

The truth about Tokku (Special zone)

Summary

Creation of special economic zones, “Tokku” in Japanese, has become one of the symbols of the growth strategy of Abenomics. Abe administration is scheduled to publish a new version of their growth strategy package by the end of June and the package will include the creation of 6 National Strategic Special Zones. Among the six special zones, the special zone of Tokyo is said to potentially have a large impact on the economy. For example, the government is said to take measures to make it easier for foreigners to acquire resident status, and simplify the procedures of starting a business in the special zone of Tokyo. When you see all the fanfare and measures supposedly planned for these special zones, you might think that they could be quite effective for Japanese economy. But how effective will they really be? The truth is that Japanese government have introduced many special zones in the last 10 years, but the impact of these special zones has been limited and many of special zones failed to produce hardly any results at all. Our following examination of past examples and currently proposed batch of special economic zones suggests they are likely to equally ineffective.

Japan created more than 1000 special zones in past 10 years

The concept of special zones started to be systematically used in 2003 when Koizumi administration introduced the idea to promote structural reform. Since then, more than 1,000 special zone proposals were approved since 2003. Some special zones did better than others, but even successful ones had very limited impact to the Japanese economy and vast majority of them had zero impact as the condition to make use of special zones were simply not practical. Below, we examine some of the past examples.

Example 1: Opening farm business to corporations

In Japan, corporations were not allowed to enter into farming business for a long time. In 2003, for the first time, companies were allowed to start agricultural business directly by leasing farmland from farmers in a special zone in Niigata prefecture, located north-west from Tokyo. After the trial in this special zone, the deregulation started to be applied nationwide across Japan. Before the end of 2013, 1,108 companies leased farmland and entered into agricultural business. This special zone scheme is considered to be one of the most successful cases as it spearheaded a deregulation in agriculture, the most protected industry in Japan. The nationwide effects of the deregulation has been nevertheless limited. The farmland that has been leased to companies is less than 0.1% of total farmland in Japan, at the end of 2013. There are several factors that prevent companies from entering into farming. Companies are still not allowed to own farmland. Companies who lease farmland have to return it based on owner's requirement. Only agricultural production corporation can own farmland, but companies cannot acquire a majority stake of agricultural production corporation. These factors keep companies from entering into farming business.

Example 2: Increasing cargo handling by easing regulation of customs and harbor

Using the system of special zone, Kita-Kyushu city in the Kyushu Island deregulated the restriction on the operating hours of cargo handling and customs clearance with an aim to increase the cargo handling by 2.5 times in 5 years. While the amount of cargo handling did increase, the increase was limited to 30% between 2003 to 2008, even with the relatively robust economic growth in Japan in this period.

Example 3: Allowing companies to run a clinic

Allowing companies to run a medical clinic was one of the prioritized issues of regulatory reform by Koizumi administration in 2003. A special zone for such purpose was created in 2005. But only one clinic run by a private

company was opened in the special zone so far. Why the low uptake? It is because the permission to open a company-run clinic came with number of conditions attached. For example, such clinic could provide only very narrow and specified advanced medical care, such as advanced treatment of aesthetic plastic surgery, gene therapy of lung cancer etc. Moreover, patients could not use their healthcare insurance to pay the medical costs in these clinics. We would count this special zone case as a part of a failure as it produced only one clinic despite all the attention and political capital spent by the Koizumi administration to create the zone. The nationwide extension of the deregulation never happened.

Special zones in 2014 unlikely to differ much from past examples

Abe administration advertises “National Strategic Special Zone” as one of major pillars of growth strategy. The law for National Strategic Special Zone was established in 2013 and the government has already chosen six areas as its candidates in May 2014. Among the six candidates, Tokyo area is said to have the biggest potential impact on the economy. Examples of measures discussed for the special zone of Tokyo, “International business and innovation hub” include following.

Supporting establishment of corporation by foreigners, easing the conditions for acquiring resident status, improving and expanding the medical care for foreigners. On surface, these measures may seem to be effective in attracting foreign firms to Tokyo.

But, in fact, a special zone with similar features already exists in Tokyo. The zone is called “Special zone for Asian headquarters” and it has been in operation since 2011. In the plan for “Special zone for Asian headquarters”, the local government of Tokyo already requested a number of deregulation measures such as simplifying the procedure of immigration examination and increasing quota for foreign physician. Tokyo government already set up concierge services to support foreign firms in conducting administrative procedures and living in Tokyo. Other measures such as improving the environment for business jets, and simplifying and speeding

up the procedures for acquiring resident status were also taken. Moreover, government decided to implement a tax break for firms that satisfy certain conditions to attract them in this “Special zone for Asia headquarters”.

How is the “Special zone for Asian headquarters” doing? When the zone was established, government officials set a goal to attract more than 500 foreign firms, including 50 corporate headquarters for Asia and R&D centers before 2016. So far, the special zone attracted only 2 headquarters or R&D centers, far below the target number of 50. And no firm received the tax break treatment as the conditions were too stringent.

With regard to increasing foreign physicians practicing in Tokyo, the currently proposed measure, increasing the quota for foreign physicians, is unlikely to increase the number of foreign physicians in Tokyo. Even with the current regulation, physicians from United States, United Kingdom, France and Singapore are allowed to provide medical care to foreign patients if they pass the examination for medical practitioners in English. The quota of doctors is 7 for UK, 1 for France, 9 for Singapore and there is no quota for U.S. But only seven physicians and dentists have made use of the system as of May 2013. The quota is not the limiting factor. The number of foreign physicians in Japan is low, not because of the quota, but for other reasons such as that they have to take an exam in Japan, they are not allowed to provide medical care to Japanese, and the treatments by the foreign doctors are not covered by healthcare insurance. As it stands today, even if the government increased the quota for foreign physicians, the number of foreign doctors is unlikely to increase if other conditions are unchanged.

Opposition by vested interests made it difficult to ease regulations drastically

Why is the government failing to ease regulations drastically even in special zone? Strong opposition by vested interests, of course. For example, farmers in Japan have typically very small farmland and most of them will be uncompetitive if companies are allowed to enter agricultural businesses. If the entry regulation is eliminated, these farmers will be forced to stop

farming. They oppose deregulations even in special zones because they fear that an exemption in special zone would lead to deregulation outside the special zone. Even when deregulation takes place, it tends to take a prolonged period before it is implemented. For example, Japanese government agreed to reduce the tariff rates on chilled beef in an agreement on FTA with Australia in April 2014. But the tariff rates will be reduced from 38.5% to 23.5% over a period of 15 years.

Lukewarm attitude of the government is also the reason why special zone is not working as advertised. For example, special tax treatment for firms in the special zone of Tokyo have not been applied to any company, primarily because the conditions were set precisely to limit the cases that can be applied. Similarly, the government is willing to increase the number of quota for foreign physicians in the currently proposed special zone, probably with the knowledge that such change will not effectively lead to a meaningfully larger number of foreign physicians practicing in Japan, as in the past case of nominally allowing clinics to be run by a company, but effectively disallowing it by attaching stringent conditions.

Economic impact of “Tokku” by Abe administration will be limited

As seen above, impact of past special zones were quite limited and there is little reason why we should expect the new batches of special zones planned by Abe administration to be any different. Of course, any progresses made through special zone are positive, but when we compare the attention and efforts spent in creating these special zones, the actual results are disappointingly small. We should not expect too much of the special zone introduced by Abe administration.