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Kishida's New Capitalism and its implications for EU-Japan relations

An Analysis of Japan's Economic Policy after
Abenomics and its External Impact

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Abstract

During his campaign running for the presidency of the Liberal Democratic Party (LDP) in November 2021, Fumio Kishida showed his plan for a "New Capitalism" for the first time. Largely inspired by the similar economic policies of his predecessors, the implications of the current Prime Minister's policies remained at that moment unclear and hardly applicable. Since then, a "Grand Design" of a "New Capitalism" and the first annual fiscal and economic policy guidelines were approved by the Japanese cabinet on 7 June 2022, shedding light on some of the economic measures scheduled to be taken under Kishida's administration. The plan pledges modernization of the Japanese economy through greater support of innovation, decarbonization, and digitalization, towards positive growth and a better distribution of wealth. The LDP's strong victory in the Senate elections following the attack on former Prime Minister Shinzo Abe also provided Kishida with the authority and legitimacy to carry out these policies. Thus, the erection of "Kishidanomics" will address many issues impacting foreign economic policy, directly affecting Japan's historical partners such as the European Union. In this EIAS Policy Brief we analyse how this will substantiate itself in Japan and EU-Japan relations.

Keywords: *EU-Japan, Kishidanomics, New Capitalism, three arrows, Green Alliance, digitalization, economic security, corporate tax*

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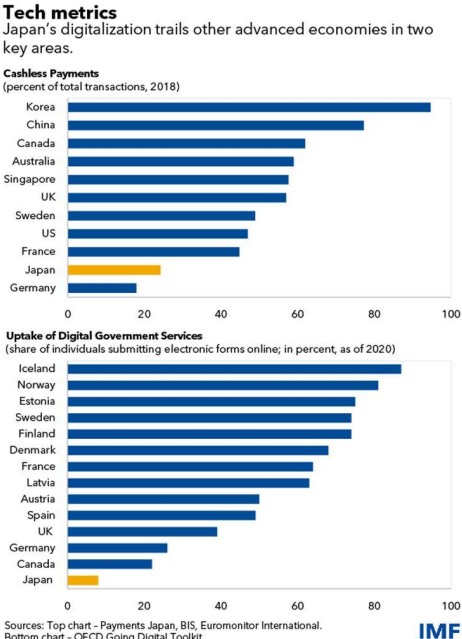
The need for a “New Capitalism”

On 7 June 2022, the Japanese cabinet approved [the first annual fiscal and economic policy guidelines](#) established under Prime Minister (PM) Fumio Kishida, as part of his "Grand Design for New Capitalism". [The plan](#) pledges modernization of the Japanese economy through greater support of innovation and startups, efforts to decarbonize, and digitalization, moving towards positive growth and a better distribution of wealth.

This policy brief aims to clarify why Japan needs a new form of capitalism and seeks to address its structural problems observed since the "Lost Decades", in an economy even further weakened by a lack of growth and increasing inequalities triggered by the post-pandemic context. Today, the current context of the shocking assassination of Shinzo Abe and the July 2022 senatorial elections strengthens Fumio Kishida's power within the LDP, and the power of the LDP party within Japanese society. This could herald a fresh start for Kishida, and allow for effective implementation of his "New Capitalism”.

Digitalization and Innovation

Japan is well-known for robotics, automation, artificial intelligence (AI), and high-tech development and innovation. Yet, nowadays the services streamlined by the digital revolution in much of the world are, in Japan, still cluttered by "[sclerotic digital systems](#)".



In terms of the digital skills of its population, Japan is rated [62nd out of 64 countries by the International Institute for Management Development \(IMD\)](#). Its schools rank last in teachers’ knowledge of digital technologies and their ability to teach it. Resources to help said teachers are also critically lacking. [According to the International Monetary Fund \(IMF\)](#), the pandemic emphasized Japan’s struggles with digitalization, whether in shifting to remote work, online-based procedures, or implementing cashless payments and

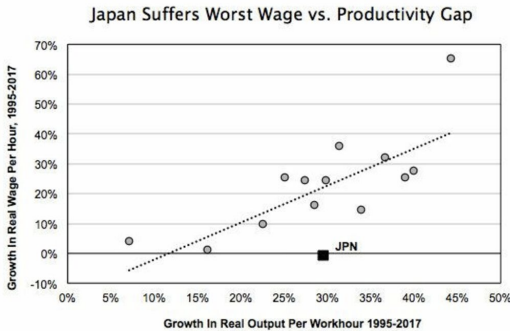
e-commerce. Especially in this context, digitalization could provide true momentum for a post-pandemic economic rebound.

