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# MAPPING THE POLITICAL ECONOMY OF THE JAPANESE FINANCIAL ECOSYSTEM

AUGUST 2021



1. Introduction to E3G's political economy mapping of the global financial ecosystem
2. Mapping the Japanese financial ecosystem
  - Overview of key financial indicators
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  - Opportunities and barriers to a green recovery
  - Assessing the greenness of economic response to Covid-19
  - Integration of climate-related risks into the financial system
  - National positions in multilateral institutions

# 1. INTRODUCTION: MAPPING THE POLITICAL ECONOMY OF THE GLOBAL FINANCIAL ECOSYSTEM

- > **Aim** - E3G’s political economy mapping of the global financial ecosystem takes stock of opportunities and challenges for systemic economic and financial reform for climate safety across 14 key countries and institutions (“venues”). It aims to better understand countries and institutions’ positions on key aspects of fiscal and monetary policy, and financial regulation, analyse the interactions between these venues, show the main champions and blockers of a progressive sustainable finance agenda, and assess opportunities for green reforms over the next 12-24 months.
- > **Method** – E3G is working with a number of in-country partners to develop this research. We have used a mixed-research methodology for each venue – a mixture of desktop research and semi-structured interviews with key stakeholders (policymakers, academics, civil society) following a series of defined research questions. E3G compiles the findings into a presentation for each venue, tests the results internally with other E3G colleagues and then presents the results as appropriate to external stakeholders.
- > **Usage** – This research will be used as an internal and external resource to inform civil society and financing strategies for specific countries.

## 2. JAPAN: OVERVIEW OF KEY FINANCIAL INDICATORS



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GDP (Current USD, 2020)	5.31 trillion
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GDP growth (2021, projected)	2.8%
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GDP rank	3
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Value add of finance sector to GDP	4%
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Share of public & private debt in GDP (2019)	Public: 234.9%
	Private : 206.6%

Human Development Index (HDI) Rank (2019)	18 / 189
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GHG Emissions: (Mt, COT, 2019)	1,212 (12.3% decrease compared to 2005)
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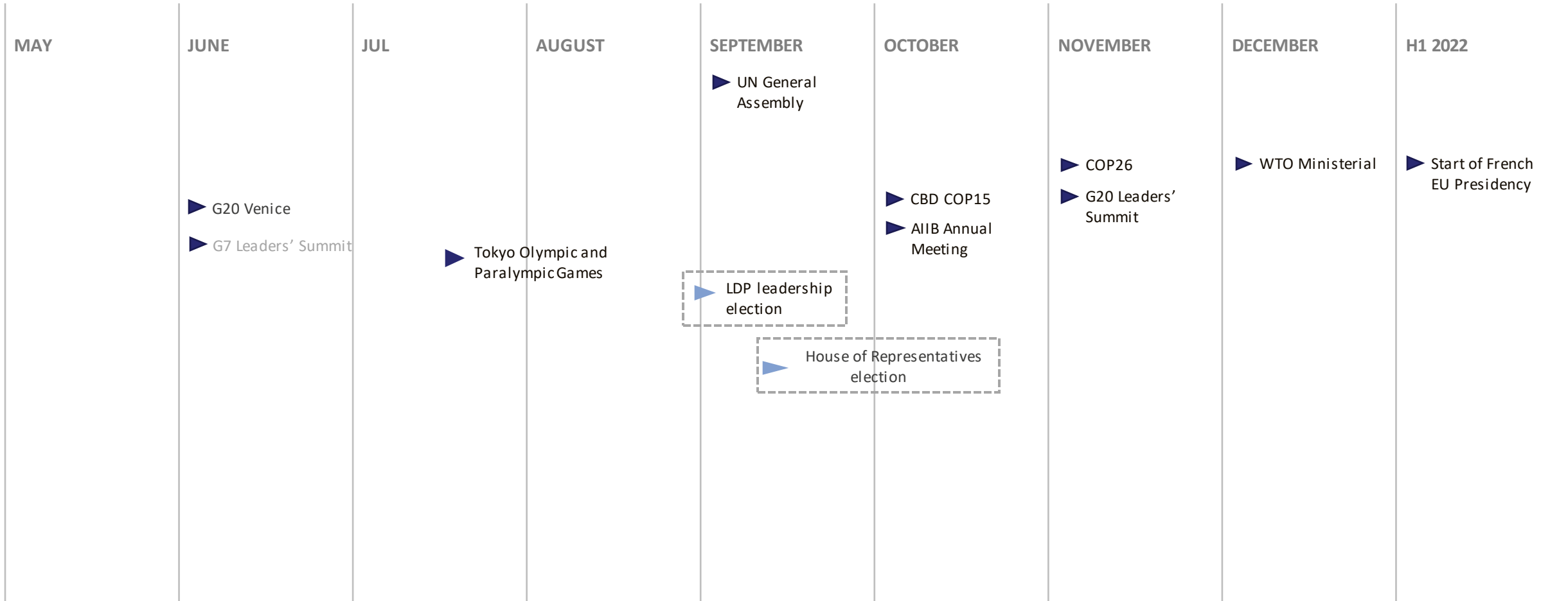
Country rating: (2021)	A (Fitch)
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# JAPAN— POLICY AND DIPLOMATIC CALENDAR 2021



