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## Asia Conference Report

# UK–Japan Global Seminar: Fostering Strategic Partnerships

20–21 June 2013



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## **ABOUT THE UK–JAPAN GLOBAL SEMINAR**

The UK–Japan Global Seminar series launched with the event ‘UK–Japan Global Seminar: Fostering Strategic Partnerships’ at Chatham House on 20–21 June 2013. The seminar marked the first in a five-year series, held alternately between London and Tokyo, to examine the UK–Japanese relationship and think strategically about areas of mutual interest in the short to medium term. Through four sessions on the economy, security, energy and environment, and frameworks for cooperation, the inaugural seminar explored Japanese views of key international developments and how Japan approaches these from a domestic and regional perspective, while also identifying areas of convergence with and divergence from the United Kingdom and Europe.

The second major event in the series is scheduled to take place in Tokyo on 2–3 October 2014.

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## INTRODUCTION

### Dr John Swenson-Wright

#### *Head, Asia Programme*

More than one year on from the advent of the government of Shinzo Abe and the prime minister's bold claim that 'Japan is back', it is clear that the world is giving greater attention to Japan and its global role. Japan's governing politicians have shown a renewed interest in thinking strategically about their country's actions and status on the world stage. This new pro-activism is not without controversy, not least because of the intensification of tensions between Japan and its neighbours, most notably China and South Korea, over a range of issues including territorial tensions and disputes over the historical legacy of the Second World War and Japan's colonial experience in East Asia.

Notwithstanding the importance of these tensions, particularly given growing international concern that they might escalate into direct regional conflicts reminiscent of the interwar period in 20<sup>th</sup>-century Europe, it would be a mistake to be overly preoccupied with the legacy of the past. Japan's role as the world's third largest economy means that it is potentially poised to contribute constructively to the process of resolving a number of critical global challenges.

In an effort to explore these contributions, Chatham House's Asia Programme, in cooperation with the Nippon Foundation and the Great Britain Sasakawa Foundation, last year launched a new five-year research initiative to consider options for enhancing Japan's cooperation with the United Kingdom and other European states in meeting a range of pressing policy problems. In its first year, the initiative involved a major conference that convened in London and which addressed potential areas for cooperation in the economic, security and environmental fields. The deliberations, involving scholars and practitioners from Japan and Europe, were intentionally wide-ranging and reflected a diversity of viewpoints.

This report summarizes the substance of our discussions and also includes four issue-specific sections (authored in early-2014) that emerged from and were influenced by the substantive ideas raised in the conference. It is clear that there are a number of valuable ideas for enhanced bilateral cooperation between Japan and the United Kingdom set out in the following pages, as well as other proposals that stress some of the independent initiatives that Japanese and British government officials might develop. Emerging from the first conference, the organizers are now in the process of planning a second one that will take place in Tokyo in October 2014.

The theme for that conference will be more focused than the wide-angle perspective of Year One. It will consider three concrete issue-specific areas in order to analyse the efficacy of the nation-state in combatting global challenges, either separately from or in concert with international institutions. The issues in question are: the challenge of confronting failed or failing states; the consequences of natural and man-made disasters; and the practical problems associated with the transition to democracy in former authoritarian regimes. Our deliberations will not only consider the practical lessons emerging in each of these areas, but also will seek to develop concrete policy recommendations that will form the core of a series of initiatives, whether country-specific, bilateral or multilateral, that might be developed by Japan and the United Kingdom in the near future. As we look ahead to 2015, and the 70th anniversary of the end of the Second World War, the challenge is to find a way to harness the aspirations and capabilities of two states that, at the level of national governments and their domestic populations, have a long and distinguished history of international engagement.

*March 2014*

## **‘ABENOMICS’ ONE YEAR ON: PROGRESS AND THE CHALLENGES AHEAD**

**Yukiko Fukagawa**

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### **Introduction**

A year has passed since Japan introduced the bold set of economic policies called ‘Abenomics’ in 2013. As is well known, ‘Abenomics’ consists of ‘three arrows’. The first consists of massive monetary easing, followed by the second arrow of flexible fiscal policy, and the third arrow focuses on growth strategies. So far, the standard assessment is that the first arrow has hit the target, the second has shifted a little, and the third will probably need another shot.

However, the three arrows were not intended to be shot simultaneously. Rather, they were supposed to be shot at different times and at different speeds, in order to maintain positive expectations for as long as possible. Since the start, policy-makers have been unsure about the impact and development of such an unprecedented policy. Under constant pressure from market forces, the three arrows will need to continue to be flexible in both their combination and speed to reach their final goal.

The purpose of this section is to give an assessment on the progress of ‘Abenomics’, to provide a brief consideration of what has been achieved so far and to outline some of the challenges that remain.

### **A good start: three stages for the three arrows**

‘Abenomics’ aims to shake off two decades of deflationary expectations in order to return to a normal macroeconomy within approximately two years. In line with Japan’s political calendar, the first stage of this strategy focused on the upper house election in July 2013, which was crucial for the leadership of the ruling Liberal Democratic Party (LDP)<sup>1</sup>. The first 200 days were strongly led by the first arrow with the implementation of an intensive monetary easing policy in cooperation with the central bank, soon followed by flexible budgetary support to accelerate the reconstruction and management process after the 2011 Eastern Japan earthquake and the resultant nuclear crisis.

The next 200 days follow on from the upper house election in July 2013 and will continue until April 2014 when the consumption tax is to be lifted from five per cent to eight per cent to sustain the fiscal position. During this period, monetary policy will be used to stimulate inflation expectations, while currency depreciation continues. The third arrow, announced in June 2013, will then focus on private-sector-led growth in hope of maintaining discipline over the government sector.

The remaining 300 days are expected to be led by the third arrow, with the private sector serving as the major engine for sustainable growth. An industrial revival plan focuses on using ‘National Strategic Special Zones’ that will showcase reforms, enhancing labour mobility, innovation, IT society, locational advantage, and small and medium enterprises (SMEs). While deregulation is linked to strategic market-creation at home, industrial globalization has been encouraged through support for various mega free trade agreements (FTAs) like: the Trans-Pacific Partnership (TPP) Agreement; Japan–EU FTA; the Regional Comprehensive Economic Partnership (RCEP) with the

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<sup>1</sup> The Democratic Party of Japan (DPJ) lost the upper house election in 2010, but still maintained a majority in the lower house, which caused the policy decision-making process to stagnate. The LDP then won the lower house election in 2012, but had to wait until the upper house election in 2013 to gain control of both houses of parliament.

ASEAN 10 plus China, Korea, India, Australia and New Zealand; and the Japan–China–Korea FTA.

### **Positive responses from the capital market**

'Abenomics' began with many concerns over its potential side effects, including market instabilities and price hikes from the depreciation of the yen, which were feared could hinder the policy. However, thanks to a quick, positive response from the capital market, as well as quiet enthusiasm for Abe's 'decisive politics', the first 200 days successfully met expectations, mainly via the first arrow.

The capital market responded very positively to the scale of monetary easing. The nominal exchange rate rapidly depreciated about ¥25 to reach ¥104, encouraging the expectations of investors, especially those overseas, to increase their portfolio of Japanese exporting giants. The average Nikkei stock price soared more than 50 per cent, reaching ¥16,000 for the first time in the last six years. Following 'Abenomics', the aggregated equity market gained more than ¥150 trillion in terms of current prices, led by overseas investors with high expectations for the recovery of Japan's exporting powers. Bond markets experienced larger fluctuations right after the shock; but interest rates remained stable at a low level and the capital market enjoyed the triple merits of currency depreciation, equity market hikes, and stabilized interest rates.

Another positive response came from the property market, where residential and commercial land prices in three of the largest cities started to record positive growth and, partly thanks to the success of the 2020 Tokyo Olympic bid, J-REIT values reached a record high at the end of 2013.

### **Positive responses from the corporate sector**

In the deflationary environment, the corporate sector's response through deleveraging and restructuring shrank the economy consistently. While an over appreciated yen pushed down export competitiveness and pressured profits, the corporate sector tried to survive by deleveraging, adding other negative pressures to the equity and property markets. This big shift in the capital market led to big changes in the corporate sector: the profits of listed companies peaked during the first half of FY2013, with the end of FY2013 expected to make another record. Profit recovery has been led by the non-manufacturing sector, such as: the hotel industry welcoming increasing numbers of foreign tourists, retailers enjoying increased luxury goods consumption, and construction following increases in public spending and housing investment. Global firms enjoyed the sudden yen depreciation of about ¥3 trillion, with continued export growth, including in the automobile sector, while importing business suffered, including those in the food, paper and pulp, chemical, and energy industries.

### **Progress: lagged responses in investment and wages**

Despite a quick response from the financial sector, the spread of positive impact in the real economy has differed in speed, and progress in escaping deflation has remained patchy. Japan's core consumer price index (CPI), the overall one excluding fresh food, has risen 1.2 per cent, approaching the target of two per cent. However, energy has made the largest contribution to this increase thanks to seasonal trends in usage, which will fade away in April. In addition, the negative GDP gap is expected to widen again, when consumption tax is increased that month. Therefore, for 'Abenomics' to succeed, consistent and sustainable efforts to narrow the gap are needed, through investment by the corporate sector and wage hikes to further stimulate consumption. This is why the corporate sector has been focused on building up the expansionary cycle in the economy and why 'Abenomics' is said to be 'pro-business'.

After experiencing an historic fall in 2009, reaching a low in 2010, Japan's business investment started to fall again in 2012. Under 'Abenomics', the non-manufacturing sector picked up again in

2013; but the speed of this recovery has been slow, and has not recovered to the level of 2008, before the global financial crisis. For sustainable growth, intensive reforms for enhancing locational advantage are needed so that investment propensity continues to rise alongside improved profits from firms.

On the other hand, employment has improved relatively more quickly. The number of those in employment has increased since the latter half of 2012, accelerating with the introduction of 'Abenomics'. The service sector, including construction, transportation, and personal and business services, has started to suffer from labour shortages, in contrast with manufacturing. Therefore, overall, the labour market has been tightened, and irregular pay and special pay such as bonuses have increased. However, per capita pay has not yet started to increase, mainly due to the slow pace in increasing the number of working hours and base pay, especially in non-manufacturing sectors. In these sectors, part-time workers have taken up the majority of new jobs and, in addition, pay cuts in the public sector have added additional negative pressure for wage increases. The government has pressured business managers in large firms, which accumulate huge internal reserves, to increase base pay; but the response has been sluggish, still influenced by global economic uncertainty. Nevertheless, under 'Abenomics', SMEs in the non-manufacturing sector have improved their profits steadily, and this sector is expected to contribute to wage rises. SMEs are by far the largest employing sector in Japan's labour market.

Wage rises are the most crucial part of 'Abenomics' in combating deflation, pushing up consumption and narrowing the GDP gap. However, the relatively slow pace in wage increases has revealed complexities in the labour market structure, highlighting that Japan needs serious reform to enhance mobility and flexibility and overcome mismatches.

### Sluggish export growth

Another focus has been on the export growth expected following the yen's depreciation. In fact, Japan's exports collapsed in 2009 after the global financial crisis with a V-shaped recovery in 2010, but fell rapidly again from 2011 to late 2012, due to slower growth in emerging economies. Following this, and the yen's rapid depreciation, exports have shown a stronger performance in 2013. In late 2013, volume factors started to contribute more positively to exports, while price factors remained stable. It is possible that better profits will attract more attention to exports in the near future.

Nevertheless, export recovery has still been more modest than expected, especially in terms of volume, which, despite increasing, has not picked up as much as hoped. The real export-import index increased only after October 2013 and remains lower than the peak recorded in 2008.

The prolonged period of deflation in Japan has seen its locational advantages erode intensively, allowing other competitors like South Korea or China to gain in competitiveness prior to the introduction of 'Abenomics'. Labour protection and environment protection were intensively strengthened under the Democratic Party of Japan (DPJ) government, and stringent business compliance and high rates of corporate tax have further constrained Japan's competitiveness against these rivals. Energy price hikes, as well as a lack of progress in high-level FTAs, are also believed to serve as additional handicaps.

