **Create one-stop shop for business registration (A-H)**
 - Eight procedures to start a business require a visit each to the Ward Office, Ministry of Justice, District Tax Office, Municipality, Labor Standards Inspection Office, Japan Pension Service, and Public Employment Security Office.
 - A one-stop shop in Tokyo would allow entrepreneurs to register with all the above agencies in a single visit.
- **Cut registration fees (L-L)**
 - Currently higher of 0.7% of the official stated capital or ¥ 60,000 to register the company. This accounts for the bulk of the monetary cost to start a business.
 - By reducing registration fees to ¥1,700 (0.2% of income per capita; level of Denmark), Japan can substantially cut the cost to start a business.

Construction permits (rank: 19th)

- In Japan, it requires 12 procedures (compared to 7 in Sweden), 197 days (compared to 29 days in Korea), and direct monetary cost of 0.6% of warehouse value (compared to 0.1% in Slovak).
- Instead of making the process cheaper, Japan made dealing with construction permits more costly by increasing inspection fees in 2012.
- How can Japan improve?
 - *Reduce number of permits*
 - *Introduce statutory time limits for issuing a permit*
 - *Scale back inspections for small projects*

Construction permits (reforms)

- **Reduce the number of permits (A-L)**
 - Currently must complete 14 steps to build a warehouse. Some of these are redundant. For example, the builder needs two separate procedures for intermediate and final inspections and yet another for completion certificate.
- **Introduce statutory time limits for issuing a permit (A-L)**
 - Getting approvals from the Government of Tokyo and Labor Central Office account for the bulk of time (130 out of 197 days). The government can introduce “silence is consent” rules for issuing building licenses.
- **Scale back inspections for small projects (A-L)**
 - Smaller projects could receive less scrutiny. For example, Korea exempted them from the requirement of an advance building permit.

Getting electricity (rank: 9th)

- It requires 3 procedures and takes 105 days although it costs a negligible amount of money.
 - It takes only 17, 18, and 22 days in Germany, Korea, and Iceland, respectively.
- How can Japan improve?
 - ***Reduce the number of days to 25 days by improving process efficiency (A-H)***
 - Japan can reduce the time between submitting application to TEPCO and getting connection works. After an initial contact with TEPCO, it currently takes 93 days before electricity connection works start.

Registering property (rank: 23rd)

- Requires 6 procedures, takes 13 days and costs 5.8% of the property value.
- In New Zealand, the entire process can be completed in 2 online procedures at a monetary cost of 0.1% of the property value. Confirmation is returned within minutes.
- How can Japan improve?
 - *Reduce the time by 7 days by introducing fast-track procedures*
 - *Cut the number of procedures by 2 by combining and eliminating some procedures*
 - *Lowering registration fees to 0.2% of property value*

Registering property (reforms)

- ***Reduce the time by 7 days by introducing fast-track procedures (A-L)***
 - An entrepreneur currently spends 7-10 days to file an application at the Legal Affairs Bureau.
 - Introduce optional expedited procedures: pay a slightly higher fee and the registration is completed faster.
- ***Cut the number of procedure by 2 by combining and eliminating some procedures (A-L)***
 - Combine the processes to obtain corporate registry certificate and official seal certificate.
 - Eliminate the requirement for obtaining stamps for stamp duty at a post office.

Registering property (reforms)

- **Lower registration fees to 0.2% of property value (L-L)**
 - Currently, an entrepreneur must pay a registration and license tax of 1.75% of property value and a property acquisition tax of 4% of property value. The cost to register could be reduced significantly by replacing these taxes by a low fee of 0.2% of property value.

Getting credit (rank: 22nd)

- Looks at (1) credit information systems and (2) laws on collateral and bankruptcy.
- Japan gets 6 (out of 8) on the depth of credit information index and a score of 4 (out of 12) on the strength of legal rights index.
- How can Japan improve?
 - Create a unified legal framework for secured transactions including creation, publicity and enforcement of security interests in movable assets
 - Create a collateral registry in which all functional equivalents can be registered
 - Reform bankruptcy law
 - Allow credit bureaus to provide more information to lenders

Getting credit (reforms)

- **Create a unified legal framework for secured transactions including creation, publicity and enforcement of security interests in movable assets (L-H)**
 - Allow businesses to grant a non possessory security right in all the assets without a specific description of collateral
 - Security right should extend to future or after-acquired assets and automatically to the products, proceeds or replacements of the original assets
- **Create a collateral registry in which all functional equivalents can be registered (L-H)**
 - For both incorporated and non-incorporated entities and unified geographically and by asset type
 - With an electronic database indexed by debtor's name
 - Accessible and searchable online by anyone

Getting credit (reforms)

- **Bankruptcy law reform (L-H)**
 - Allow secured creditors to be paid first (before tax claims and employee claims) when a business is liquidated
 - Introduce automatic stay for creditors in court-supervised reorganizations
- **Allow credit bureaus to provide more information to lenders (L-H)**
 - Distribute credit information on individuals
 - Provide credit scores as a value-added service to help banks and financial institutions to assess the creditworthiness of borrowers

Protecting minority investors (rank: 17th)