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▶ Domestic    ▶ International    □ Timing to be confirmed



# JAPAN: OPPORTUNITIES AND BARRIERS TO A GREEN RECOVERY



- > The announcement by new Prime Minister, Yoshihide Suga, early on in his premiership, committing Japan to achieve net zero emissions by 2050 came as a surprise to many, particularly in industry.
  - Suga is a pragmatic politician, more interested in enacting change than ideologies. He is keen to operate independently of interest groups, significantly also distancing himself from Ministry of Economy, Trade and Industry (METI), traditionally a driver of “industry friendly” policy. Under Suga (and his predecessor, Shinzo Abe), decision-making has become increasingly centralised in the Prime Minister’s office and the Cabinet Secretariat with top-down decisions such as the net zero commitment setting direction for the whole government.
  - This is a new dynamic in the Japanese government where decisions have traditionally been made by consensus (including with industry) and behind closed doors. Stakeholders commented that the announcement served to shift the policy landscape in Japan with the net zero agenda now being taken much more seriously across government.
  - Suga’s choice of making net zero central to his overarching policy direction was also politically savvy -it is difficult for anyone to directly oppose, it serves to increase Japan’s international standing, and is also in line with the influential (particularly in Japan) Biden administration.
  - Although it initially came as a surprise, officials in METI are now working on sectoral roadmaps on how the goal will be reached. Updated Green Growth Action Plans were also issued in June.
- > However, METI has direct responsibility for oversight of and policy towards many sectors vital to decarbonisation and achieving the net zero goal: natural resources, energy, steel, automotive industry etc. Although METI still tends to view emission reduction as very costly it is nevertheless taking action and wants to be viewed positively for the actions it is taking. It remains close to industry, however, much of which is resistant to rapid change
- > Large-scale scaling up of renewable energy is challenging due to Japan’s geographical constraints: Japan is not grid connected to the Asian mainland; inland areas are mountainous and project development is costly; offshore wind is being developed but has long lead times; and like many countries grid investment is required to enable more renewables deployment.



# JAPAN: ASSESSING THE GREENNESS OF ECONOMIC STIMULUS / RESPONSE TO COVID-19



- > In December, Prime Minister Suga unveiled an economic stimulus package of 73.6 trillion yen, the first to be approved since he took office in September. This package follows two previous stimulus packages which were worth a combined 60 trillion yen. The latest continued crisis and stimulus measures but also focused on Prime Minister Suga's two new policy priorities: digitisation and decarbonisation.
- > While not explicitly framed as a response to the Covid-19 pandemic, Suga's October commitment to net zero emissions by 2050 led to the release of the overarching "Green Growth Strategy for Net-Zero Emissions in 2050" (GGS) by METI in December 2020.
  - The strategy sets the overall context for Japan's policy and is significant as it is a shift away from the previous government's thinking that emission reduction efforts would have a negative impact on economic growth.
  - Traditionally Japan has been cautious in setting targets, preferring incremental "achievable" goals to "aspirational" ones where it is not yet clear how it will be met. METI's preference is for incrementalism, grounded in discussions with industry, whereas Suga is now shifting to policy design increasingly driven by backcasting, creating roadmaps to achieve targets after a goal has been set.
  - The strategy includes an action plan with detailed targets in 14 sectors identified as having high growth potential while also contributing to achieving decarbonisation
- > A 2 trillion-yen fund, the Green Innovation Fund (GIF), was established to encourage companies to develop innovative green technologies, and ultimately help Japan achieve carbon neutrality by 2050. The fund was established under Japan's New Energy and Industrial Technology Development Organization (NEDO), a national funding agency for research and development, overseen by METI. It provides grants to private companies to encourage them to invest in R&D and develop new green technology. The fund was set up to support technology innovation in the 14 priority sectors set out in the Green Growth Strategy.

