



## Abenomics: What economic picture will its third arrow draw in the middle-term?

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### [Summary]

*The third arrow of Abenomics, a growth strategy, aims at revitalizing industries, creating markets for selected sectors with the promise of future growth, and expanding global outreach. Prime Minister Abe's growth strategy, formulated in June 2013, gave a timeline for implementing measures to realize these goals; many are expected to be on schedule. This would remedy one of the weaknesses of Japan's business environment – the ease of starting a business.*

*However, not all measures in the growth strategy have a clear direction, nor do they all contribute directly to structural reforms. Creating markets in Japan's health-care and agricultural sectors are examples of this, though the premier has shown a strong will to deregulate these and may have a clearer vision of their impact. Still, challenges remain for the private sector, in a rigid employment system and with high corporate taxes. Attention should be paid to the premier's leadership in these fields, for which he has just started coordination but has yet to decide a clear direction.*

Prime Minister of Japan Abe Shinzo has introduced “three arrows” for economic recovery and growth. The first and second arrows were launched earlier in 2013, these being monetary easing to fight deflation and flexible fiscal injections to support the economy. The third arrow, a growth strategy known as the “Japan Revitalization Strategy,” was considered a disappointment by the business sector, judging by the Nikkei 225's major plunge as the Prime Minister gradually announced details of the Strategy in late May to mid June this year. However, this plunge may not have resulted from a skeptical reception of the growth strategy, but from an undervalued yen. Indeed, the index bounced back 20% over the following month, though this has not led to a positive re-assessment of the third arrow.

Much disappointment has been expressed regarding what the growth strategy did not include, but few discussions over the third arrow take an in-depth look at what it does include. It could be worth bringing focus to the details of Abe's growth strategy, in particular what it aims at, and what sectors it attempts to develop as promising industries. The seriousness of the Abe cabinet in revitalizing Japan's growth potential should be reassessed, paying close attention to the “bureaucratic wording” used to dress up the strategy's policy measures, and to other measures



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suggested by the premier even after the announcement of his growth strategy in June 2013.

## Japan's current business circumstances and the aims of the Strategy

One of main pillars of the premier's growth strategy is to revitalize Japan's private sector by improving the business environment.

How "bad" is it now? According to the World Bank's "[Doing Business 2014](#)" report, Japan ranks twenty-seventh in overall business circumstances (ease of doing business: EoDB) among the 189 countries surveyed. However, it ranks fifth among the G7 countries, falling behind the Asian NIEs (Singapore, Hong Kong and Korea). As seen in Table 1, there are some specific issues (cells colored in grey) that stand in the way of improving Japan's business circumstances. Of these, "starting a business" and "paying taxes" rank below the top 100, while "dealing with construction permits" and "registering property" rank below the top fifty. The countries whose ranking is within the top ten overall maintain a high ranking for all categories (for example, Singapore does not rank below fifty in any category, compared to one for the United States, two for Korea, and three for the UK, none of them having any category that ranks below the top 100). This suggests Japan must tackle the issues mentioned above if it hopes to improve its rank (i.e. to improve Japan's business circumstances).

Table 1: Ease of doing business ranking

Economy	Singapore	USA	Korea	UK	Canada	Germany	Japan	France	Italy	China
Ease of Doing Business Rank	1	4	7	10	19	21	27	38	65	96
Starting a Business	3	20	34	28	2	111	120	41	90	158
Dealing with Construction Permits	3	34	18	27	116	12	91	92	112	185
Getting Electricity	6	13	2	74	145	3	26	42	89	119
Registering Property	28	25	75	68	55	81	66	149	34	48
Getting Credit	3	3	13	1	28	28	28	55	109	73
Protecting Investors	2	6	52	10	4	98	16	80	52	98
Paying Taxes	5	64	25	14	8	89	140	52	138	120
Trading Across Borders	1	22	3	16	45	14	23	36	56	74
Enforcing Contracts	12	11	2	56	58	5	36	7	103	19
Resolving Insolvency	4	17	15	7	9	13	1	46	33	78

(Note) Cells colored in pale and dark grey indicate that the rankings of the category are below 50 and 100, respectively.