On innovation and startups, although Japan's Research and Development (R&D) expenses represent 3.3% of their Gross Domestic Product (GDP), Tokyo is only allocating 8% of financial aid to companies with fewer than 250 employees (the lowest share in the OECD), while the rest goes mostly to traditional Japanese conglomerates maintaining cross-holdings, called “Keiretsu”. The “iron triangle” linking the Liberal Democratic Party (LDP), large corporations such as Kereitsu, and the bureaucracy, creates a public infrastructure that lags behind on mobility and innovation capacity. By continuously supporting the firms through loan restructuring that keeps credit flowing, interest rates are often much higher for a 10-year-old healthy company than 50-year-old Keiretsu with a poorer credit score. State-supported innovation used to be effective because it reduced the uncertainty of business risk-taking. Today it merely allows the various actors in the Japanese economy to stick to their positions, leading to a reduction of the profits for smaller healthy firms, discouraging their entry and investment. Thus, as Japan’s aid is usually allocated via a tax credit, banks often resist granting loans to young entrepreneurs, especially women. Startups and small and medium enterprises (SMEs) therefore face a lack of legitimacy in a Keiretsu-dominated Japan, technical issues due to the lack of digitalization for administrative procedures, and more and more obstacles to funding. In 2021, venture capital investment in Japan was less than 1% of that in the US, and 5% of China’s, while Japan only had six “unicorns” – companies valued at one billion dollars or more – mostly in advanced technology like AI. That is still less than India, South Korea, or Singapore.

Wages and productivity growth

To make Kishida’s “New Capitalism” an effective and coherent public policy for the Japanese economy, the PM will above all need to tackle a domestic problem that even his predecessors have failed to address: the almost stagnant growth of wages.

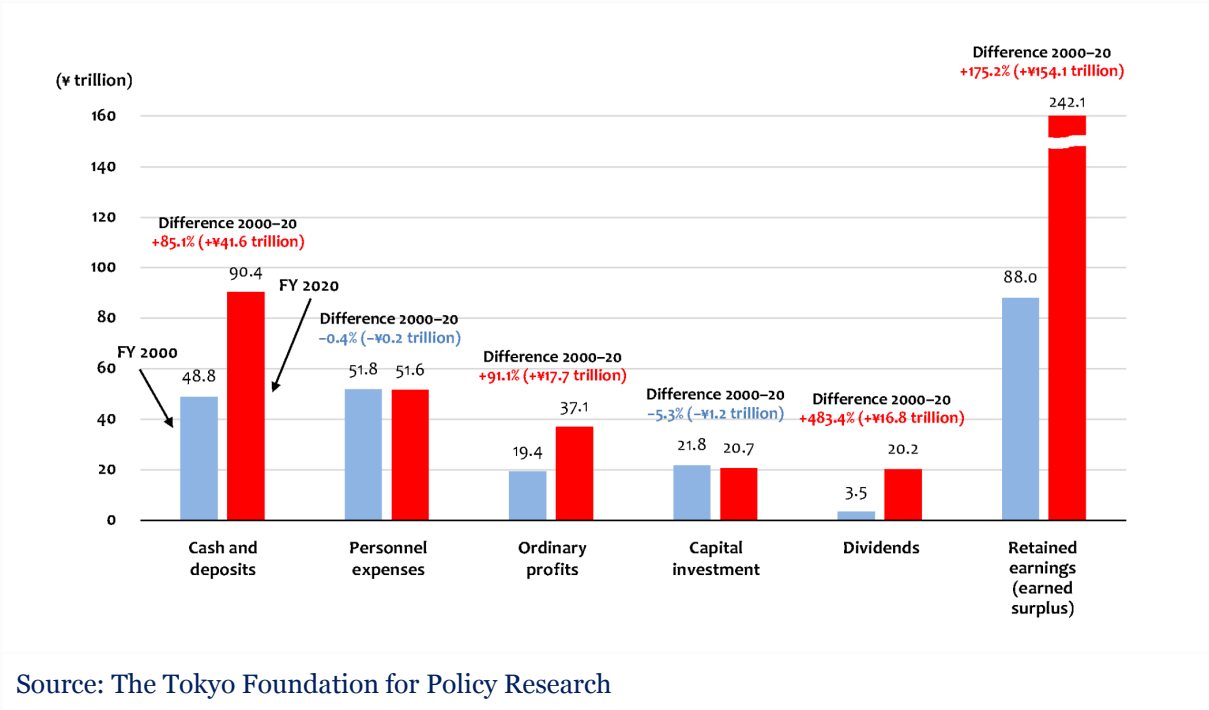
Between 1995 and 2017, Japan’s productivity growth increased by 30%. However, real hourly earnings (i.e., workers' earnings) fell by 1%. As a consequence, anemic consumer demand did not allow for sufficient tax collection by the government, resulting in an increasing deficit, where the little hard-earned wealth of workers is generally not spent on goods and services, but saved in anticipation of