- Japan scores 7/10 on disclosure, 6/10 on director liability, 8/10 on the ease of shareholder suits, 4.5/10.5 on governance structure, 4.5/9 on corporate transparency, and 7.5/10.5 on shareholder rights.
- How can Japan improve?
 - *Increasing disclosure requirements*
 - *Increase directors' liability*
 - *Allow the plaintiff of a shareholder suit request categories of documents without identifying specific ones*
 - *Strengthen corporate governance*
 - *Enhance corporate transparency*
 - *Improve shareholder rights*

Protecting minority investors (reforms)

- **Increase disclosure requirements (L-H)**
 - Require resolutions at the board as well as general shareholders to approve business transactions that entail a conflict of interest of a director and shareholders. Currently a resolution at the board is sufficient.
 - Require an *ex ante* review by an external body.
 - Require immediate disclosure of transactions.
- **Increase directors' liability (L-H)**
 - Give the judicial system the power to void a business transaction if it is deemed unfair to minority shareholders.
 - Require directors to pay the damages caused to the company and also repay the profit made from self-dealing.
 - Make it possible to punish directors at fault by fines and imprisonment.

Protecting minority investors (reforms)

- ***Allow the plaintiff of a shareholder suit request categories of documents without identifying specific ones (L-H)***
- ***Strengthen governance structure (L-H)***
 - Prohibit CEO from also serving as chair of the board.
 - Require a separate audit committee.
 - Require a potential acquirer to make a tender offer to all shareholders when it acquires 50% of a company.
 - Limit cross-shareholding to 10% of outstanding shares.

Protecting minority investors (reforms)

- **Enhance corporate transparency (L-H)**
 - Require disclosure of ownership stakes of 10% or more
 - Require disclosure of compensation of individual managers
- **Improve shareholder rights (L-H)**
 - Allow shareholders to amend company bylaws with a simple majority
 - Grant shareholders automatic subscription rights on new shares

Paying taxes (rank: 30th)

- This indicator measures the time and cost associated with paying required taxes.
- On annual average, a firm in Japan makes 14 tax payments, spends 330 hours preparing, filing, and paying taxes and pays 51.3% of profit as taxes.
- How can Japan improve?
 - *Reducing number of payments*
 - *Reducing corporate tax rates*

Paying taxes (reforms)

- **Reduce number of payments to 4 (L-H)**
 - Currently 14 payments (corporate income tax, social security contribution, value added tax, fuel tax, inhabitants tax, a depreciable fixed assets tax, a fixed assets tax on land and building, employer paid employment and health insurance premium, real property acquisition tax, business premises tax, stamp tax, registration and license tax, automobile tax, and automobile tonnage tax)
 - Would reduce hours needed to pay taxes to 150
- **Reduce corporate profit tax rate (L-H)**
 - Reduce profit tax rate from its current 51.3% to below 34%

Trading across borders (rank: 14th)

- It takes 11 days to comply with all the procedures required to export or import goods in Japan.
- The cost associated with procedures required to export (import) is 29% (45%) lower in Hong Kong than in Japan.
- How can Japan improve?
 - *Allow electronic submission and processing*
 - *Link agencies through an electronic single window*
 - *Use risk-based inspections*
 - *Improve transparency in trade regulation*

Trading across borders (reforms)

- ***Allow electronic submission and processing (A-L)***
 - Allow exporters and importers to submit their documents from anywhere and to pay duties online.
- ***Link agencies through an electronic single window (A-L)***
 - An electronic single-window system allows traders to file standard information and documents through a single entry point to fulfill all import, export and transit-related regulatory requirements.
- ***Use risk-based inspections (A-L)***
 - Combine use of scanners with risk-based profiling
 - Risk-based inspections are the norm in OECD
- ***Improve transparency in trade regulation (A-L)***
 - Provide easier access to documentation of requirements and tariff schedules

Enforcing contracts (rank: 16th)

- It takes 360 days (or nearly 1 year) from the moment a case is filed until the creditor receives payment and the average cost amounts to 32.2% of the value of the claim.
- How can Japan improve?
 - *Limit adjournments and make enforcement of judgments more efficient*
 - *Introduce performance measures for judges*
 - *Maintain specialized commercial court, division or judge*
 - *Expand case management systems and automation*

Enforcing contracts (reforms)

- **Limit adjournments and make enforcement of judgments more efficient (A-L)**
 - Adjournments are responsible for much of 280 days that it takes to get trial and a judgment.
 - Time limits can be enforced to reduce long delays.
- **Introduce performance measures for judges (A-L)**
 - For example, disposition rate (the number of disposed cases divided by the number of incoming cases)
- **Maintain specialized commercial court (A-L)**
 - Specialized courts have been found to improve efficiency.
- **Expand case management systems and automation (A-L)**
 - Judicial case management involves monitoring and managing cases in the court docket from the filing of the claim until judgment is rendered.

Resolving insolvency (rank: 2nd)

- Identifies the main procedural and administrative bottlenecks in the bankruptcy process.
- Japan already ranks second in the world on this indicator.
- To sustain its ranking on the ease of resolving insolvency, Japan can ***promote specialized courts*** to ensure that insolvency cases receive attention more quickly.

Concluding remarks

- Setting a clear target makes sense.
- But it is not clear how the Japanese government will try to achieve it.
- This paper clarifies what it takes for Japan to be among top three countries in DB.
- We identify and classify various reforms that Japan could implement to improve the ranking.
- Similar exercises would be useful in other reform areas as well.