While inbound foreign direct investment (FDI) has remained outstandingly minor in Japan, outbound FDI, including large-scale mergers and acquisitions (M&As) continued to rise, and ratios of overseas production soared until 2012. It is possible that the sluggish export growth experienced, especially in terms of volume, may be due to the 'J curve' (time lags), but it may also reflect larger overseas production and bigger outsourcing networks.

On the other hand, the import sector has naturally suffered from the yen's depreciation. In industries where the majority of transactions are not made in yen but in foreign currencies, for example, in the food, paper and pulp, chemicals and textiles industries, the yen's depreciation has raised purchase prices and cut out profits. Among the mechanical industries, the electronics industry is most open and its profits have underperformed in comparison to other industries where

very high value-added production or research-and-development-related activities still remain in Japan, such as the production of transport machinery. In addition, energy imports have substantially increased to further widen the trade deficit.

With limited export gains and increasing imports, Japan started to record a trade deficit in 2011 and this has been expanding ever since. Income transfers were able to cancel out the trade deficit at the end of 2012; but a widening trade deficit pushed the current account into deficit in 2013.

### **Challenges: managing growth while raising tax**

While the first 200 days of 'Abenomics' succeeded in sending a positive message to the capital market, the 200 days that followed have seen several challenges come mainly from the real economy sector. If 'Abenomics' fails to fulfil positive expectations after April 2014, when the consumption tax is raised, implementation of the third stage may face difficulty.

In October 2013, the government announced a package to mitigate the shock from the forthcoming tax increases. It includes ¥5 trillion for government spending, including infrastructure building for the 2020 Olympics, and ¥1 trillion of tax cut measures. However, there is scepticism over the programme. First, a three-per-cent consumption tax increase will raise an additional ¥8 trillion for the government; but it is uncertain whether these funds will be sufficient to cover the ¥5 trillion required for government spending. If this necessitates the issuance of more government bonds, this may challenge the country's fiscal position. The efficiency of public spending has already been challenged by labour shortages, and it is uncertain whether spending more will improve progress.

Second, the government has pressured firms to raise the base pay for their employees, including offering tax incentives for them to do so. However, many firms are not confident enough to raise base pay and absorb the resultant increase in their fixed costs.

Third, the package is aimed at FY2014, and if the positive impacts seen in the economy so far fade in FY2015, the government may be pressured to issue a new package, especially in the run-up to further consumption tax increases to 10 per cent, which are expected in the latter half of FY2015. Further, with the Liberal Democratic Party (LDP) leadership elections due in autumn 2015, and with the added possibility of lower and upper house elections in 2016, political distractions may alter the consistency of the government's policy and the package may turn out to be inefficient.

### **Maintaining fiscal sustainability**

In June 2013, with the third arrow of growth strategy, the government released its vision for 'Basic Policies for Economic and Fiscal Management and Reform'.<sup>2</sup> The third chapter of this vision set up the goal of fiscal sustainability, whereby the primary balance<sup>3</sup> of central and local governments should reduce the deficit against GDP in FY2015 to half that of FY2010 (-3.2 per cent), and should aim for a surplus in 2020. However, according to the simulation provided by the Cabinet Office, to reach this goal – even with a consumption tax increase to 10 per cent, the control of social security increases by aging, a zero ceiling on policy spending and no supplementary budget – Japan would still require a ¥5 trillion balance improvement through either growth or additional spending cuts.

As mentioned above, Japan has seen a fall in its current account surplus and is likely to continue recording a yearly deficit into the near future. Japan's fiscal stability has been sustained by a structure where Japanese government bonds (JGBs) are almost completely absorbed by domestic investors. But in response to the change in position of the balance of payments (BOP), the proportion of foreign holders has increased to reach eight per cent in September 2013. Therefore,

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<sup>2</sup> *Basic Policies for Economic and Fiscal Management and Reform: Ending Deflation and Revitalizing the Economy*. 2014, Cabinet Office, Japan. [http://www5.cao.go.jp/keizai1/2013/20130614\\_2013\\_basicpolicies\\_e.pdf](http://www5.cao.go.jp/keizai1/2013/20130614_2013_basicpolicies_e.pdf).

<sup>3</sup> Primary balance is the balance of tax and out-of-tax income and spending, excluding national bond imbursements and interest rate payments.

Japan's fiscal stability has started to feel pressures from the market, which is historically a new experience for Japan's policy makers, especially politicians.

In the second stage of 'Abenomics', the second arrow is expected to shift from the role of economic booster to anchor, with the booster role to be taken up by the private sector and fiscal improvement that continues to ride off positive expectations. Up until the third stage, policy discussion over sustainability will focus on three issues, the first of which is social security reform. Social security payments were already ¥110.6 trillion (22.7 per cent of GDP) in FY2013, and with further societal aging, are expected to reach ¥150 trillion in 2025. To maintain the sustainability of the system, comprehensive reform that increases burden while cutting benefits is inevitable. In August 2013, the government passed a new law based on a report from the National Council on Social Security System Reform. The report called for the creation of a '2025 model' for social security, proposing a shift from an age-based burden to one based on capacity-sharing. It provided specific plans and time frames for major social security reform, including birth rates, medical care, nursing insurance and the public pension system. As a result, various reform laws are to be presented to the Diet from FY2014 to 2017 and the government has prepared a comprehensive blueprint for this.

However, each proposal will require time-consuming debates and bargaining: for example, as society ages and there are fewer individuals in work, we will see a consecutive decline in pension contributions, increasing the burden on the social security system. One solution could be to require part-time workers to increase their pension contributions and introduce means-tested benefits that cut social security benefits for wealthier classes. However, even if the government is committed to reform, the current time frame remains too flexible and there is always the risk that plans may be postponed for political reasons; in a rapidly aging society, the older generations can form powerful voter blocks with a tendency to resist painful reforms. Quick and positive results of a corporate tax cut and smooth social security reforms will be two crucial focal points for 'Abenomics'.

The second focus will be the establishment of a clearer standard and more accountability regarding the focus of fiscal spending. One of the few positive legacies of DPJ leadership was the priority principles introduced by Prime Minister Yoshihiko Noda in 2012. These included a number of innovative fiscal policies that combined fiscal and private funds, in the form of private finance initiatives (PFI) and public private partnerships (PPP). These policies may prove politically important for preventing the LDP from returning to their familiar faction politics, competing for vested interests and concessions.

The final issue is a greater role for the capital market. Since the introduction of 'Abenomics', financial assets by household have seen a drastic turn: from the last quarter of 2012 to the third quarter of 2013, household financial assets increased by ¥30.6 trillion in equity, ¥13.2 in trust and ¥7.7 in insurance. Of the ¥1,600 trillion in household assets in 2013, 53.5 per cent was held in cash and 27.3 per cent in insurance and pensions, with only 4.7 per cent in trust. Investment-promoting measures to shift such assets into risk assets requires policy support, the promotion of defined contribution (DC) plans, investment from individual saving accounts (NISA) and measures to enhance early inheritance by the younger generation.

## Improving locational advantages

Japan's balance of payment position has been changing rapidly, and enhancing locational advantage has become not only a domestic issue for investment and jobs, but also an issue of international competitiveness. In both contexts, the major focus on locational advantage consists of three issues: corporate tax cuts, labour mobility including deregulation, and energy policies.

Corporate tax reduction has already become one of the core elements of the third arrow. After the decision to abolish the reconstruction special tax a year early at the end of 2013, and along with the consumption tax increase, tax reduction to encourage facility investment will be introduced in 2014. 'Abenomics' has committed to cutting effective corporate tax rates gradually after FY2015. In the case of Tokyo in 2013, effective corporate tax was 38.01 per cent, far higher than major European countries and competitors like China and Korea.

However, Japan's big firms have accumulated large cash flows through their reluctance to invest, so even if effective corporate tax is cut, it is uncertain whether this will be sufficient to encourage investment without the implementation of other measures to enhance locational advantage, including regulatory reforms. Serious efforts to attract foreign firms are also crucial. Without confidence in the prospect of corporate tax cuts, there could be a political backlash following consumption tax increases, with criticism that pro-business policies sacrifice the poor, especially those with low-paid or temporary jobs.

Here, labour mobility is another key focus, solving mismatches, encouraging new business, and increasing value-added productivity. Labour protection in Japan is not very powerful. According to the OECD protection index for regular employees, Japan's protection level is lower than most European countries, at a level close to Ireland and Australia. However, the working style of regular employees has in the past been quite path-dependent, with many firms committed to providing long-term employment for their staff; a change to regular job rotations and intra-firm transfers could affect the accumulation of professional skills of Japanese workers. It could also become a constraint for employees who require flexible conditions to care for children or seniors.

When market prospects have looked uncertain, Japanese firms have been reluctant to hire large numbers of regular employees. This means that once an individual loses a job, finding suitable replacement work is difficult, with the situation worsened by an insufficient social safety net.<sup>4</sup> To raise labour mobility, a new working style has been promoted that bridges the hire of regular employees with various types of irregular employees, including part-time and temporary workers. The opportunity to learn skills and training is considered crucial as part of the social safety net. 'Abenomics' has stressed the importance of labour participation by women; but encouragement of labour mobility and flexibility is inevitable for this policy too. The younger generation who may have missed opportunities for skills accumulation and senior citizens who wish to continue working should also benefit from the labour reform.

Thanks to the tightening market, labour reform is a high policy priority. However, the introduction of a more flexible system under the proposal of the National Strategy Special Zone Working Group has been hotly debated, including the possibility of relaxing rules about sackings, making it easier to terminate temporary workers' contracts and so on. The speed of these reforms is likely to be challenged further by those who still favour better protection of the labour force as well as those who simply do not like pro-business ideas.

Finally, energy policy is another focus but probably the most noncommittal part of 'Abenomics'. In the third arrow, energy was categorized as part of 'strategic market creation', stressing the potential for, for example, exporting power generation systems or promoting recyclable energy; but the mid-to long-term energy policy remains unclear. In particular, many of the arguments regarding cost have been cautiously avoided or simply postponed.

However, so long as 'Abenomics' aims to enhance locational advantage, energy costs may prove even more fundamental than corporate tax cuts. Japan competes not only with the United States and EU but also with neighbours such as Korea and China. Three years have passed since the 2011 Fukushima tragedy and virtually all nuclear power plants have been closed. Japan's energy supply has thus become intensively dependent on thermal power, and soaring imports of mineral fuel have proved a major factor in widening the trade deficit. Thermal power has not only imposed an additional cost of ¥3.6 trillion for businesses and households, but has also hampered Japan's commitment to CO<sub>2</sub> reduction. These setbacks have allowed emerging economies to catch up with Japan even further, so it is important that the energy cost argument is not postponed any further.

Voters should be provided with an intensive cost comparison between nuclear power and other energy sources, including the potential for recyclable energies and the prospect of further technological development in this field. This should be done as soon as possible, to enable clarity on how to further enhance energy efficiency through co-generation and other technologies, as well as on the optimum energy mix.

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<sup>4</sup> Japan's public spending on the safety net for labour remains only 0.6 per cent of GDP, which is less than half of major OECD economies.

## Reforms by market pressures

Finally, one interesting aspect of ‘Abenomics’ is its globalism, which lies in contrast to its political nationalism. While growth strategies from Prime Minister Junichiro Koizumi to Abe’s own first government in 2006-2007 focused solely on reform and deregulation in the domestic market, ‘Abenomics’ has sought ideas that are more global in context. As previously mentioned, Japan has the latecomer’s advantage in negotiating mega FTAs through, for example, the Trans-Pacific Partnership (TPP), RCEP, as well as with the EU and China and South Korea, and the 2020 Olympics will provide further globalizing opportunities. If ‘Abenomics’ is successful in its use of *gaiatsu*, or foreign pressure, in contrast to Koizumi’s more political approach, this may prove a better way to enable sustainable reform. Participation in agreements such as the TPP may provide the government with more room for manoeuvre over issues where vested interests have traditionally been too strong. Agriculture and medical service both fall into this category.