(Source: OECD)

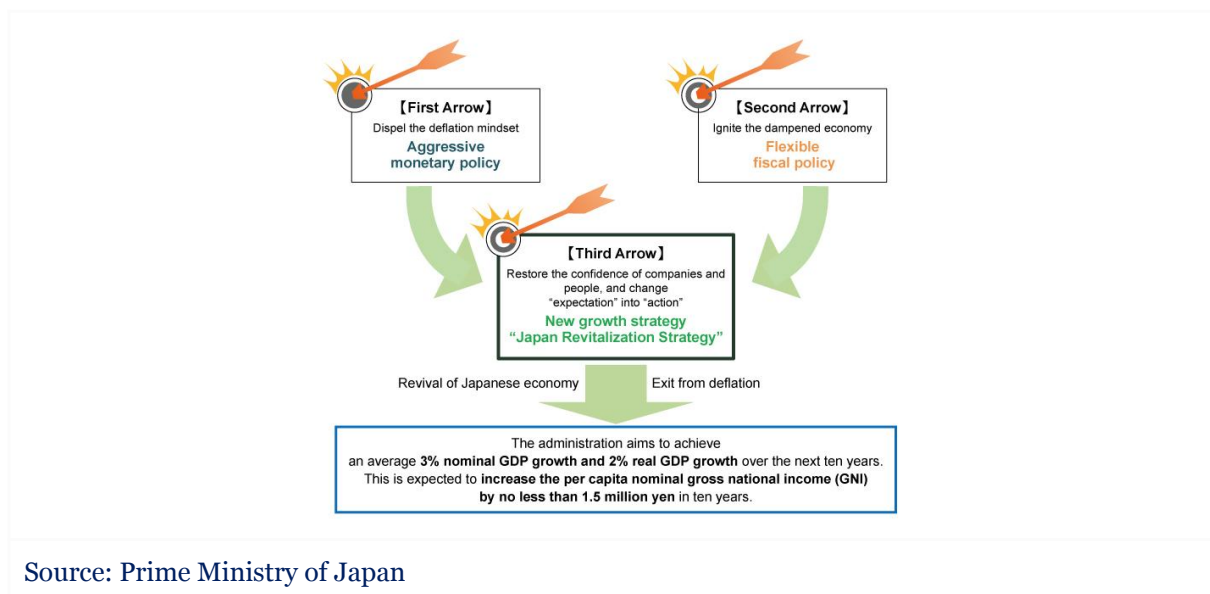
more difficult times, maintaining a vicious circle of debt. In 2022, Japan’s long-term debt hit a new high, above one quadrillion yen, breaking records for the 18th consecutive year. The social implications of this evolution are compounded by structural changes, such as the shift to non-regular employment, representing 37.5% of today’s Japanese workforce.