(Source) World Bank "Doing Business 2014"

Abe's growth strategy aims to bring Japan into the top three among the G7 (but without a target year), by replacing old businesses, and passing regulatory and industrial reforms, but is short on measures to climb the "paying taxes" category (such as simplifying tax payment procedures and reducing corporate taxes). This explains at least part of the disappointment with Abe's third arrow.



## What will be delivered by Abe's growth strategy?

What kind of structural changes will follow from Abe's growth strategy? Table 2 lists the number of policy measures in each category with a rough schedule of their implementation<sup>[1]</sup>.

The growth strategy consists of three "plans": Industry Revitalization Plan, Strategic Market Creation Plan, and Strategy of Global Outreach. As the Strategy of Global Outreach aims mainly to accelerate the negotiation of economic partnership agreements, it does not necessarily require new policy measures. Instead, it is time to have a detailed look at the first two plans.

### **1: Industry Revitalization Plan**

The Industry Revitalization Plan has six pillars. Its basic principle is to (1) accelerate structural reforms first, and then build economic competitiveness by (2) reforming the employment system and reinforcing human resource capabilities and by (3) strengthening science, technology and innovation<sup>[2]</sup>. To realize this, it suggests that (4) establishing the world's leading IT society, (5) strengthening the international competitiveness of Japanese megacities as business hubs, and (6) revitalizing small and medium-sized enterprises (SMEs) through innovation will be of help.

The policy measures for (1) accelerating structural reforms have a clear direction and schedule of implementation, irrespective of the necessity for legislation. This is because the Plan is formulated to restructure and reorganize the industries intensively in a short period of time. In fact, the government will implement, or at least submit relevant bills on, all the policy measures in this category not later than the beginning of the next fiscal year in April 2014. In addition, for the policy measures in the category of (5) strengthen Japan's international competitiveness as a business hub, the premier takes an initiative to utilize "National Strategic Special Zones" which are created "to serve as gateways for the execution of bold regulatory reforms and other measures as a new approach to realize Japan's growth strategy." So the implementation of policy measures in this category will advance favorably. Indeed, the bill to establish the Zones was submitted to the Diet and is discussed in Diet sessions. Most of the policy measures in the categories of (4) IT society and (6) revitalize SMEs through innovation are financial and other assistance schemes for relevant industries and enterprises. As measures which expand the budgets and powers of ministries could be implemented relatively smoothly, policy measures in this category are likely to advance at a favorable pace.

By contrast, the category of (2) reinforce human resource capability and reform the employment system includes two policy measures determined to "examine," but not to be followed by clear initiatives. These are "reviewing the worker dispatching system" and "reviewing evacuation standards for registered childcare facilities." The necessity of amending current legislation has been discussed for a long time, and the inclusion of these measures suggests Abe's cabinet has finally decided on a general direction for its policy. However, the strategy uses phrases such as "to hold discussions" and "to advance the consideration" (both are translated from one Japanese word, "kentou-suru"). This term in Japanese sometimes means that a government will consider the pros and cons of a policy change, but will take no policy action based on the results. What is more, although many policy measures will be taken in this category, twenty-four measures (of fifty-nine) are about budget requests. These policy directions could prove efficient, if new measures for employment stability and fluidity are implemented after the necessary budgetary treatment in the beginning of the next fiscal year. However, some of them (especially measures aimed at women, the youth and elderly) are really surveys or research to "understand the potential problems" with the current system or with a future reform<sup>[3]</sup>.



Table 2: Number and timing of policy implementation of the "Japan Revitalization Strategy"