Before joining the TPP, it was uncertain whether Japan would give up protection over rice, wheat, beef and pork, dairy goods and sugar; but the decision to participate in the partnership has contributed to a consensus that reform is desperately needed to enable the sustainability and survival of Japanese agriculture. The basic reform started with the consolidation of rice fields, including abandoned fields, in order to scale up and reduce the cost of agriculture. Intermediary organizations that have been newly established, thanks to fiscal support, are able to borrow land and lend it to farmers interested in larger-scale agriculture. Regarding rice, the government has announced plans to end its policy of cutting back acreage and limiting rice production to maintain artificially high prices. Diversification of crops has also been promoted with a compensation programme that has been prepared for farmers when they face price falls, with the government to provide intensive support for selected farmers.

Still there are many ambiguities in the details, and it is uncertain whether politicians will be strong enough to challenge Japan’s well-established agricultural lobby. Regardless, in the long run, price–mechanism-led reform may prove to be more efficient and consistent than the current system.

Finally, like agriculture, medical services have been heavily protected and subsidized but have recently been subject to reforms to enhance competitiveness. In this sector, social security reform pressures have cut costs in services, even though the commercial market is rapidly expanding because of demographic change. Because of the growth potential, medical services were given special consideration in the third arrow of ‘Abenomics’.

Regarding medical services, three policies have been announced under the third arrow: the first is to enhance medicine and medical machinery industries, including tissue engineering. Second is the establishment of a National Institute of Health (NIH) to serve as the headquarters for research and development in medicine and related fields. Third is the promotion of international research and development and service activities, which should adhere to internationally recognized regulations. Japan has a mixed history in promoting innovative technologies, sharing limited success at home but never managing to go global, and ‘Abenomics’ is trying to learn from these experiences.

## Conclusion

‘Abenomics’ is an unprecedented economic package to combat two decades of deflation. The first 200 days made good progress by giving a shock to the market, and the sudden rise in equity and the positive turn in the property market have started to change expectations, which were previously accustomed to a deflationary environment. However, the second 200 days until the consumption tax increase in April 2014 are crucial and largely dependent on two things: whether the tightened labour market sees wage hikes to push up household income and whether expectations are further endorsed by fiscal sustainability. Improving the locational advantage of Japanese firms and pushing reforms while preparing high-level FTAs will also be important, helping to sustain positive expectations until the final goal is reached.

The designers of ‘Abenomics’ are well aware of the significance of policy consistency for its success and are lucky that they are relatively free from political distraction until elections in 2016.

However, Japan's fiscal position needs state-of-the-art management, including social security spending cuts while demographic aging is still in progress. Labour mobility is important; but the labour market may suffer from insufficient quality levels after many years of under-investment in human capital. Japan's participation in mega FTAs will provide good opportunities for reform. However, continued political and diplomatic frictions will seriously harm Japan's economic integration with its neighbours, where Japan's supply chain has the best value in the world. Therefore, while 'Abenomics' has started with reasonable success, the road ahead is still long and winding.

## THE EAST ASIA SECURITY SITUATION AND THE ROLE OF THE UNITED KINGDOM

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### Introduction

Tensions in East Asia are higher than ever since the end of the Cold War. The aim of this section is to analyse the security situation in East Asia by focusing on the policies of the United States, China, Japan and South Korea, and to suggest what the United Kingdom could do to ease the tension in this region.

### The United States

Recognizing that America's future prosperity and security are intertwined with the East Asia-Pacific region, President Barack Obama has made a strategic commitment to rebalance its effort and investments toward Asia. Some say that the United States had never left Asia; but certainly it has until recently not committed too much to Asia politically or militarily because of its involvement in the Middle East. Japan welcomes this rebalancing very much.

However, unless two conditions are met in the near future, rebalancing may remain rhetorical. The first is whether or not the United States can really withdraw from the Middle East. This will not be an easy task at all, although there is a good possibility for the United States to reduce its military commitment because tensions with Iran have eased since the start of the Rouhani presidency in August 2013. As for Syria, the United States decided in September 2013 not to use military forces against the Assad government, even over the issue of chemical weapons. Although many people strongly criticized the decision, it still served as an act of restraint in terms of military deployment.

On the other hand, even if the United States can reduce its military activity in the Middle East, it will still have to engage in a series of difficult diplomatic challenges there. Given this situation, it is uncertain whether the United States will have enough resources remaining to dedicate to Asian affairs.

The second condition regards the budget: whether the US Congress can overcome party rivalries and support the necessary budget for the rebalancing to Asia. As shown in Obama's 2014 State of the Union Address, economic issues look likely to remain the dominant factor in the United States this year, and again I wonder if the United States has enough time and energy to invest in Asia.

### China

China's military build-up has, with a few exceptions, been proceeding at a rate of over 10 per cent per year over the past three decades. This is unprecedented in modern world history. Chinese international behaviour has been even more worrisome regarding its claim to have rights over 80 per cent of the South China Sea. This includes not only the disputed Paracel Islands and Spratley Islands, but also much of the high seas, which should be open to any country. The Philippine government brought this issue to the International Tribunal of the Law of the Sea asking for arbitration, but China refused to enter into the arbitration, even though it was mandatory.

In the East China Sea, China began to send its government ships towards the territorial waters of Japan in 2008, namely towards the disputed Senkaku islands.<sup>5</sup> Further disputes took place in 2010 and in 2012. Historically, no Chinese have, however, ever lived on the islands and it had made no territorial claims over them prior to 1971. The 2012 incident was triggered by the ‘nationalization’ of the main island of the Senkakus; however this represented the purchase of the islands from a Japanese citizen by the Japanese government and was not related to territorial rights. It is clear that it was China that tried to change the status quo by force.

There are some historical reasons behind China’s policy towards the Senkaku islands. First, there is no tradition in China that the rule of law is supreme. No law ever bound the Chinese emperors, while there were many laws and powers, such as feudal lords and the church, that constrained the power of the Japanese emperors, the Japanese shogunates and the European kings. Even today the rule of law is not supreme, because the equality of all people before the law, which is its essence, does not exist in China. Second, a Middle-Kingdom mentality is still prevalent: it is widely believed that China is the centre of the world (or Asia) and other countries are located below China in a hierarchical international system. Therefore power prevails over the law internationally as well as domestically.

Another important reason for China’s provocative approach in foreign relations is its domestic instability. After being shocked by the collapse of the Soviet Union, the Chinese Communist Party began to use nationalism as a means of consolidating the nation. This is one reason why Sino–Japanese relations, which had been good until the mid-1990s, have deteriorated in recent times. Japan has often been framed as an enemy from the viewpoint of Chinese nationalism, and patriotic education has influenced negative feelings of the young generation towards Japan.

With increasing wealth disparities and the continued violation of human rights in China, including the suppression of minorities, a focus on nationalism has helped to draw people’s attention from domestic problems to issues outside. This is reflected in the country’s tough foreign and defence policy.

## Japan

### *Defence policy*

When Shinzo Abe formed his first cabinet in 2006, he convened a council to consider the establishment of a National Security Council, and another council to consider the restructuring of the legal basis of national security to cope with a deteriorating security situation in Japan’s neighbourhood.<sup>6</sup> Following a recommendation from the first council, the Abe cabinet sent a bill to the parliament, but this was not enacted because of Abe’s illness and subsequent resignation. The second council made a proposal to Abe’s successor, Yasuo Fukuda, although his government did not pay much attention to this recommendation.

When Abe formed his second cabinet upon his return to office in December 2012, he reconvened a council to establish the National Security Council (NSC), which began its work in January 2014. The NSC is a necessary organization to overcome the notorious sectionalism in Japanese politics and to engage in long-term planning. In addition, Abe also organized a council on national security and defence capabilities in September 2013 to discuss and initiate a *National Security Strategy* (NSS) and *New Defence Programme Guidelines* (NDPG 2014).<sup>7</sup>

As already pointed out, Japanese politics is notorious for its sectionalism, which served as the reason why no authoritative and effective document has been produced that could lead a comprehensive and integrated foreign and defence policy. The NSS was prepared and adopted in

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<sup>5</sup> The island chain is claimed by both Japan and China, which respectively refer to the islands as the Senkaku and Diaoyu islands.

<sup>6</sup> The author was a member of those two councils.

<sup>7</sup> The author was appointed to chair this council.

December 2013 as the document to lead the NSC and to integrate foreign and defence policy. The NSS has two key concepts, namely: ‘international cooperation’ and a ‘more proactive contribution to peace’. Article 9 of Japan’s constitution stipulates that Japan shall have no army, navy, air force or any war potential. This can be interpreted as a form of passive pacifism – having no military force as a means of achieving peace. But this is not a realistic path to peace, nor a route that a big country like Japan should take. Through promoting a ‘more proactive contribution to peace’ Japan will be able to contribute more substantially to international peace and stability while confirming its basic post-war foreign policy. This will build upon Japan’s work that has provided official development assistance (ODA) to Asian countries since the 1950s, its participation in UN peacekeeping operations since 1992 and its work promoting the concept of human security to solve problems in developing countries.

The National Defence Outline after 2014 was also adopted in December 2013. Its key concept is the ‘dynamic joint force’. This is a continuation of the concept of ‘dynamic defence’ featured in the NDPG adopted by the DPJ (Democratic Party of Japan) government in 2010, and a departure from the obsolete defence posture directed by the Soviet threat until 2010. Attention to Japan’s south-western area, mobility and the integration of operations are stressed here.

Abe has also reconvened the council on restructuring the legal basis of national security.<sup>8</sup> In order to promote a ‘more proactive contribution to international peace’, it is essential that the legal basis for defence is restructured.

Because Japan’s defence policy had to be built around Article 9, Paragraph 2, which prohibits the possession of a land, sea, or air force, there are many shortcomings in the legal system of defence. The prohibition of Japan’s exercise of the right to collective self-defence is one of these shortcomings. This has seriously strained Japan’s cooperation with other countries. For example, Japan’s Self-Defence Force (SDF) is not allowed to assist any US vessels that are engaged in fighting with another country if Japan is not involved in the fighting yet. The SDF is not allowed to help the military of foreign countries that are deployed in UN peacekeeping operations either.

Some criticize Abe’s security policy, saying it might bring Japan back to a pre-war mentality. However, this is wrong and we should instead look at how Japan moved towards military expansion.

In the 1930s there were many people who argued for territorial expansion, believing it would guarantee the security and prosperity of Japan. This represented a time when freedom of speech was suppressed and the prime minister’s control over the military was weak under the Meiji constitution. In particular, after the Great Depression, when major powers were trying to establish bloc economies, many Japanese leaders and people believed that Japan had to expand to secure materials and the market.

However, no one believes that territorial expansion will guarantee the security and prosperity of Japan today. Its prosperity has instead been guaranteed by the global free trade system. As a trading nation Japan can import materials and resources and can export its products all over the world. In short, the peace-loving posture of post-war Japan has been guaranteed by its political and international structure and Japan’s commitment to liberal principles, not by Article 9 of the constitution.

Thus, the changes in defence policy under Abe represent just a modest step towards a more ordinary defence policy. Even if all of Abe’s policies are adopted, and further accelerated, Japan will remain one of the most peace-loving countries in the world.

### *Historical issues*

There has also been criticism of Abe’s ideology. Many media reports have described him as hawkish, reactionary and right-wing. Certainly, Abe has made some ambiguous comments about the war and the ‘comfort women’ issue. However, there has also been bias in the Western media.

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<sup>8</sup> The author was appointed as the acting chair of this council.

Abe says that he will respect the spirit of the Murayama and Kono statements in which Japan recognizes its responsibility for its involvement in the war and for the ‘comfort women’ respectively.

What about the Yasukuni shrine issue? On 27 December, Prime Minister Abe visited the controversial Yasukuni shrine and was strongly criticized by China, South Korea, North Korea and by some in Japan. The United States also said that it was ‘disappointed’ with Abe’s decision.

Japanese people remain divided on this issue. Some, including this author, are of the opinion that top leaders should not visit the Yasukuni shrine because former class-A criminals, some of whom were really responsible for the war, have been enshrined there since 1978.

However, it is too much of an exaggeration to criticize Abe’s visit as an act meant to justify the war or to revise history. Abe says that his visit was not intended to justify the war, but rather to pray for eternal peace. Moreover, had he wanted to challenge history, he would have visited Yasukuni on 15 August (‘Victory over Japan Day’), or on some other memorable date, when there would have been a massive gathering of the right wing. He tried to avoid such a situation.