A fundamental problem also resides in the unbalanced distribution between corporate and household incomes. The government has reduced the top tax rate for large corporations from 52% of profits in 1994, to about 30% in 2021. Companies are accumulating "retained earnings," which they are not putting back into the economy through wage increases, investment, or even taxes. The Keidanren and the Ministry of Economy, Trade, and Industry (METI) had envisioned that companies would use the extra money to spend more on wages and investment and thereby boost per capita GDP. However, this promise has not sufficiently benefited Japanese society thus far. Between 2000 and 2020, the combined annual profits of Japan's largest companies nearly doubled (18 trillion yen, or 132 billion USD), while worker compensation fell by 0.4% and capital investment by 5.3%. In order to rebalance the income differences between companies and households, a deep and structural reform of the Japanese economy would therefore be necessary to have a more efficient redistributive policy, with finally visible “trickle-down” effects for the whole economy.



Beyond Japan's traditional economic policies

New Capitalism keywords reveal [many similarities with older reforms](#) and growth strategies put forward by Yoshihide Suga's administration a year ago, and with Shinzo Abe's well-known "[Abenomics](#)". New Capitalism selectively [incorporates and refines aspects of Abenomics](#), including its "three arrows": flexible fiscal policies, increased money supply, and longer-term structural reforms. Under Abenomics between 2012 and 2018, Japan enjoyed a 71-month period of economic growth, the second-longest since the end of World War II. Yet, maintaining adequate demand in Japan's aging economy is not enough nowadays. Kishida's plan goes beyond Abe's economic policies, notably by investing massively in human resources after having been weakened by an ever-increasing number of precarious workers. The current Prime Minister's capitalism relies on a large middle class that would enjoy the fruits of economic growth, with wage increases for all, to finally boost efficient consumption.



The New Model of Capitalism also echoes the old model from the "golden age of capitalism" of the 1960s. At the time, as part of the "Economic Miracle", wages and productivity rose hand in hand in Japan. A modern version of former Prime Minister Ikeda Hayato's 1961 "[income doubling plan](#)" will allow Japan to revitalize its growth. The income doubling plan reaffirmed the government's responsibility for social welfare, vocational training, and education, while also reconceptualizing growth to include consumers as well as producers. Between 1960 and 1967, not only did GDP growth average double digits, but [workers' income also doubled](#). Likewise, Kishida's plan is based on special attention to workers and the will to make their incomes grow: if successfully implemented, it would ease the burden of Japan's growing number of irregular workers.

Facing those issues, it becomes essential for the Japanese economy to renew itself. For now, Kishida will have to face several challenges if he wants to gain legitimacy and have the cards in hand to transform his vision into implementation and turn the Japanese economy around.

New rhetoric for not-so-new challenges

From vision to implementation

Kishida's action plan for a New Capitalism contains [34 pages of policy recommendations](#), drafted by a panel of experts formed by the Prime Minister himself. So far the plan mostly involves broad themes but it has been [calling for](#) investment in training, the establishment of blank-check investment companies, a goal to double household income from financial assets, and a requirement for firms to reveal gender pay gaps among their employees. The measures already announced aim to foster innovation, appointing a new minister responsible for [centralizing and managing start-up policy](#) within government agencies, and who will be tasked with developing a plan to increase the number of Japanese start-ups to a tenfold over the next five years.

This plan represents a novelty compared to the usual Japanese public policies. For the first time, a Japanese LDP Prime Minister [intones against neoliberalism](#), pointing to the growing inequality and poverty that it fuels. This criticism is aimed at the [neoliberal policies implemented since the Koizumi government](#) (2001-2006) like privatizing the postal delivery, savings, and insurance system, but also [those maintained and reinforced by Shinzo Abe](#), in particular deregulation and monetary easing. Kishida, although the head of a rather left-wing section of the LDP, clearly declared his preference for egalitarianism and social stability, [facing accusations of promoting socialism](#).

In order to implement his actions, Kishida promised to create a Committee for a New Japanese Capitalism to ["develop a vision for a post-pandemic economy and society"](#). Established in mid-October, the Headquarters for the Realization of New Capitalism, of which he is the chairman, is the first official institution to develop the New Capitalism project and measures to promote a sustainable cycle of economic growth and wealth distribution. [Members include](#) Yoshino Tomoko, president of the Confederation of Japanese Trade Unions (Rengo), and Shibusawa Ken, descendant of Shibusawa Eiichi, the father of Japanese capitalism.