	Number of policy measures	Not mentioned about legislation										Legislation				Programme / promotion framework
		Improve or speed-up existing measures	Implement top	Implement in the autumn	Implement in early next year	Implement	Begin of FY2014	Implement if budget is allocated	Implement in later time	Submit in this Diet session	Submit in early next year	Submit in later time	Examine but no clear direction			
	286	83	10	6	11	39	29	42	12	4	4	10	36			
<b>1 Industry Revitalisation Plan</b>	157	28	10	4	8	22	26	19	11	4	4	6	15			
<b>1 Accelerating structural reform programme</b>	32	6	2	3	3	7	0	0	10	0	0	0	1			
1 Stimulating private investment	5	0	0	0	0	2	0	0	3	0	0	0	0			
2 Establishing a system which enables challenges to frontiers being free from anxiety	3	0	0	0	0	0	0	0	3	0	0	0	0			
3 Promoting investment in business ventures and investment to challenge business again fully utilising resources in and outside Japan	10	3	1	1	2	2	0	0	0	0	0	0	1			
4 promoting business restructuring and reorganisation	9	2	1	2	1	1	0	0	2	0	0	0	0			
5 Promoting overseas operations aiming to become global leading companies	5	1	0	0	0	2	0	0	2	0	0	0	0			
<b>2 Reforming the employment system and reinforcing human resource capabilities</b>	59	8	5	0	0	4	24	8	1	3	2	2	2			
1 Policy change from excessive employment stability to labour fluidity (realising labour movement without unemployment)	6	0	0	0	0	2	3	0	0	1	0	0	0			
2 Enhance matching function by utilising the private-sector human resource business	6	0	2	0	0	0	3	1	0	0	0	0	0			
3 Realising various ways of working	7	1	0	0	0	2	2	0	0	0	1	1	0			
4 Promoting active participation by women	10	2	1	0	0	0	4	0	0	0	1	1	1			
5 Promoting active participation by the youth / the elderly	13	1	0	0	0	1	11	0	0	0	0	0	0			
6 University reforms	9	2	2	0	0	0	0	2	0	2	0	0	1			
7 Strengthening human resources capabilities for global operation activities	7	2	0	0	0	1	1	3	0	0	0	0	0			
8 Utilising highly skilled overseas personnels	1	0	0	0	0	0	0	0	1	0	0	0	0			
<b>3 Promoting science, technology and innovation</b>	12	2	1	0	0	0	2	2	0	0	1	0	4			
1-6 Reinforcing headquarter function of science and technology policy, Launching programmes for innovation, etc.	6	0	0	0	0	0	2	0	0	0	0	0	4			
7 Strengthening intellectual property strategies / standardisation strategies	6	2	1	0	0	0	0	2	0	0	1	0	0			
<b>4 Becoming the world's leading IT society</b>	15	0	0	1	2	1	0	6	0	0	0	2	3			
1 Reforming regulation / systems suitable for the age that the existence of IT is "natural"	1	0	0	0	0	0	0	0	0	0	0	0	1			
2 Promoting private sector access to public data and developing innovative electronic administrative services	5	0	0	1	1	1	0	1	0	0	0	1	0			
3 Realising safe / convenient environment through IT utilisation	1	0	0	0	0	0	0	0	0	0	0	0	1			
4 Developing the world's top-level communication infrastructure	4	0	0	0	0	0	0	3	0	0	0	1	0			
5 Promoting cyber security measures	1	0	0	0	0	0	0	0	0	0	0	0	1			
6 Cultivating / securing highly-skilled IT human resources that will be the source of industrial competitiveness	3	0	0	0	1	0	0	2	0	0	0	0	0			
<b>5 Further Strengthening Japan's international competitiveness as a business hub</b>	24	8	0	0	3	4	0	2	0	0	0	2	5			
1 Realising "National Strategic Special Zones"	1	0	0	0	0	0	0	0	0	0	0	0	1			
2 Opening up operation right of public facilities, etc., to the private sector (expand utilisation of PPP/PFI)	2	0	0	0	1	1	0	0	0	0	0	0	0			
3 Improving infrastructure such as airports, ports and harbours	5	4	0	0	0	0	0	0	0	0	0	1	0			
4 Improving the competitiveness of cities	13	4	0	0	2	3	0	2	0	0	0	0	2			
5 Vitalising financial / capital markets	1	0	0	0	0	0	0	0	0	0	0	0	1			
6 Management of public and quasi-public capital	1	0	0	0	0	0	0	0	0	0	0	1	0			
7 Overcoming constraints of environment / energy	1	0	0	0	0	0	0	0	0	0	0	0	1			
<b>6 Innovation of SMEs</b>	15	4	2	0	0	6	0	1	0	1	1	0	0			
1 Using, mobilising and commercialising regional resources as brands	8	1	2	0	0	3	0	0	0	1	1	0	0			
2 Accelerating the restructuring of SMEs	1	1	0	0	0	0	0	0	0	0	0	0	0			
3 Supporting SMEs which will enter the strategic market	4	0	0	0	0	3	0	1	0	0	0	0	0			
4 Supporting SMEs which expand internationally	2	2	0	0	0	0	0	0	0	0	0	0	0			
<b>2 Strategic Market Creation Plan</b>	110	44	0	2	3	16	3	23	1	0	0	3	15			
<b>1 Extending the nation's "healthy life expectancy"</b>	42	24	0	2	0	5	2	4	1	0	0	1	3			
1 Enhancing effective preventive care services and health management	13	3	0	1	0	3	2	2	0	0	0	1	1			
2 Activating medicine-related industries	19	15	0	1	0	1	0	0	1	0	0	0	1			
3 Improving access to better medical care and nursing care	10	6	0	0	0	1	0	2	0	0	0	0	1			
<b>2 Realising clean and economical energy demand and supply</b>	21	2	0	0	0	0	0	16	0	0	0	0	3			
1 Realising clean and economic energy supply	7	0	0	0	0	0	0	7	0	0	0	0	0			
2 Realising efficient distribution of energy through competition	3	0	0	0	0	0	0	0	0	0	0	0	3			
3 Promoting wise consumption of energy	11	2	0	0	0	0	0	9	0	0	0	0	0			
<b>3 Building safe, convenient and economical next-generation infrastructure</b>	9	2	0	0	1	4	0	0	0	0	0	0	2			
1 Providing safe and resilient infrastructures at low cost	5	2	0	0	0	2	0	0	0	0	0	0	1			
2 Providing safe and comfortable transportation for people and goods	4	0	0	0	1	2	0	0	0	0	0	0	1			
<b>4 Building regional communities that use their unique local resources to appeal the world</b>	38	16	0	0	2	7	1	3	0	0	0	2	7			
1 Realising world's best quality agricultural products	18	4	0	0	2	6	0	2	0	0	0	1	3			
2 Utilising the potential of tourism resources to invite many world's tourists to regional communities	20	12	0	0	0	1	1	1	0	0	0	1	4			
<b>3 Strategy of global outreach</b>	19	11	0	0	0	1	0	0	0	0	0	1	6			
<b>1 Building strategic trading relations and promoting economic partnership</b>	4	0	0	0	0	0	0	0	0	0	0	1	3			
<b>2 Strategic initiatives for obtaining overseas markets</b>	14	10	0	0	0	1	0	0	0	0	0	0	3			
1 Exporting infrastructure and securing natural resources	1	0	0	0	0	0	0	0	0	0	0	0	1			
2 Intensive support to potential SMEs	8	7	0	0	0	0	0	0	0	0	0	0	1			
3 Promoting Cool Japan	5	3	0	0	0	1	0	0	0	0	0	0	1			
<b>3 Improving infrastructure concerning funds and human resources to support the economic growth (attracting foreign companies)</b>	1	1	0	0	0	0	0	0	0	0	0	0	0			