Still, it could be argued that Abe’s visit was unwise, giving China and South Korea the excuse to criticize Japan. In order to break the stalemate with these countries over the Yasukuni issue, the government should try to persuade the shrine to separate out the class-A war criminals, or explore the possibility of an alternate institution where politicians can pay their respects to the war dead, as was examined under the Koizumi cabinet. Japan should also promote the joint study of history with China and South Korea, as was the case in the first Abe cabinet,<sup>9</sup> using the opportunity to bring together scholars from other countries.

## South Korea

One important change in dynamics in East Asia relates to South Korea president Park Geun-Hye’s closer relations with China. Korea has survived among a number of big neighbouring powers – China, Russia, United States and Japan – for many centuries. It therefore has a strong desire for independence but, at the same time, a tendency to side with strong partners. Based on this, South Korea is now quickly becoming close to China. Its dependence on trade is roughly three times that of Japan. The fact that China has become the country’s biggest trading partner is thus much more important for South Korea than other countries, which are not so dependent on trade. South Korea is comfortable with being close to China because it has been subordinate to it for centuries at a time throughout most of the country’s history.

The Park government has also been quite soft towards North Korea. It seems that they have almost forgotten the sinking of *ROKS Cheonan* and the shelling of Yeonpyeongdo that killed a number of civilians in 2010. Former President Roh Moo-Hyun, who was known as pro-North Korea and was indicted for corruption after his tenure and later committed suicide, has risen in popularity again in South Korea.<sup>10</sup>

We should not underestimate the impact of North Korea’s nuclear activities on South Korea because of its burning desire for autonomy. One recent opinion poll in South Korea shows that trust in US nuclear deterrence has declined to 50 per cent and the support for nuclear armament has risen beyond 65 per cent. Chung Mong-joon, a former presidential candidate, has visited the United States to argue this issue, strongly arguing for the reprocessing of nuclear energy. If South Korea becomes a nuclear power, or if the North and South are united with nuclear weapons, Japan’s policy will change fundamentally.

Contrary to its approach to China and North Korea, South Korea’s antipathy towards Japan is stronger than ever. When the General Security of Military Information Agreement (GSOMIA) was

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<sup>9</sup> It was started in December 2006, and was concluded in December 2009. The author was the leader of the Japanese group.

<sup>10</sup> Robert Gates, the former US secretary of defense, writes he was once shocked to hear from President Roh that he believed the biggest threats to South Korea were the United States and Japan. Gates, Robert. *Duty: Memoir of a Secretary at War* (Knopf, 2014).

ready to be signed between it and Japan in 2012, it was halted by President Park because of the tension caused by 'historical issues' with Japan. However, GSOMIA is a necessary agreement for the sake of South Korea's own security. In other words, its antipathy is more sentimental than based on rational calculation.

Moreover, President Park has tried to establish a security dialogue forum with the United States and China, excluding Japan. This is a strange arrangement because possible US military assistance to South Korea is likely to be given through US bases in Japan. In other words, without cooperation from Japan, the United States would be unable to help South Korea effectively in the case of an emergency. It seems that President Park has therefore taken it for granted that Japan would cooperate with the United States and South Korea should such a circumstance arise. However, should the latter continue to criticize and insult Japan vocally, expecting goodwill in such cases may not be realistic.

Recently a museum for An Jung-Geun was opened in Harbin, China. An was an assassin who killed Hirobumi Ito, a Japanese statesman who was the first prime minister of Japan and the first governor general of Korea from 1905 to 1908. This was seen in Japan as a very provocative act on the part of China and South Korea. Such acts have helped previously positive feelings in Japan towards Korea (seen through the popularity of Korean athletes, TV stars and singers) to wane.

### **The United Kingdom and other European countries**

As already discussed, Japan is in the process of normalizing its defence policy. One important policy change concerns the relaxation of its rules on arms exports, which previously banned international arms sales. Because production of new generation weapons is very costly, this is typically done with international cooperation, resulting in the lifting of Japan's ban on arms exports (where technology and materials were both prohibited).

Since the relaxing of this rule, the United Kingdom has already proposed joint production of helicopters with Japan. Japan has also been in discussion with the ASEAN states regarding the use of Japanese defensive equipment, such as coastguard ships. Such cooperation among peace-loving, industrialized and non-expansionist democracies should be further encouraged.

What should the United Kingdom and European countries not do? The West should not pretend to be neutral when it comes to the antagonism between Japan and China. The United States and other countries urge Japan and China to talk to each other to avoid conflict, and dialogue is definitely needed. However, it is important that this message is sent to China because Abe has stated that he will meet with his Chinese counterpart at any time and without condition. On historical issues, China and South Korea say that unless Prime Minister Abe changes his position they will never meet. However, it is important for these leaders to meet each other precisely because their opinions are so different.

The world experienced two great wars in the 20<sup>th</sup> century. Since then, the decision not to use force to solve international conflicts is one of the most important commitments we have made. The rise of China is not understood as a threat to the West; but actually it is challenging some of the most important principles that human beings have achieved. China's expansionist policy is related to the suppression of minorities and other violations of human rights. How can the West, the champion of democracy and human rights, ignore this?

## ENERGY AND ENVIRONMENT

### Mutsuyoshi Nishimura

*Former Ambassador of Japan for the Global Environment*

#### On climate science

Today scientific consensus is solid on climate change: warming is taking place, most of the recent warming is very likely due to emissions of carbon dioxide by human activities, future warming could increase and the impacts of this are profound. These are the sobering conclusions issued by the latest assessment report<sup>11</sup> from the UN Intergovernmental Panel on Climate Change (IPCC) published on 27 September 2013.

There are already serious climate impacts all over the world that are predicted to intensify in the coming decades. Temperatures are rising, rainfall patterns are shifting, glaciers are melting, sea levels are getting higher and extreme weather resulting in hazards such as floods, droughts and desertification is becoming more common. These changes pose a serious threat to human lives, health and safety. Heat waves pose a direct risk to the elderly, the disabled and to low-income households. More broadly, global warming affects the economic development of all countries, as well as the eco-system and bio-diversity. Many developing countries are among the most vulnerable to climate change. It poses daunting challenges for food and water availability for growing populations.

The latest scientific evidence suggests that, if little or no action is taken to reduce global greenhouse gas (GHG) emissions, by the end of this century global warming is likely to produce temperatures as much as 5°C higher than those in pre-industrial times (1850–1900). An increase of 2°C is seen by scientists as the limit beyond which there is a much higher risk of provoking catastrophic changes in the global environment. For this reason the international community has recognized the need to keep warming below 2°C. However, current GHG emission trends are believed to be heading towards a 3.6°C increase.

Obviously time is not our friend when it comes to this problem. However, uncertainty should not let our determination vacillate. We have to act rapidly lest we lose time; and we must act cost-effectively lest we squander billions.

#### Kyoto or what else?

Indeed we have to act rapidly and massively. Yet, there is no robust action in sight. Is the Kyoto Protocol fit for the job? Many argue that Kyoto's is a rigid system of targets and timetables and it pushes governments into a zero-sum game. In fact, under the Kyoto approach each government must pledge and achieve its national emissions target within the adopted timetable regardless of the cost of doing so. Increased ambition would often mean increased loss of added values for economies. Thus, all governments try to lower their commitments, creating interminable disputes over the varying levels of ambition. Contrary to the intentions of the agreement drafters, the system reduces rather than enhances governments' ambitions. Put simply, it is shooting itself in the foot.

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<sup>11</sup> The Intergovernmental Panel on Climate Change (IPCC) is a scientific body under the auspices of the United Nations. It reviews and assesses the most recent scientific, technical and socio-economic information produced worldwide relevant to the understanding of climate change. Its *Assessment Report* is published regularly.

New ideas are being offered. One such strand is called ‘nationally determined commitments and/or contributions’<sup>12</sup>. It intends to achieve climate goals by making the game supple, flexible and less rigid. They say such a system would give rise to more robust action since it integrates flexibility with strength. The basic structure is for governments to make ‘nationally determined mitigation commitments’ which would allow countries to determine the right level of commitment consistent with their own circumstances and capabilities.

This commitment would then be assessed by all other governments as well as civil society and analytic bodies, which would have an opportunity to review and comment. Proponents say this process would enable governments to raise their commitments. They argue that public scrutiny and peer pressure would force governments to pledge more ambitiously. Yet, experts and scholars are not sure whether such a reform would achieve adopted climate targets like 2°C since they essentially remain the ambition-based arbitrary pledges of governments.

Since short-term pledges can be changed at will, there is a search for surer solutions. A group of experts is proposing that all countries commit to phasing out their GHG emissions by mid-century.<sup>13</sup> Such a long-term commitment would achieve the 2°C temperature goal. The proposal allows countries to take mitigation actions suitable to national circumstances which would be subject to international *ex ante* review and *ex post* verification.

Yet others are suggesting a new strategy that focuses on the global carbon budget and carbon market.<sup>14</sup> The carbon budget is the maximum amount of GHG emissions that can be globally emitted when a temperature goal is established. If we are to achieve the 2°C target, we have to contain global emissions within the corresponding budget. In their proposal, an assembly of all governments would establish the global carbon budget for adopted targets and sell the budget as allowances to all those who burn fossil fuels worldwide. A uniform carbon price would thus be created, forcing all economic players to burn less or more efficiently.

Any international agreements on climate change that the world community might choose at the 2015 Conference of the Parties<sup>15</sup> in Paris must achieve a specific temperature target. They must be goal-oriented instruments and must work to achieve the globally held objective of 2°C. As the Paris conference draws nearer, the UN negotiations will definitely need to provide the surest climate solution that seeks to achieve the target in time and most cost-effectively. The United Kingdom, EU and Japan should join forces in finding the right solution in this critical process.

## National action: Japan, the United Kingdom and Europe

In the context of national actions, both Japan and Europe have difficulty in raising their reduction commitments in a short-term context. Japan, once riding high with a 25-per-cent reduction pledge, has since lowered its ambitions largely due to the shut-down of nuclear power production. Meanwhile, EU industries are raising their voices on competitiveness, speaking out against the recently announced target resetting of 40 per cent by 2030. They are calling for an energy and climate policy that is workable for energy-intensive industries and is sustainable for the EU economy.

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<sup>12</sup> See the presentation by the US Special Envoy for Climate Change, Todd Stern, on 22 October 2013 at Chatham House in London. ‘The Shape of a New International Climate Agreement’.

<http://www.state.gov/e/oes/rls/remarks/2013/215720.htm>.

<sup>13</sup> Haites, E., Yamin, F. and Hohne, N. 2013. ‘Possible Elements of 2015 Legal Agreement on Climate Change’, IDDRI Working Paper No. 16. <http://www.iddri.org/Publications/Possible-Elements-of-a-2015-Legal-Agreement-on-Climate-Change>.

<sup>14</sup> Akinobu Yasumoto and Mutsuyoshi Nishimura. 2009. ‘A Proposal for a Global Upstream Emission Trading System (UGETS)’. Available at <http://belfercenter.hks.harvard.edu/files/Nishimura.pdf>.

<sup>15</sup> The United Nations Framework Convention on Climate Change (UNFCCC) is an international treaty that is aimed at stabilizing GHG concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system. The parties to the treaty have been meeting annually in Conference of the Parties (COP) to assess progress in dealing with climate change. It is expected that the COP in Paris in 2015 will produce a new international agreement that will govern international actions after 2020.

Yet, in a longer-term context, both the EU and Japan are maintaining their previously adopted objectives, Japan upholding its goal to reduce GHG emissions by 80 per cent by 2050 and the EU by 80 to 95 per cent. In the long run, both the EU and Japan are amongst the leaders in the fight against climate change. This is all the more remarkable and important, as the achievement of targets such as 2°C depends upon total cumulative emissions over decades, rather than individual short-term performances. It is thus hoped that strong long-term commitments from the EU and Japan will spearhead global action and contribute to achieve adopted targets.