Challenges ahead

In order to present a truly revolutionary economic plan, Kishida will have to overcome several major challenges. The first one comes from the Japanese corporate sector, especially the Keidanren, the most influential employer union. While a rearrangement of the tax system was supposed to be at the core of Japan's economic policy in order to assure better redistribution, as the [IMF had suggested](#), Kishida clarified in [October 2021](#) that this would no longer be the case. His statement was followed by a fall in stocks as a result of his announcements, also called the “[Kishida shock](#)”. Initially, the reform planned to increase [capital gains tax](#) (today estimated at [23.2%](#) for companies). However, this recommendation was removed after being contested by the corporate sector. This placated the business sector, investors, and wealthy individuals, who under the current income tax system are deriving their income from stocks and paying fewer taxes compared to lower-income individuals.

The second challenge comes directly from the LDP and specifically from Shinzo Abe's legacy. Until his assassination, on 8 July 2022, Abe remained the leader of the largest faction within the party, the Seiwa Seisaku Kenkyū-kai. In Japanese faction-centered politics, this meant that until then [Kishida had been dependent on Abe's approval](#) to effectively implement his policies. This challenge was significant and centered around important points of divergence, like monetary policy. Directed by the Bank of Japan (BoJ), [yen depreciation was once welcomed by Abe](#) as a measure to tackle disinflation and boost the Japanese economy. Today, however, Kishida and current BoJ President Haruhiko Kuroda [argue](#) that the weakening yen, despite its long reputation, affects the purchasing power of Japanese households by increasing the price of imports. For now, further intervention from the BoJ has yet to be announced, with [Kuroda stressing](#) that it would continue its monetary easing program to support the economy. Nevertheless, the recent assassination of Shinzo Abe has reshuffled the deck, and the structuring of the faction after his death remains an important question in assessing future economic policy. More than ever, Kishida has the opportunity to fully implement his policies on the ground with the approval of the faction, and the whole party.

Last but not least, many economists remain skeptical and question whether Kishida's new capitalism is anything more than talk. Kaya Keiichi, a columnist for Newsweek, [argues that Kishidanomics is elusive](#), or as one LDP candidate noted, "[long on words but short on action](#)". Motohiro Sato, a professor of economics at Hitotsubashi University, [points out](#) the lack of sufficient details and required revenue for the redistribution of wealth to be feasible. Beyond this criticism, it may also be that Kishida's rhetoric reveals a “[misdiagnosis of his](#)

[country's ills](#)". Japan's measure of inequality has hardly moved since the 1990s and its Gini coefficient only does slightly worse than the OECD average. Many of the challenges facing the Japanese economy [are not addressed](#) by the new form of capitalism advocated by Prime Minister Kishida, such as the fiscal imbalance. Japan's budget deficit has long been the largest among advanced economies and has increased further due to the massive fiscal outlays undertaken to cope with the pandemic.

Thus, for the implementation of a "New Capitalism", the greater challenge resides in mobilizing support from a wide range of interest groups, as its implementation would drastically change the Japanese economic structure. Following the victory of the Upper House elections on 10 July 2022, [Kishida can now show his hand](#) on potentially unpopular issues, such as taxes or wages. Having comfortably secured [63 seats out of 125 up for grabs, and a clear majority in the Upper House with the Komeito](#), the LDP has all the cards in hand to follow through with the reforms.