(Source) By the author. Each policy measure and its schedule is sourced from "Japan Revitalization Strategy" and "Japan Revitalization Strategy: Short- to Mid-term Progress Schedule."

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## **2: Strategic Market Creation Plan**

The ‘Strategic Market Creation Plan’ singles out industrial sectors that could potentially obtain a significant market share in the world but would have difficulties in market formation without the government’s initial support. Health-care, energy, infrastructure, agriculture and tourism are the chosen industries to be supported under this Plan, and the government will take necessary actions to meet its target in 2020 or 2030. The government’s seriousness for reforms should not be judged from the fact that few policy measures will be implemented in the immediate future, as most of them will require a long-term effort until the effects have taken place, or they are fully implemented. Table 2 shows that no new policy actions will appear by the beginning of the next fiscal year. However, some programs for energy sector reform have already been decided, with a list of regulatory reforms to take place in the longer term (and important amendments of relevant legislation approved by the Diet in autumn 2013). Policy measures for infrastructure development are also expected to advance, although slowly, as these meet the needs of both the government and the private sector.

On the other hand, policies for market creation in health-care, agriculture and tourism may have problems advancing. More than half of the policy measures listed in the categories of health-care and tourism are about improvement or acceleration of existing policies and, as for the discussion in (1) above, several policy measures state the government’s intention to examine the problems of current systems, despite having argued the necessity of amending these policies for a long period of time. These include “consideration of a better system for the supportive contribution to medical insurance for the elderly aged seventy-five and over,” and “consideration of implementing a system which allows foreigners who meet certain conditions to stay for an extended period.” For health-care industries to develop, it is important to introduce “more advanced medical care.” The Plan has many policy measures to conduct empirical research and promote home-based R&D for advanced medical care, but lacks the promotional policies for expanding access by the national public and medical workers (especially for general practitioners) to develop the necessary skills to fully utilize it.