## Carbon pricing

Today, putting a price on carbon is believed to be the most cost-effective way to achieve temperature targets, even more so than when the Kyoto Protocol was signed. By pricing carbon, economies would burn less fossil fuel and/or use it more efficiently. The theory is simple and effective; but practising it requires trial and error. The woes surrounding the EU's emissions trading system (EUETS) are a case in point.<sup>16</sup> Yet, as pricing systems improve, there is a hope that a greater number of nations will resort to a pricing strategy, particularly when they take on ambitious commitments in the context of the 2015 agreement. The EU, United Kingdom and Japan should work together to promote this cost-effective policy tool.

## Energy

On energy, the world is set to face new challenges as an era of resource abundance looks increasingly likely. 'Peak oil' theory may be disappearing over the horizon, largely due to fracking and the shale gas revolution. Depending on whether or not the shale gas revolution can overcome its own environmental liabilities, the new energy landscape will affect a whole array of issues in multifaceted ways. The energy independence of nations must be looked at in a new light just as with all other crucial issues like price structure, relative cost dynamics against nuclear and renewables, roles of fossil fuels in combatting climate change and so on. It will also even impact on geo-political formations, through fundamental changes to supply-demand relationships. No major power will escape the impact that the new geo-political dynamics will give birth to.

However, the most serious challenge comes from the fight against climate change as the use of fossil fuels become less expensive in relative terms. What will drive the energy transition to low- or non-carbon systems in an era of resource abundance? People will ask: if we have lots of oil and gas, why do we still need a transition?

Another problem is generating increased attention for issues regarding stranded fossil fuel assets and the quantities that must be kept underground and unburned if we are to achieve climate targets like 2°C. Such questions are difficult to deal with during times of resource abundance, since achievement of the 2°C target still allows around one-third of proven reserves to be burned, according to the International Energy Agency.

## Energy efficiency

Energy efficiency and energy saving are the two most important engines to help realize a low-cost energy transition. In most cases, they are the cheapest measures. And they must be done at all stages of the energy chain: generation, transformation, distribution and final consumption. In most countries, policy tools are focused on public transport and building sectors where the potential for savings is believed to be greatest. Other measures include the introduction of smart meters (which encourage consumers to manage their energy usage better) and clearer product labelling. The

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<sup>16</sup> The emissions trading system of the EU (EUETS) is a flagship policy tool to reduce GHG emissions. It has nevertheless faced difficulties as the falling price of allowances has failed to provoke enough innovation towards a low-carbon energy shift.

United Kingdom and Japan have long been champions of energy efficiency and have been developing extensive sets of policy tools that are effective. Their cooperation would benefit not just the two countries but the world at large.

## Nuclear power

Nuclear power offers a rare instance where public opinions in the United Kingdom and Japan differ substantially. According to a 2013 survey, the Fukushima nuclear accident in 2011 had virtually no impact on British public attitudes towards nuclear power, whereas in Japan it triggered a move to either reduce or end the country's nuclear reliance.<sup>17</sup> Japan is yet to make a choice between the two and the Japanese people have been debating the issue, with some arguing that nuclear power is indispensable for the continued growth of the world's third largest economy and others arguing that a non-nuclear Japan, with massive investments in cleaner energy technologies, would open up a new and dynamic era of sustainable growth. Rarely has an issue been so polarizing in recent history. Whichever direction the two countries go, there is merit for both sides to stay in communication both in the policy and technical domains.

## Conclusion

On climate and energy, the world finds itself in a period of system design. A new system must be sought and adopted reflecting rapidly changing dynamics. The United Kingdom and Japan are evidently among the top powers intent on innovation and efficiency. Innovation in particular is needed to design a new climate regime at this make-or-break juncture. Energy is no less important as the situation is likely to provoke a groundswell of changes and disruptions. Both countries must join forces and work together in order to bring about new perspectives that are innovative, efficient and beneficial, not just for two countries but for the rest of the world. The launch of the UK–Japan Global Seminar will no doubt offer the best opportunity for such collaboration.

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<sup>17</sup> 'Opposition to nuclear power in Britain has fallen since 2005 despite Fukushima accident'. 2013. UK Energy Research Centre. <http://www.ukerc.ac.uk/support/article3253-British-public-split-on-nuclear-power>.

## THE FUTURE OF THE ABE ADMINISTRATION AND UK–JAPAN COOPERATION

### Kiichi Fujiwara

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The 'UK–Japan Global Seminar: Fostering Strategic Partnerships' conference took place at a time when Prime Minister Shinzo Abe's government was highly successful both in terms of economic policy and foreign relations. At the end of 2013, Abe decided to visit the Yasukuni shrine, leading to a public relations nightmare that China was quick to take advantage of. In light of this incident, I find it more productive not to limit the discussion to the June meeting, but to offer a wider perspective that may shed light on the Yasukuni visit and its aftermath.

The question, however, remains the same. Will the comeback of the Liberal Democratic Party (LDP) in Japan with Prime Minister Abe lead to a new horizon for the UK–Japanese relationship? Such was the agenda for the meeting's fourth session, which led to a lively and heated discussion. In order to understand the intensity of the debate, we must place the second Abe government in context.

### Japan: back in business

The arrival of the Abe government in Japan was greeted with a hope, both inside and outside the country, that the change of guard in politics would put Japan on the map again. Japan had been off the map for quite some time, with the demise of her economy, political instability with prime ministers coming and going every year and an endangered alliance with the United States.

For over two decades, Japan's stagnating economy allowed China to take over the role of the leading economic power in East Asia. Politics, which had already been unstable during the reign of three prime ministers after Prime Minister Junichiro Koizumi, ran into what can only be called a train-wreck with the fall of the LDP and the beginning of a Democratic Party of Japan (DPJ) government. Foreign relations under Yukio Hatoyama, the first prime minister of the DPJ government, proved to be a disaster, as the relocation of Futenma air base in Okinawa led to a serious disagreement between Tokyo and Washington.

When things get so bad, there is room for wishful thinking. The lower-house elections of 2012 that brought the LDP back to power were actually more a defeat of the DPJ than a victory for the LDP.

The first few months of the Abe government were quite successful. The economy picked up quickly, with stock market prices shooting up to ¥14,000 from ¥8,000. Although there is reason to believe that this boom started before Abe took office, the recovery came to be called 'Abenomics', connecting the new government with the image of economic recovery.

The recovery expanded public support for the ruling party, and the upper-house election of 2013 resulted in a remarkable landslide for the LDP, ruling out any hope for the DPJ to regain political power in the near future. Moreover, national elections, will not be held until 2016, when the government will enjoy the opportunity to hold a 'double election', or a simultaneous election of both the upper and the lower houses, which past history tells us tends to be in favour of the incumbent party. Unlike all prime ministers after Koizumi, who each left office after about a year, Abe may be able to stay in office for four years or even longer.

Japan's relationship with the United States had already improved after Hatoyama stepped down in 2010, but Abe entered office in a much better position to stabilize relations, for, as a member of the LDP, he could rely on old hands such as Shotaro Yachi, an ex-diplomat and Japanese foreign policy guru. Abe also managed to skilfully coordinate relations with the Okinawa prefecture, forcing

the governor to accept the relocation of the Futenma air base to Henoko, the original location previously agreed by Washington and Tokyo, thus taking out one source of conflict.

## Japan for the Japanese

So far, so good. There remains, however, one undercurrent that needs to be examined, namely, the inward-looking development of Japanese society, which has been increasing for some time. I doubt if the Abe government has changed that trend; worse, I fear that it has accelerated in at least some parts of society, providing the basis for what I am tempted to call a nationalization of politics, where nationalism dominates political and social discourse at the expense of any liberal-internationalism that may still remain in Japan.

Seen from the outside, one may think that Japan was always inward-looking and nationalistic, exemplified by the right-wing chauvinism that accompanied the Second World War. One should not dismiss, however, the *Kokusaiha*, or the internationals, who carried substantial political and social influence for decades following the defeat. Japan fought a murderous and suicidal war, the internationals would argue, because Japan paid little attention to international society outside of its territory; the way out from such self-inflicted seclusion was to open up to the world, especially to Western Europe and the United States. To be sure, since the Meiji restoration Japan was always trying to catch up with the West, but this time the catching up was about political institutions, the ideas that lay behind them and the market as a space quite distinct from the industrial policies adopted by the state. The turn to the West was dubbed as the second *Kaikoku*, or opening up, the first being the Meiji restoration.

The golden days of the Western-educated intellectuals were short lived, however, as many were quick to find that a developing economy need not be accompanied by liberal political institutions and ideas. The urge to learn from the West, however, carried on well into the 1960s; university graduates would proudly quote from Gide or Sartre, enjoy plays by Chekov or Ionesco and play light jazz. The West was in, Japan was out.

The first challenge started from the early 1970s. Japan's spectacular recovery from the oil crisis stood out as an example of the supremacy of the Japanese economy, society and culture. While American and European economies struggled through the crisis to develop a neo-liberal economy where finance overtook manufacturing to take the driving seat, pride in the comparative advantage enjoyed by Japan's manufacturing resulted in inertia without structural transformation. Economic development, therefore, had its side effects. A new culture of a triumphant Japan took over from the internationalist culture attuned to the West.

The 1970s and 1980s, moreover, signalled the end of high culture in Japan, and the shift towards subculture was not just directed toward pop culture, but a *Japanese* pop culture; people simply stopped listening to foreign music, reading foreign novels or learning from foreign works. In many cases, they stopped reading at all.

All these subtle changes accompanied the transformation of political ideas and ideologies. One of the paradoxes of political discourse in post-war Japan is that the internationals, in many cases, overlapped with the left, where liberal internationalism and communist-leaning anti-American nationalism mingled to produce a strange marriage. What with atrocities in the Soviet Union and communist China, such leftist wishful thinking was already doomed, and hyper-economic growth kicked out any belief of the end of capitalism. The demise of the left, however, had a Japanese twist. Efforts to depict atrocities committed by the Japanese military, for example, were taken to be a typical case of leftist propaganda, and it was taken for granted that such arguments that put a bad face on the Japanese military should go away, along with the leftist propaganda that had already shown its futility. The demise of leftist ideologies accompanied the glorification of the Japanese wartime empire.

Shinzo Abe, being among the most active members of *Nippon Kaigi*, was the key figure in this ideological battle. Members of parliament who gathered in that conservative group openly denounced the Tokyo International Tribunals as victor's justice, the Nanjing massacre as a myth

propagated by the Chinese Communist Party, and *ianfu* – sexual slavery – as mere prostitution twisted into a crime by the Japanese left and Koreans. The centre of gravity of their arguments shifted with the declining power of the left in Japanese politics from anti-leftist slogans to anti-Chinese and anti-Korean slogans. But the message remained the same: China, Korea and the Japanese left were neglecting the proud history of Japan, and the conservatives were the ones who would restore it.

### From pragmatism to ideology

Conservatives in Japan were not known to be ideologues. A long chain of prime ministers – Shigeru Yoshida, Hayato Ikeda, Eisaku Sato, Kakuei Tanaka – kept economic growth as their top priority, sacrificing nationalist and ideological purity in favour of the advancement of secular interests. The United States could tolerate excessive remarks made by Japanese conservatives so long as the LDP remained strong enough to keep the left out of power. The paradox here, therefore, is that conservative politics in Japan was far more pragmatic in the days of the Cold War. The end of the Cold War, which more or less took place at the same time as the stalling of the Japanese economy, led to an outburst of nationalist discourse in Japan.

The first break took place, strangely, under a socialist leader. Prime Minister Tomiichi Murayama, a long-time socialist, only became prime minister to kick out the non-LDP coalition that took power in 1993. So long as he could keep the Socialist Party (later renamed the Social Democratic Party) intact, Murayama was happy to go along with his conservative coalition counterpart; but his plan to issue a statement of remorse at the 50<sup>th</sup> anniversary of the end of the Second World War ignited fierce resistance from the more conservative wing of the LDP, with Abe among the more vocal leaders. Murayama did make his statement, but that statement was watered down immensely due to the revolt from the right. The statement was intended to put the ‘history issue’ between Japan, South Korea and China to rest; angry and vocal protests against the Murayama statement assured that the ‘history issue’ would remain unsolved in the future.