Kishida's vision on foreign affairs

On the international scene, the implementation of "[Kishidanomics](#)" allows the Prime Minister to stand out. Many key points of the project concern foreign economic policy, directly affecting Japan's historical economic partners such as the European Union. Notably, their [2019 Economic Partnership Agreement](#) (EPA) has been the cornerstone of the recent rapprochement between the EU and Japan. The EPA has created one of the world's largest free and advanced economic zones with about a quarter of global GDP and a third of global trade. It has also set ambitious standards for sustainable development, with the text including for the first time in international relations a specific commitment to the Paris climate agreement. In 2019, a [Strategic Partnership Agreement](#) (SPA) was also implemented, based on long-standing cooperation, shared values and principles - including democracy, the rule of law, human rights, good governance, multilateralism, and open market economies. Within this strategic partnership, the EU and Japan also signed a [partnership on sustainable connectivity and quality infrastructure](#) for action in a variety of areas: energy, digital, transportation, and people-to-people connections. Following previous agreements, the economic and political ties between the EU and Japan are therefore likely to expand even further under Kishidanomics, in an increasing diversity of domains. Domestic measures on digitalization, innovation, trade, and transition to green energies and technologies will definitely have an impact on the intertwined economies of Japan and the EU.

An analysis of "New Capitalism" is thus essential to fully grasp EU-Japan economic relations under Kishida's administration. This especially after the [28th EU-Japan Summit in](#)

[May 2022](#), in the context of the war in Ukraine and growing security concerns in the East China Sea, and the victory of the LDP in the [Upper House elections on 10 July 2022](#) - two days after former Prime Minister Shinzo Abe was shot dead - which will also determine the trajectory of Kishida's economic program for the next 3 years.

Implications for EU-Japan relations

The EU has a long history of interaction with Japan, despite the great geographical distance between them. With their relationship expanding from economics and trade to politics and security, Kishida's New Capitalism will therefore have concrete consequences for its exchanges with the EU, irrigating multiple areas of cooperation. Notably, the joint declaration of the [28th EU-Japan Summit in May 2022](#) emphasizes two new areas of cooperation: digital and economic security development. It also states that both sides will continue to implement the [EU-Japan Green Alliance](#).

Cooperation on digitalization

As mentioned, the COVID-19 pandemic proved how much digital technology remains "[indispensable in solving social problems](#)", including the depopulation of rural areas and an aging population in Japan.

With Kishida's New Capitalism, we can expect public policies to be aligned with the [6th Science Technology and Innovation \(STI\) Plan](#). Led by the Ministry of Sciences and Technology (MEXT) since 2021, the plan specifies future priorities according to Japan's social and economic challenges, with technology and innovation as major themes until 2025. In addition, in June 2021, the [Integrated Innovation Strategy](#) (IIS), drafted by the Cabinet Office, complements the key measures for 2022 defined by the STI in the field of digitalization, with new elements including the development of advanced semiconductor technology manufacturing, R&D investment in quantum technology, the revision of AI, and biotechnology strategies to align with recent geopolitical developments. Kishida will therefore be able to build on the projects inaugurated by his predecessors, notably through the [Digital Agency](#) (DA), inaugurated in September 2021, which provides for greater authority and will centralize Japan's governmental decisions on digitalization. Given its recent inauguration, the role and responsibilities of the agency are still being discussed and negotiated. It will come down to Kishida to use this institution wisely. Nevertheless, the agency [gives a grounding point](#) for international discussion and for future EU-Japan cooperation in the

digital domain, perhaps allowing Tokyo to gain inspiration from Brussels when it comes to digital policy-making.

Indeed, the conclusions of the EU-Japan summit on 27 May 2021 explicitly called for enhanced [Digital Partnership between Japan and the EU](#), a first that the EU signs with a partner country, to support an inclusive, sustainable, and people-centered digital transformation. Inheriting Japan's [National Data Strategy](#) (2021) and [Priority Policy Program for Realizing Digital Society](#) (2021), as well as the [European Data Strategy](#) (2020), this Digital Partnership enables the creation of a true internal data market aimed at implementing the vision of a “5.0 Society” and realizing a ["Data Free Flow with Trust" \(DFFT\)](#) to maximize the benefits of data flows. In the political context of the Ukraine war, both parties seem to recognize the predominant importance of moving data across borders for economic growth and innovation. [This partnership acts as a “forum”](#), giving political steer and impetus for joint work on digital technologies in areas such as “Beyond 5G/6G technologies”, safe and ethical applications of artificial intelligence, or the resilience of global supply chains in the semiconductor industry.