For agriculture, the Plan includes various new policy measures for facilitating innovation in the sector and for promoting export of agricultural products. A scheme aiming at improving productivity such as “further liberalization of corporate entry into agriculture” is stated with, again, the bureaucratic wording of “will examine it” (although it is included in the Plan). For a problem which obstructs consolidation of farmland, widely regarded as one of the limitations to facilitate productivity in the agricultural sector, Abe’s growth strategy gives no promotional policies but maintains the current policy.

### **Further measures for strengthening growth potential: Regulatory reform**

Among the policy measures listed in Abe’s growth strategy, those expanding the budget and power of the line ministries will advance most quickly. However, some important deregulation requests from the private sector were not included in the growth strategy at all.

Requests for reforms from the private sector derive from the perception of a “six-fold burden” arising from the Great East Japan Earthquake in March 2011. The six problems considered to have led the Japanese economy to the difficult situation are as follows: appreciation of the yen, energy shortages, high corporate taxes, strict employment regulations, green-house gas regulations, and a delay in negotiations for free-trade agreements. So far, the first arrow of Abenomics, monetary easing to exit deflation, has had the side-effect of depreciating the yen. Prime Minister Abe has already decided on his reform package for the energy sector (as explained above) and announced the new commitment to reduce Japan’s greenhouse gas emissions by 3.8%, down from the previous government’s commitment of a 25% reduction. Also, the government has started negotiations on an economic partnership agreement with the EU and fifteen countries in East Asia, as well as the TPP (Trans-Pacific Partnership agreement).



Still, two problems – high corporate taxes and strict employment regulations – remain unsolved. In addition, Japan’s problems of starting business and paying taxes, highlighted in the EoDB ranking, cannot be fully solved without structural reforms. A survey of business managers conducted by the Nikkei newspaper after the announcement of the Abe cabinet’s growth strategy in June 2013 shows that although 88% of respondents assess the growth strategy positively, 95.4% request reductions in corporate tax rates. Other requests related to deregulation (not all of them necessarily related to the starting-up of business) include promotion of corporate enterprises’ entry into agriculture and health care, and expansion of immigration.

The premier’s responses to the requests from the business sector should be checked. As the government and leading parties will decide the treatment of corporate tax reductions by the end of 2013, the focus here is on regulatory reforms, in particular on corporate entry into agriculture and health care and on strictness of employment.

The Prime Minister instructed the Council of Regulatory Reform to prioritize discussions on easing restrictions on consolidating farmlands and lifting the ban on mixed medical treatment<sup>[4]</sup>, in addition to a review of the worker dispatching system. The Ministry of Agriculture, Forestry and Fisheries suggested some relevant deregulation measures soon after this instruction, and recently decided to gradually abandon the policy of reducing rice acreage under cultivation in favor of large-scale farmers. The Council’s discussions on easing the ban on mixed medical treatment and on the worker dispatching system are still underway. However, as the Labour Policy Council will finish “examining” the pros and cons of the reform with a view to having it concluded by the end of 2013, the Council of Regulatory Reform is trying to complete its recommendations for necessary amendment of the laws.

### **The attitude not only of politicians and the administration but also the business sector and national public is important for reforms to succeed**

Regulatory reform is the key for regaining the growth potential of Japan’s economy, and the menu for important deregulation is widely recognized at least among policymakers and experts. However, regulatory reforms were not always successful in the past. Such experiences have engendered skepticism about embarking on new reforms.

What, then, would be the obstacles for regulatory reform? [Saito \(2013\)](#) reviews past minutes of Diet proceedings, meetings of governmental organizations for regulatory reforms and the Council for Economic and Fiscal Policy, and so on, and summarizes the causes for a reluctance to carry out regulatory reform. He identifies eight possible causes in the realms of politics, administration, business, and the national public as consumers. He also focuses on two successful examples of regulatory reform (liberalization of the aviation sector and easing of the ban on selling medicine by non-medical retailers) and analyzes conditions leading to successful reform. Table 3 summarizes these points. It might be suggested that ministries’ awareness of the necessity of changing regulation leads to successful deregulation, if there is either the prime minister’s leadership or a request from the relevant business sector for deregulation, coupled with public attention to the need for reform.