When Abe first became prime minister in 2006, he played it safe. His first international visit was not to the United States but to China, an apparent gesture to mend fences with Beijing after bilateral relations broke down with his predecessor’s visit to the Yasukuni shrine. It was strange; Koizumi, a pragmatist if there ever was one, visiting Yasukuni, while Abe, a known ideologue on the right, rebuilt Japan’s relations with China. This led to the belief that Abe might carry rightist ideologies but was also smart enough to know that rightist ideologies would jeopardize Japan’s foreign relations, not only with China and South Korea, but with the United States and Western democracies.

When Abe returned to office in December 2012, the same belief, if not hope, that he would play it safe ruled the day. It almost seemed that Washington had learned to stop worrying and accept Abe as the most capable leader in Japan since Koizumi. And Abe indeed behaved himself during the first year of his government. His visit to all ASEAN nations, an achievement unseen for some time, was an obvious attempt to form a network surrounding China, but he refrained from emphasizing the geopolitical interests that may have driven him and merely called for the safety of maritime transportation. In parliament, MP after MP tried to trick him into making rightist remarks; but he managed to escape with euphemisms that could mean anything.

While Abe cautiously maintained his pragmatic face, the Japanese economy picked up. The conference at Chatham House took place right before the upper house election, which the LDP won in a landslide. Things were indeed looking good for Abe. Then he decided to visit the Yasukuni shrine, which jeopardized whatever achievement he may have made during a year of careful and successful diplomacy.

### Prospects for cooperation

What will the Abe government bring to the future UK–Japanese relationship? Some answers are clear. As the strongest one since Koizumi’s, with a firm commitment on trade liberalization, we can

anticipate further cooperation on economic policies. Even asset management and the management of the public pension scheme, an area so politically charged that few politicians will dare touch it, can now be open for international collaboration. And, although many challenges await the EU–Japan free trade agreement, I will not rule out the possibility of its development, since Japan is now eager to take advantage of an open market not a closed one.

It is also clear that Japan will work hard to bring the United Kingdom into a grand network, if not a coalition, that is united by anxiety over China's foreign policy, especially the activity of her blue water navy. Proposals for the United Kingdom and Japan to work together in the face of China, with shared commitments to democracy and the rule of law, look very much like policies that will win approval from both Japan and the United Kingdom. Governments with strong interests in keeping the status quo can agree on many things.

The real challenge, however, may come from the inward turn of Japan, and here the Abe governments has two hats. The first hat is internationalism, with strong interests in cooperation with Western democracies and market liberalization. The second hat is the restoration of Japan's glory, where nationalist discourse overrules the request from liberal internationalism. At present, it looks as though Abe may wish to keep both hats.

## MEETING SUMMARY

### Economy

This session considered ‘Abenomics’, the new set of policy measures advocated by the government under Prime Minister Shinzo Abe, and its possible impact on the Japanese economy. Speakers also discussed issues regarding the Trans-Pacific Partnership (TPP), economic productivity and female labour force participation. The session was chaired by Robin Niblett, director of Chatham House. Panellists included: Yukiko Fukagawa of Waseda University, Motoshige Itoh of the University of Tokyo, David Pilling of the *Financial Times*, Richard Werner of the University of Southampton and Linda Yueh of the BBC and the University of Oxford.

**Motoshige Itoh** opened the session by explaining that Japan has not recovered following the financial crisis of 2007–08: its growth has remained stagnant, its currency has appreciated and its general wage price level has remained negative. He outlined three hypotheses regarding why this has happened: the first suggests that the Bank of Japan has made a series of bad decisions; the second, that the Democratic Party of Japan, which was in power during the crisis, managed the situation badly; and the third, that the ‘lost two decades’ have made the Japanese economy very weak. While it is possible that all three factors may have had implications, since Prime Minister Abe came to power, the first two factors have changed. Japan has since followed the actions taken by the European Central Bank and Federal Reserve Bank of the United States following the financial Crisis, leading to a belief that Japan should be able to catch up with the rest of the world in terms of exchange rate and stock prices.

Professor Itoh emphasized the importance that Japan’s current period of monetary expansion should be followed by a supply-side change. This would then be marked by a demand-side change in investment and in the private sector. He explained that an important aspect of ‘Abenomics’ is whether the Japanese economy can shift from halting deflation in the first instance to achieving more sustainable growth. Professor Itoh said that if there is sufficient stimulation in the Japanese economy to promote investment, the economy should be ready to move in a more positive direction.

**Yukiko Fukagawa** explained that Japan is a late-comer to free trade agreements (FTAs) and is the last of the mature economies to still heavily protect its agricultural sector. The TPP will provide a comprehensive agreement that does not just deal with tariffs, but will also involve investment, competition policy, environment, labour, intellectual property rights and other areas. Professor Fukagawa underlined the view that the TPP should thus be regarded as part of a wider strategic process that will place more external pressure on internal sectors in Japan. She suggested that Japan’s membership of the TPP will be a breakthrough and that, once Japan has been able to abandon agricultural protectionist measures and break through the farm lobby, it will be much easier for the country to design other FTAs. Indeed, she said that Japan has now become a linchpin in free trade negotiations and will potentially be the only country to participate in the TPP, an FTA with the European Union and United States, and a Regional Comprehensive Economic Partnership (RCEP) with ASEAN+6.

**Richard Werner** identified the first arrow of ‘Abenomics’ (monetary policy) as the most important for Japan’s economic recovery. He argued that stagnant bank credit has been the primary cause of Japan’s recession over the last two decades and expressed concern that current reforms are still not sufficient to address this. In his view, bank credit is the key determining factor behind nominal GDP, which in turn influences the growth rate. Because Japan is yet to hit the mark with regard to the first and second (fiscal stimulus) arrows, Professor Werner stressed that it is too early to focus on the third arrow of structural reform. He stated that structural reform itself is not necessary for recovery.

**David Pilling** identified Japan’s biggest economic problem as the absence of nominal growth. He explained that, while it is commonplace to talk about 20 years of Japanese recession, the country’s real growth and productivity performance have not been far out of line with that of the United Kingdom or United States. In contrast, the country has seen no nominal growth since 1990.

He outlined his belief that Abe is trying to initiate big change. He explained that the previous Bank of Japan (BOJ) policy had assumed that there was little to be done about deflation, which it saw as requiring structural reform. However, Abe's appointment to the BOJ of Haruhiko Kuroda, who takes the view that deflation can be tackled by the central bank and solved by monetary means, has meant that the BOJ now has a price inflation target of two per cent and a governor who has placed impetus on achieving this. While the BOJ may need to develop further policies and firepower, he emphasized the psychological importance of Kuroda's commitment to this goal.

In **Linda Yueh's** view, declining total factor productivity (TFP) has played a key role in the stagnation of Japan's economy. Drawing upon Prime Minister Abe's speech on 'Japan's Economic Revival' in June 2013,<sup>18</sup> she argued that greater inclusion of women could increase Japan's GDP by one per cent to effectively double the country's real growth rate over the past 20 years. She stated that it is not possible to increase demand by simply unleashing lots of credit and identified raising wages as the only way to sustainably raise prices in the economy. To do this, she emphasized the need for labour market reform in order to get firms to produce more, thereby justifying the increase in the marginal product of labour that equals the wage. She stated that, in Japan, wages are currently not increasing and will only do so sustainably if the economy has more sources of demand. She stressed that this is why the Chinese market has been such a huge boost to the Japanese economy.

In response, **David Pilling** questioned whether Japanese productivity has actually fallen behind other advanced economies. He explained that, depending on the measures used, some accounts show Japanese productivity as zooming ahead – some statistics even show Japan outperforming the United States and Germany, particularly during the Koizumi years and partly as the country caught up in IT. He said that, while he supports bringing more women into the workforce, he did not believe it will necessarily improve productivity, but instead simply add to the pool of labour. He, however, emphasized that Japan needs to move from a manufacturing economy to an economy that can generate new ideas; greater participation from women, increased immigration and a greater focus on entrepreneurship are all ways that can help to achieve this.

**Motoshige Itoh** stated that, while reform with regard to female participation and the TPP are important, it is also necessary to consider the policy mix – macroeconomic policy and structural reform. He emphasized that structural reform with regard to, for example, urban policy and energy reform, had not been successful in helping Japan to realize growth because of a combination of poor macro policy and deflation.

He went on to comment that, although at first sight Japan's TFP over the past 20 years may look poor, when TFP is measured against labour population, Japan's is actually highest among all countries with a labour population over 50 million. **Richard Werner** agreed with this point, stating that productivity is driven by new technology and ideas; since 1993, when the Japanese recession started, patent registrations in Japan rose to a record high and have seen post-war highs ever since.

**Robin Niblett** closed the session by stating that the economies of the United Kingdom and Japan face structural challenges and, while some elements differ, this may give space for the United Kingdom and Japan to learn from one another. He commented that, while the session did not discuss how much investment Japan brings to the United Kingdom while at the same time transferring innovation and business practices, this was an important point to bear in mind. Finally, he remarked that Japan hopes to gain a lot from the potential FTA agreement with the EU.

## Security

This session reflected on prospects for future UK–Japanese security cooperation, particularly in light of the launch of the 'Strategic Dialogue' in October 2012. The session also considered the United States' policy realignment towards Asia and its impacts, as well as discussing changing regional security dynamics in East Asia. The session was chaired by Patricia Lewis of Chatham

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<sup>18</sup> Transcript available at <http://www.chathamhouse.org/events/view/191865>.

House. Panellists included: Rt Hon. James Arbuthnot, MP, of the UK House of Commons Defence Select Committee, James De Waal of Chatham House, Katsuhisa Furukawa of the National Graduate Institute for Policy Studies and Shinichi Kitaoka of the International University of Japan.

**James Arbuthnot** began by commenting on the relationship between the United States and Europe. He suggested that Europe has for too long relied on the US defence umbrella and that European members of NATO should devote more attention to Europe's need to defend itself. This is particularly the case given that Europe is the only continent in which defence spending is decreasing. He noted that the international community's focus on Asia, the new centre of economic power, is overdue and should be welcomed.

**Shinichi Kitaoka** identified the US military budget as a key issue in Japan's security considerations and expressed concern over sharp congressional budget cuts to US military spending, questioning whether the United States' military power can be sustained. Pointing to the threat of North Korean nuclear armament, he noted that approximately 65 per cent of South Koreans believe that the country should reduce its reliance on American military support and develop its own nuclear deterrence programme to counter the North Korean threat. He stated that these polls reflect South Korea's perception that the US military umbrella is no longer reliable. He affirmed that many South Koreans regard China as a more important ally than the United States, noting that this is in large part due to trade, which has seen a shift in focus from Japan and the United States to China.

Shinichi Kitaoka went on to state that, were South Korea to nuclearize, this would likely result in a complete revision of Japan's defence policy. He argued that this was one reason why the nuclear armament of North Korea should be stopped with as much collaborative effort as possible. However, in response, **James Arbuthnot** suggested that Japan should not be overly concerned about South Korea's increasing closeness to China, arguing that it is a natural response to the fact that China is an ally of North Korea.

**Katsuhisa Furukawa** argued that the US–Japanese bilateral alliance has on the whole strengthened in recent years, particularly after the major earthquake and tsunami that occurred in Fukushima in 2011. While the management of US military bases in Japan has always been a problematic issue, he stated that relations have moved towards greater cooperation in many areas. In contrast, he expressed disappointment in the state of UK–Japanese relations, lamenting that he has not seen the development of a multi-layered, multi-disciplinary partnership. He commented that the Strategic Dialogue focuses on very limited areas of defence procurement and that there are many other issues that need to be addressed in the security arena. He emphasized that these issues cannot be addressed solely through the foreign and defence ministries and highlighted the necessity of deeper intelligence-sharing between stakeholders in multidisciplinary fields, as well as the importance of public-private sector cooperation to this end.

**James De Waal** agreed that the UK–Japanese bilateral relationship requires further strengthening, but suggested that the initiation of the defence and security conversation has been a positive step. He nevertheless argued that British defence and security policy is still dominated by continuing operations in Afghanistan and that its defence doctrine is, in practice, limited to regions such as the Mediterranean and Africa. He thus questioned the extent to which it is possible for concrete cooperation between the United Kingdom and Japan to be achieved, given their divergent doctrines and priorities. He said that the two countries appear divergent in their willingness to use force, the role of force in national debate and culture, and in the way their armies are trained and deployed. While he stated that there was still the possibility of convergence in the future – for example, in the case of increased UK interest in East Asia or the fulfilment of Japan's aspirations to play an enhanced role in stability-building missions overseas – he affirmed that there is still some way to go. He noted that the fundamental challenge is how to place the longer-term development of broader relationships in such a way that the tyranny of the immediate does not wipe these efforts out.