Further than that, cooperation on digitalization and innovation through New Capitalism policies represents a good opportunity for EU firms: the shortage of domestic digital talents and the need for disruptive solutions pushes Japanese firms to look into foreign solutions which cannot be found locally. As Europe has displayed strengths in counting multiple startups and innovation hubs recognized internationally, [the opportunities for EU companies are promising](#), bringing digital talents and disruptive innovation to Japan, especially on e-governance, secure data transfers, software-as-a-service (SaaS), and smart cities domains.

Cooperation in economic security

The concerns about “economic security” issues have been heightened by the escalating tensions between Japan and China over ownership of the Senkaku-Diaoyu Islands in the East China Sea, which rekindled about ten years ago. Since China's trade embargo on rare earth exports, Japan [has sought to strengthen its supply chains, economy, and industry](#). The calls for the protection of Japan's economic intelligence were also exacerbated by [the US-China trade and telecommunication dispute](#) and the US confrontation with [Huawei and Tiktok](#), anticipating further tensions in the region. More than ever, Fumio Kishida repeatedly stresses the link between economic growth and national security, and the intertwined notion of economic security.

Today, Japan is in an intensive phase of policy and legislation development that has deepened in response to the invasion of Ukraine and the COVID-19 pandemic. Notably, [the Minister of Economic Security](#) is the centerpiece of Mr. Kishida's New Capitalism. Kobayashi Takayuki, the new minister, will [protect](#) Japan's reputation and dominance in the electronics and semiconductor sector, as well as prevent industrial espionage through legislation outlining economic security goals. The promotion council will have [four objectives](#): securing supply chains, the security of basic infrastructures, expanding public-private technological cooperation, and protecting critical technologies, notably in the military.

In this context, coordination in economic security between Japan and the EU will be a growing area of "[strategic alignment](#)". The 28th summit between the EU and Japan [again recalled](#) the international context and the extension of both entities' practical cooperation in the security field, with coordination in areas such as cybersecurity, the fight against disinformation, crisis management, and maritime safety. As an example, the latter will be implemented through intensified naval cooperation, joint port calls, and bilateral exercises between Japan and the European Union Naval Force (EUNVF). Furthermore, cooperation on economic security issues is particularly relevant in a context where all [industrial economies will seek to stabilize the supply of critical technologies](#), either through foreign direct investment or by diversifying trade sources.

Continuity of the Green Alliance

The EU-Japan summit also highlighted the will to continue the decarbonization plans initiated in May 2021. [Both the EU and Japan shared](#) the aim of becoming carbon neutral by 2050. While Japan still remains the sixth-largest emitter of carbon dioxide, [its goals are in line with targets set by the EU](#). Further cooperation around the Green Alliance [will facilitate building EU-Japan business cooperation](#), including to further promote business collaboration in third countries markets.

Collaboration on the decarbonization of the European-Japanese economies could notably take root on issues related to the circularity of "[strategic metals](#)". The availability of these critical raw materials is key to ensuring their strategic autonomy and the industrial resilience of Japan's economy in the wake of the pandemic and the war in Ukraine. As the management of these metals is also intimately linked to Kishida's plans in its New Capitalism outlook for the development of "green technology" and the digitization of the Japanese economy previously discussed, cooperation with the EU may be relevant to ensure both domestic and foreign momentum on issues related to the carbon-neutral economy and digitalization. This cooperation [could be illustrated](#) in areas such as clean energy and mobility

technologies and could operate through an appropriate legislative framework, mobilizing the basis of Public-Private Partnership (PPP), Private Finance Initiative (PFI), or common objectives of green public procurement (GPP).

Conclusion: Continuity or disruption from Abe's legacy?

The New Capitalism plan initiated by Kishida's administration, if implemented successfully, will structurally change the way the Japanese economy operates. In this scenario, EU-Japan relations will benefit from further cooperation on topics such as digitalization, innovation, economic security, or decarbonization, reinforcing their presence in the Indo-Pacific and on the international scene by doing so. The victory of the LDP in the 10 July 2022 upper-house elections gave Kishida all the cards in hand to follow through with his plan without too many confrontations. Nevertheless, to do so he will need the full support of his party on thorny issues like taxes and redistribution, and the courage to carry out his own reforms while honoring and respecting his predecessor Abe's past ones.

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