The current circumstances for regulatory reform are clearly different from those at the time of the DPJ (Democratic Party of Japan) cabinets. It cannot be assessed yet whether there is any difference in individual business sectors’ behavior with regard to regulatory reform between the current and previous governments, but the national public’s awareness of the need for regulatory reform has become more significant, owing to Abe’s branding his reform as “the third arrow.” The leadership shown by the premier on regulatory reform is more convincing, judging from his public appearances and speeches, Abe stating time and time again that regulatory reform is the top priority for him when advancing his growth strategy. Although bureaucrats’ distrust of the private sector may not have changed, the Industry Revitalization Plan works around this by supporting the

private sector's voluntary actions toward innovation.

**Table 3: Causes affecting the success/failure of regulatory reform**

Causes	Successful examples		Abe cabinets, compared with DPJ cabinets
	Aviation	Medicine	
<b>Politics</b>			
Lack of leadership of Prime Minister (incl. lack of power of regulatory reform organization)		PM's leadership, organization's efforts	PM now puts first priority on reform
Too much regard to the groups supporting the leading party			
<b>Administration</b>			
Distrust to private sectors (wise consumption, dealing with difficulties by themselves, etc.)			Growth strategy will support private sectors
Lack of incentives of amending the regulations (in regulators)	Existence of officers serious for the reform	Existence of officers serious for the reform	
<b>Business sectors concerned</b>			
Activities to maintain vested interest			
Mentality of avoiding competition or reform	Existence of companies thinking about new entry		
<b>National Public / Consumers</b>			
Low concern for regulation and regulatory reform	Expansion of demand for aviation		More interest with the word "third arrow"
Lack of awareness of self-responsibility as consumers			

(Source) By the author, partly based on the information from Saito (2013).

## Conclusion

To realize the stronger growth potential of the Japanese economy, a good strategy and surefooted implementation are essential. Revitalizing Japan's industries will start with shifting resources from old industries to new ones and fostering home-based innovation, but more labor market reforms might be inescapable. Regarding market creation in his five prioritized sectors, Abe's growth strategy may have left some areas untouched, especially in health care and agriculture, but recently the premier has begun to take the initiative for deregulation in these sectors too. The role of the government in market creation is smaller than it was under the previous growth strategy formulated by the DPJ governments. Once officers in regulatory ministries who are eager for reforms have room to express their thinking more freely inside and outside their ministries, structural changes will occur more smoothly and these will strengthen Japan's potential for growth.



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*This article is an updated version of “[The Third Arrow of Abenomics: What Economic Picture Will It Draw in the Middle-Term?](#)” published by Bruegel on 29 September, 2013. [2013]*

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### **Notes**

- [1] Note that the counting is rather rough, because the author counted the number of policy measures irrespective of their type (e.g. the acceleration of a current policy measure and newly introducing a comprehensive policy program are equally counted as one).
- [2] In Japan, the government’s basic principle on fostering scientific and technological innovation is that the government should not take the initiative for innovation but support the private sector in increasing innovation through a proper allocation of budget. Therefore, the growth strategy does not include any particular policy measures for raising country-level innovation.
- [3] [Hoshi and Kashyap \(2012:9\)](#) also point out that, taking past regulatory reforms, many recommendations made by organizations for regulatory reforms are counted as deregulation when this is not really the case. They take an organization’s recommendation to conduct a survey or research to understand the current problems with existing regulations as an example, and conclude that these studies often occur but do not reduce the regulation at all.
- [4] The ban on a mixed medical treatment means that, if a person takes two or more medical treatments and one or more treatment is not covered by public health insurance, the person cannot use the public health insurance at all, even for the part of the treatment otherwise covered by it. Easing the ban will reduce the medical cost for the national public (because Japan has a universal-coverage health insurance scheme), but medical workers (general practitioners who have little knowledge in advanced medical care in particular) are hesitant about it for fear that, according to the Japanese Medical Association, they would lose their patients to other medical workers with knowledge in advanced medical treatment.

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