James De Waal went on to observe that the UK–Japanese and US–Japanese security relationships appear to be on parallel tracks. He explained that there is a perception in the United Kingdom, and Europe generally, that there exists a degree of exclusivity in the US–Japanese relationship, which is often viewed as having a bilateral basis. This is clearly demonstrated through

US defence exports to Japan. He said that defence exports can help to build and strengthen relations between armed forces; if the United Kingdom and Europe perceive a domestic or US monopoly on defence exports and decide not to enter into a relationship, this can have additional implications.

**Shinichi Kitaoka** agreed that, while the role of the United Kingdom is important to Japan, it is not at the same level and could never replace Japan's relationship with the United States. He contrasted the United States' strong and direct influence in Asia with the United Kingdom's ability to offer a broader perspective with more global influence. In 2005, when Japan bid for a permanent seat on the UN Security Council (UNSC), the United Kingdom voted in favour, while the United States voted against. Professor Kitaoka asserted that the United Kingdom's intention was to encourage the participation of more powerful democracies in the UNSC, in order to widen the discussion on issues such as Syria and North Korea. He concluded that Japan's inclusion on either a permanent or semi-permanent basis at the UNSC would make a big difference to Japan and its dependence on the United States and other allies.

**Katsuhisa Furukawa** speculated that, while the United Kingdom has significant monitoring capabilities in Iran and Syria, and Japan closely monitors the activity of North Korea and its other neighbours, there is little evidence that the two countries share the information gathered with one another. He suggested that this is because of a lack of cooperation outside of diplomatic channels and the defence establishment. He went on to emphasize that the US–Japanese defence alliance is not exclusive: the two countries are now jointly cooperating to establish a regional security network and disaster relief operations but there does not appear to be any reason why the United Kingdom should not be able to participate in these efforts.

**James Arbuthnot** noted that the UK–Japan strategic dialogue only began in 2012 when, during a prime ministerial dialogue, it became clear that both sides were determined to strengthen the relationship. He explained that the first '2-plus-2' foreign–secretary-level meeting took place in October 2012 and that this has already borne fruit. While it is not yet as deep as both sides would like, he noted that there has already been dialogue on climate change and energy and on the Fukushima incident.

**James De Waal** stated that, while he believes the UK–Japanese strategic dialogue to be worthwhile, there is currently no real concept of what the defence and security relationship is supposed to achieve. While the one clear aim of establishing a closer relationship has been realized, he noted that much of the rhetoric has also been about achieving more ambitious but less clear-cut goals. He questioned whether, for example, the United Kingdom and Japan are aiming for a relationship that will lead to a joint peacekeeping deployment to replace the Austrian contingent in Syria; whether they are looking to see Japanese and British planes working together in the next UNSC-mandated peace enforcement mission; or whether they are looking to secure a permanent Japanese seat on the UNSC.

**Katsuhisa Furukawa** said that, despite the United Kingdom and Japan's shared norms, including the concept of the rule of law, the pace of cooperation has been slow, particularly given the rapid development of Asia. With regard to ASEAN, he noted that the United States and Japan have provided lots of capacity-support but need to engage in greater cooperation with likeminded countries. He recommended that the United States, United Kingdom and Japan should take the lead in building norms and promoting the rule of law in international institutions.

On the issue of cybersecurity, **James Arbuthnot** stated that there are now offensive capabilities in cyberspace against which there are no forms of defence. He emphasized the vulnerability of critical national infrastructure and commented that, within 10 years, increases in computer power will enable the sort of capabilities currently only available to states to enter the hands of individuals. In response, **Patricia Lewis** commented that governments and companies tend not to think far enough ahead on these issues, thinking about past capabilities rather than what might be needed for the future. **Katsuhisa Furukawa** further noted that the private sector has some of the most in-depth capability with regard to cybersecurity and that greater public-private sector cooperation in this sphere is essential.

To close the session, the panellists considered specific policy recommendations to further the UK–Japanese security relationship. **James De Waal** recommended the Japanese purchase of British warships. He disagreed with an earlier point made by Katsuhisa Furukawa that a lack of joint training and doctrine stops Japan from buying British equipment. He instead argued that the purchase of British defence equipment actually enables access to training, habits of cooperation, joint doctrine, as well as trust and the development of broader relationships that, in his view, can prove more valuable than the actual hardware.

**Shinichi Kitaoka** stated that, after consolidating his ‘Abenomics’ policy, many observers expect that Prime Minister Abe will turn his attention to Japan’s defence policy, taking a realist line. He expressed his hope that Abe will not take a more right-wing path and stated that he would like to see the United Kingdom and Japan work together on creating a global strategy for peace.

## Energy and environment

This session discussed bilateral and multilateral opportunities for the United Kingdom and Japan to work together on climate change, with particular regard to the achievement of the ‘two-degree target’ that seeks to limit global warming to 2°C above pre-industrial levels. The session also considered the question of nuclear power and whether this might realistically help to achieve such targets. The session was chaired by Lord Browne of Madingley. Participants included: David Cope of Doshisha University, Antony Froggatt of Chatham House, Mutsuyoshi Nishimura of the Japan Institute of International Affairs, Tatsujiro Suzuki of the Japan Atomic Energy Commission and Tim Yeo, MP, of the United Kingdom House of Commons.

**Antony Froggatt** commenced by giving background to the environmental situation in the United Kingdom and Japan. He stated that from 1990 to 2010 Japan’s emissions had risen by 13 per cent in the energy sector, while in the United Kingdom they had decreased. In 2012, however, both Japan and the United Kingdom saw their emissions rise. In Japan, this was thanks to an increase in the use of gas as a replacement for nuclear following the Fukushima disaster, while in the United Kingdom this was due to the increased use of coal to replace gas due to price differentials. He stressed that it is fundamental that both countries get back on track if they are to reach emissions targets.

He stated that there are some key areas where the United Kingdom and Japan can work together more closely, including international negotiations, where commitments should be upheld despite the lack of momentum at the current time. He emphasized the importance of building alliances and maintaining confidence in the 2020 targets. Rather than rethink its target under the Copenhagen Accord, he suggested that it would be important for Japan to stick by its current emissions reduction target of 25 per cent and reinvigorate domestic action. He went on to state that the EU, which is close to or already meeting its existing target of a 20-per-cent reduction of GHGs by 2020, should move that forward and extend its target to a 30-per-cent reduction, which he claimed is well within reach of the business as usual scenario.

Drawing upon his previous experience as climate-change negotiator for Japan, **Mutsuyoshi Nishimura** questioned the framework of the present system. He explained that this is based on government-centric systems whereby each country is requested to pledge its own ‘ambitious’ target numbers. As an alternative, he suggested the introduction of a global cap on emissions. He said that, for the 2°C target to be realized, there exists a scientific level of emissions that cannot be exceeded: total permitted emissions to 2050 must not exceed 1,000 gigatonnes. He suggested that property rights should be assigned to the 1,000 gigatonnes of emissions and sold to polluters, the funds from which would be allocated to developing countries with lower energy demands. One contributor from the audience, however, highlighted the enormous difficulties in implementing such a system and questioned whether international governance systems are strong enough to manage such large amounts of revenue.

**Tim Yeo** agreed that a carbon price is essential to the achievement of the 2°C target, highlighting that, as long as carbon prices are high enough, it will provide rewards for energy-efficient businesses, rather than penalize those businesses choosing to invest in low carbon. He

commented that the EU Emissions Trading System, which draws upon similar principals, has been negatively affected by having emissions limits set too high and a longer than expected recession in Europe.

**Tatsujiro Suzuki** suggested that the lack of pricing on carbon has made it difficult for investors to invest in low-carbon energy sources, including nuclear power. He went on to state that his personal perceptions of nuclear power have changed significantly since the Fukushima nuclear disaster and that its risks must be reconsidered. He emphasized that there are social, political and human rights issues that must be factored into the costs of nuclear power, which will inevitably translate into higher prices. He stated that the current compensation cost following Fukushima is estimated at \$60 billion, but that this is likely to increase. He explained that while he hopes there will be a future for nuclear power, this will not happen unless the safety of nuclear power plants is improved, there is a sustained international effort with regard to research and development in nuclear and the international community comes together to address the issue of spent fuel and nuclear waste management.

Taking a different perspective, **Antony Froggatt** stated that three of the world's largest economies – China, Japan and Germany – are now powered more by renewable energy sources than nuclear power. He explained that government support schemes and changing technologies have enabled prices in renewable energy to fall significantly, citing an 80-per-cent reduction in the cost of solar PV since 2009 and a 30-per-cent fall in the production of wind energy; meanwhile, the cost of nuclear power continues to rise.

He went on to highlight the importance of the energy security of different sources. He explained that because nuclear and energy renewables are generally not imported, they have added security of supply. He, however, highlighted the relative political insecurity of nuclear power, explaining that Japan's move away from 30 per cent nuclear-powered electricity to just one to two per cent has had both climatic and financial implications. He went on to state that, despite US estimates in 2000 that the country would see 20 new reactors in operation by 2020, the United States has instead largely seen a generation of non-builds. He stated that in the last two months alone, three US reactors have closed, with further closures possible. He underlined his belief that people are rethinking the issue of nuclear power, in terms of both economics and politics.

Commenting on pricing, **Tim Yeo** stated that under new electricity market reforms in the United Kingdom, the money to support both nuclear and renewable energy technologies will come out of the same £7.5 billion pot of consumers' subsidy. The different technologies will thus have to bid for their funding, which will increasingly be determined by which technologies offer best value for money.

**Mutsuyoshi Nishimura** emphasized that nuclear issues need to be put in their proper context. He explained that in theory he accepts that nuclear plants do not cause emissions and offer enormous power to fight against global warming. However, China, the largest emitting country, still generates 70 to 75 per cent of its electricity from coal burning and just one per cent from nuclear power. Because it takes 10 to 15 years to construct one nuclear power plant, he questioned the expectation that nuclear power will be able to fulfil China's power requirements sufficiently. If nuclear power is to be a panacea for global warming, he said that China must substitute the 75 per cent of its coal-generated electricity with nuclear power and must do so by 2050.

Commenting on the development of carbon capture and storage (CCS), **Antony Froggatt** noted that, while it had been received with much enthusiasm in Europe five years ago, it now looked overpromised as a technology. He explained that this was partly because of the collapse of the carbon price in Europe, which would have been one way to fund costly CCS demonstration projects. He underlined that CCS may well be a solution; but until the technology, risks, storage issues and system analysis have been demonstrated, it can neither be ruled in nor out.

**David Cope** followed by stating that while Japan is a world-leader in CCS technology, it will never be applicable to coal-fired combustion. He stated that CCS is readily applicable to gas and thus could be the answer to the increased use of methane hydrates.<sup>19</sup> **Tim Yeo** agreed that the focus

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<sup>19</sup> Large deposits of gas that are locked in ice crystals deep in the ocean.

should be to provide CCS on gas rather than coal. He stated that ideally a sufficiently high carbon price would limit coal's usage, encouraging energy users to instead opt for gas because it is a cheaper energy source with lower emissions.

Commenting on the United States' 'shale gas revolution' and the possibility of export to the United Kingdom, **David Cope** noted that the United States currently has insufficient infrastructure for shale gas export and, in addition, looks more towards markets in Asia. **Antony Froggatt** explained that there is a considerable gas price differential between the United States and Asia, providing an export incentive; approximately \$ 15 to \$16 per million BTU in Japan and approximately US\$4 per million BTU in the United States. However, he noted that, from a US manufacturing perspective, levelling the market would cause domestic gas prices to increase.

On the issue of Russia, **Antony Froggatt** commented that the country is currently the largest supplier of energy to the EU in terms of coal, oil and gas, although there has been an ongoing discussion regarding whether Russian supplies might start to move eastwards. While he accepted that this was a possibility, Russia's considerable investments in Europe, as well as the uncertainty surrounding fossil fuels and shale gas, mean it is likely to stay focused towards the EU for the next 10 years or so. In terms of long-term investment, however, he stated that there would likely be increased competition between China and Japan for these energy resources.

**Lord Browne** closed the session by commenting that although it is unlikely that there will be an international agreement on climate-change action, it is important to create a context where strong signals are given, and that the international community does not give up on a target and should keep thinking how, through various coalitions, it can obtain a carbon price. He went on to highlight the importance of adaptation, understanding the initiatives taken to date and developing new technologies. He finished by commenting on the open question of nuclear and how to rebuild trust between the government and people in Japan. He suggested that this will be an important piece of learning that can perhaps eventually be applied to other environmental issues in the United Kingdom.

## Frameworks for cooperation

This session examined the bilateral cooperation currently undertaken by Japan and the United Kingdom and Japan and the EU. This includes: the UK–Japanese Strategic Dialogue, launched in October 2012, the opening of EU–Japanese FTA negotiations and a framework agreement to provide a platform for cooperation that goes beyond trade and investment as well as a plethora of official-level contacts. The session sought to examine whether these frameworks are fit for purpose and to identify and understand the factors that might inhibit deeper partnership. The session was chaired by Sir David Warren of the Japan Society. Panellists included: Glyn Ford of POLINT, Kiichi Fujiwara of the University of Tokyo, Yuichi Hosoya of Keio University and Jesper Koll of JP Morgan, Japan.

**Kiichi Fujiwara** highlighted a recent inward turn in Japan, commenting on the population's general reluctance to engage in international affairs. This has been reflected through students who are unwilling to study abroad, a lack of research cooperation in the social sciences and humanities, and through the media, which is often uninterested in international news, unless related to domestic politics. He said that UK-related issues are not necessarily granted high priority. He explained that these perspectives can only change through education of the population and identified the international student exchange as a starting point. He argued that increasing this kind of encounter would be one way to help overcome the narrow-mindedness that has sometimes distorted Japanese policy.

**Jesper Koll** agreed with Professor Fujiwara, stating that the Japanese education system is geared towards producing the kind of students that the corporate sector desires. It does not want, and consequently does not hire, internationally minded individuals. He explained that corporate Japan produces 80 per cent of its profits from offshore operations and exports and, if it does not hire internationally minded middle managers who can preserve these external relationships, there will be a real structural problem in the long-term.

In terms of identifying concrete areas for cooperation, he highlighted the United Kingdom as an undisputed global leader in asset management, particularly with regard to pensions and insurance. Given Japan's demographic issues, he suggested that UK–Japanese cooperation in this field, especially with reference to the governance structure and financial management of the public pension scheme, could be a concrete step towards greater partnership. At the same time, he stated that the United Kingdom could learn from Japan's vast experience of caring for the aged.

He went on to suggest patents as another area for cooperation. He explained that the United Kingdom has an excellent track record in both protecting and monetizing returns on patents, while Japan has a large number of patents but is not effective at monetizing them.

Commenting on the European perspective, **Glyn Ford** stated that current negotiations for the EU–Japanese FTA and framework agreement will set the dimensions for future cooperation between the two parties. However, he noted that neither side currently prioritizes these negotiations; in Tokyo, the priority for many is the TPP, while in Brussels, the potential EU–US FTA negotiations are considered more important. He nevertheless noted that, even if this is where the respective priorities lie, the best way to achieve them will be through establishment of the EU–Japanese FTA. He argued that this would be one of the only ways to persuade Washington to make the necessary concessions for both the EU and Japan to reach their respective agreements.

He said that the one-year negotiating check on the EU–Japanese FTA will take place on the eve of European elections in March 2014 and that this could hinder progress. He suggested that certain groups in Europe, such as car manufacturers in Germany or Italy, could put pressure on MEPs to say that insufficient progress has been made and that negotiations should thus be halted. He stated that 23 EU commissioners had visited China in 2011, whereas just three had visited Japan. He emphasized that there is still a long way to go in putting Japan high up the EU agenda and that it is important for companies in Japan and Europe to loudly proclaim to their governments the potential benefits that could come from the FTA. He added that the EU has, however, not yet seen a set of trade negotiations fail to be concluded and that nobody in Europe wants Japan to be the first.

**Yuichi Hosoya** commented that Japan and the United Kingdom have rich experience in dealing with China and have learnt lessons from their historical experiences with the country. China is of great importance to both countries; for Japan, this comes partly due to geographical proximity, while for the United Kingdom, this is due to its commitment to the stabilization of the international order. He stated that in Asia, unlike Europe, democracy, freedom and the rule of law are commitments that are not shared by all of the key players. He stated that Japan would benefit from the United Kingdom's backing in trying to dissuade Chinese leaders from using military power and instead to rely upon diplomatic tools and international law, particularly in maritime areas. **Kiichi Fujiwara** agreed that Japan can benefit from the United Kingdom's long-term diplomatic relations with China and its weight as a country that practises prudence in its diplomacy.

With regard to the establishment of a stronger strategic security relationship, **Yuichi Hosoya** stated that three pillars are required: a UK–Japanese '2+2' dialogue,<sup>20</sup> the establishment of the UK–Japanese FTA and the promotion of deeper military cooperation through the Acquisition and Cross-Servicing Agreement (ACSA) to exchange military equipment and the General Security of Military Information Agreement (GSOMIA) information-protection agreement.

He went on to state that regional multilateral frameworks do not always work effectively and highlighted the Chinese-US bilateral summit meeting as the most important framework in this area. He consequently proposed a 'G2+' framework whereby, in addition to China and the United States, other players can play a role in influencing these countries to respect a broader multilateral framework.

He argued that Japan is unique in its position as the only non-Western member of the G8. He explained that Japan can play a role in persuading other Asian countries that cooperation with the West can be beneficial, and by showing that it is possible to undergo Westernization while also preserving Asian culture and patriotism.

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<sup>20</sup> Foreign and defence ministerial meetings.

**Jesper Koll** stated that the Senkaku/Diaoyu islands dispute in the East China Sea and the resulting very concrete threat to Japan's sovereignty have helped to focus the minds of the country's policy elite. This is despite the fact that trade relations and capital flows between China and Japan continue to form a very dense and stable relationship. Regardless, he argued that it is this new policy focus that helps to explain why Prime Minister Abe was elected president of the Liberal Democratic Party. Abe is now likely to be in power for at least the next four to five years and it is this certainty that has enabled him to make such bold statements and reach out to the global community. The fact that Abe chose the United Kingdom to give his major international speech is something that should be embraced.

In his concluding remarks, **Sir David Warren** noted the importance of mobilizing the educational and corporate sectors more effectively in the United Kingdom and Japan. He commented that the corporate sector had been largely absent from the conference discussion and hoped that there would be more opportunity for their involvement in future meetings. In his final point, he noted that the more intensive the bilateral context, the more realization there is that shared values and interests can only be mobilized by effective multilateral activity. He closed by asking whether the United Kingdom and Japan have the skills and capacity to deliver this.

## AGENDA

### DAY ONE: THURSDAY 20 JUNE

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#### 09.00 – 09.15

##### Opening Remarks

*Dr Robin Niblett*, Director, Chatham House

*Yohei Sasakawa*, Chairman, Nippon Foundation

*Tatsuya Tanami*, Executive Director, Nippon Foundation

#### 09.15 – 10.30

##### Keynote speeches (followed by Q&A)

*Rt Hon Hugo Swire, MP*, UK Minister of State, Far East and South East Asia

*Ambassador Hiroaki Fujii*, Chairman, Mori Arts Center; Japanese Ambassador to the United Kingdom (1994–97)

#### 10.30 – 11.00 Coffee break

### Session 1 | Economy

#### 11.00 – 12.30

- What are the key economic challenges currently faced by the United Kingdom/EU and Japan?
- What are the opportunities for Sino–Japanese economic cooperation and regional integration in Northeast Asia?
- Do the United Kingdom/EU and Japan have a common economic agenda within multilateral economic organizations, such as the WTO and G20?
- How important will EU–Japanese trade liberalization be for promoting growth and reform in Japan and deepening its connections with the United Kingdom/EU markets?

Panellists:

*Prof. Yukiko Fukagawa*, Graduate School of Economics, Waseda University

*Prof. Motoshige Itoh*, Graduate School of Economics, Faculty of Economics, University of Tokyo

*David Pilling*, Asia Editor, *Financial Times*

*Prof. Richard Werner*, Chair in International Banking, Southampton Management School, University of Southampton

*Dr Linda Yueh*, Chief Business Correspondent, BBC; Fellow in Economics, St Edmund Hall, University of Oxford

Chair: *Dr Robin Niblett*, Director, Chatham House

#### 12.30 – 13.30 Lunch

## Session 2 | Security

**13.30 – 15.00**

- How is the security relationship evolving between Japan and the United Kingdom/EU?
- What is the principal security challenge within the East Asian region? How should the United Kingdom/Europe work with Japan to address this and how might it affect the US role?
- Do changing security challenges demand that Japan become a more proactive security actor globally?

Panellists:

*Rt Hon. James Arbuthnot, MP*, Chairman, UK House of Commons Defence Select Committee

*James de Waal*, Visiting Fellow, International Security Programme, Chatham House

*Dr Katsuhisa Furukawa*, Visiting Scholar, National Graduate Institute for Policy Studies (GRIPS)

*Prof. Shinichi Kitaoka*, President, International University of Japan; Ambassador Extraordinary and Plenipotentiary, Deputy Permanent Representative of Japan to the United Nations (2004–06)

Chair: *Dr Patricia Lewis*, Research Director, International Security Programme, Chatham House

**15.00 – 15.30 Coffee break**

## Session 3 | Energy and Environment

**15.30 – 17.00**

- To what extent are the United Kingdom and Japan prioritizing responses to the national and international challenges of a changing climate and energy security?
- What are the new possibilities for United Kingdom/EU–Japan cooperation in the fields of energy and environment?
- How well-equipped are the United Kingdom and Japan to jointly pursue environmental and energy cooperation in frontier regions such as the Arctic and in Africa?
- How can the United Kingdom/EU and Japan work together to ensure that the next climate regime (to be negotiated by 2015) provides stronger solutions for achieving the 2°C objective?

Panellists:

*Prof. David Cope*, Visiting Professor, Doshisha University; former Director, UK Parliamentary Office of Science and Technology (POST)

*Dr Antony Froggatt*, Senior Research Fellow, Energy, Environment and Resources Programme, Chatham House

*Ambassador Mutsuyoshi Nishimura*, Visiting Research Fellow, Japan Institute of International Affairs; former Special Advisor to the Japanese Cabinet on Climate Change

*Dr Tatsujiro Suzuki*, Vice Chairman, Japan Atomic Energy Commission

*Tim Yeo, MP*, Member, UK House of Commons

Chair: *Lord Browne of Madingley*, Partner, Riverstone; Chief Executive, BP (1995–2007)

**17.00 – 17.30 Conclusion and Wrap-up**

**17.30 – 18.30 Drinks reception**

## **DAY TWO: FRIDAY 21 JUNE**

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**09.20-10.00**

### **Opening Remarks**

*Dr John Swenson-Wright*, Senior Consulting Fellow, Asia Programme, Chatham House

*Prof. Akiko Yamana*ka, Senior Diplomatic Fellow, Cambridge Central Asia Forum, Cambridge University; Japanese Vice Minister for Foreign Affairs (2005–06)

## **Session 4 | Frameworks for Cooperation**

**10.00 – 12.00**

- What should be the priorities for international cooperation between the United Kingdom/EU and Japan?
- Can these priorities be addressed within current bilateral and multilateral frameworks?
- What new approaches could each side pursue to deepen bilateral cooperation?

Panellists:

*Glyn Ford*, founder, POLINT; Member of European Parliament (1984–2009)

*Prof. Kiichi Fujiwara*, Graduate School for Law and Politics, University of Tokyo

*Prof. Yuichi Hosoya*, Faculty of Law, Keio University

*Jesper Koll*, Managing Director of Research, JP Morgan, Japan

Chair: *Sir David Warren*, Chairman, Japan Society; UK Ambassador to Japan (2008–12)

**12.00 – 12.30**

### **Closing Remarks**

*Dr Robin Niblett*, Director, Chatham House

**END**