# JAPAN: INTEGRATION OF CLIMATE-RELATED RISKS INTO THE FINANCIAL SYSTEM



- Although not named as one of its 14 “growth sectors”, the Green Growth Strategy acknowledges the important role finance has to play in supporting the transition. METI aims to attract private investment to help achieve the 2050 goal and outlined three specific measures in the strategy: transition finance, green finance and innovation finance. “Transition finance” is seen as a priority area and one Japan is keen to lead on internationally.
- Overarching policy direction for green finance is set in a top-down manner by the Prime Minister aided by the Cabinet Secretariat.
- Green finance policies are then co-led by METI, together with Japan’s financial regulator, the Financial Services Agency (FSA) and the Ministry of Environment (MOE). Their approach is to nudge businesses forward on green finance rather than forcing them, and to work in cooperation with industry through dialogue. Since Suga’s net zero announcement, green finance has become a very live issue with many recent developments and much relevant debate.
- Japan does not currently see the necessity to introduce mandatory rules on disclosure as it prefers to maintain a “voluntary disclosure” approach and industry and government are working closely together on this. However, some stakeholders think mandatory requirements might come in in future and as some requirements are set on a “comply or explain” basis, they are “in practice” mandatory. On the EU taxonomy, Japan wishes to be involved in the discussions but is concerned the framework may not be suitable for Japan and many other countries and may put Japanese industry at a disadvantage. Japan is keen on the TCFD framework because it is “principles based” and voluntary rather than “rules based”.
- The Ministry of Finance (MOF) is one of the most powerful of Japan’s ministries, overseeing the national budget, taxation system and public finance and scrutinising the budgets and policies of all government bodies. It is not a key driver of green finance policy, however, because it does not directly administer the financial system. Its role on achieving net zero is more one of monitoring developments and influencing other ministries through the government budget process.
- Although the Bank of Japan has recently begun exploring climate change and related financial risks, it still lags somewhat behind other central banks as the FSA leads on financial regulation rather than the BOJ.
- However, in July BOJ announced that it will introduce funds specifically targeted at efforts to combat climate change.
- BOJ Governor Haruhiko Kuroda stated the bank is moving into more “unorthodox” approaches to climate on the grounds that major climate disruptions to the macroeconomy and supply chains fall within its mandate to ensure the stability of financial system.





# HOW JAPAN POSITIONS ITSELF IN MULTILATERAL INSTITUTIONS

- > International Monetary Fund (IMF) / World Bank (WB) – Development Committee
  - In April, Japanese Minister of Finance, Taro Aso stated at the Development Committee "Japan expects the World Bank Group to support the steady transition of developing countries, which cannot leapfrog to achieve decarbonisation." He also emphasised mobilising private finance.
  - Overall Japan supported the IMF and WB vision for a green financial recovery post Covid-19 and promised to provide financial contributions to support initiatives including the Comprehensive Japan Trust Fund's efforts on climate change financial closure (US\$ 5 million) and the Global Infrastructure Facility co-chaired by Japan (US\$10 million).
- > IMF –The International Monetary and Financial Committee
  - Japan has called for better transparency and accountability during the allocation of new Special Drawing Rights (SDRs). It also set debt transparency as a priority issue following the extension of the Debt Service Suspension Initiative (DSSI).
  - Japan expressed its support for the New Arrangements to Borrow (NAB) and for the new round of bilateral borrowing agreements (BBAs) to be activated when the IMF responds to tail risks, as requiring member countries to set aside reserves is considered inefficient.
- > Asian Development Bank
  - Japan is one of the ADB's largest shareholders and its president is traditionally Japanese.
  - Japan is supportive of policies to encourage a green recovery from the pandemic. It is particularly keen to promote private investment. Japan emphasizes the need for a "just transition" to lower emissions –a holistic approach considering all the SDGs means high energy costs should not be simply imposed on populations suffering from poverty.
  - Gas is regarded as a "transitional fossil fuel" by the ADB but there is awareness that the time window for its appropriateness needs to be monitored closely.
  - At the May 2021 Annual General Meeting, Japanese Minister of Finance, Taro Aso, emphasized: "We should provide support to intermediary areas in between "green" and "non-green" rather than follow a binary classification, and transition finance should be promoted to advance this inclusive approach. Japan expects these points to be reflected in the new ADB energy policy."

# RECOMMENDATIONS FOR ACTION

## 1. End public fossil fuel financing

- Commit to no new public finance to overseas coal projects, regardless of technology used
- Engage with partner countries to support renewable energy transition
- Commit to phase-out of domestic coal power plants

## 2. Continue to lead on transition planning and financing

- Build on METI's sectoral decarbonisation strategies by bringing together a coalition of government, financial institutions and private companies to exchange information and to promote transition finance

## 3. Enhance subnational engagement on climate issues

- Support prefectures and cities to transform their Net Zero City commitments to concrete energy actions
- Leverage Kyoto's Powering Past Coal Alliance (PPCA) membership – recruit new members
- Support Tokyo's new energy goals (50% RE by 2030)

## 4. Greening monetary policy and macroprudential regulation

- The Bank of Japan should implement NGFS recommendations on greening central banks' portfolios
- The BoJ should work with the FSA to develop climate stress tests for the economy and financial system
- The BoJ and FSA should integrate climate risks into macro and microprudential frameworks, look at greening collateral frameworks and consider credit steering options



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This presentation was based on a report written by GR Japan as part of E3G's global ecosystem mapping initiative: GR Japan (2021), *Political Economy Mapping: Green Finance in Japan*.

GR Japan is the largest and leading government relations and public affairs consultancy in Japan, with particular experience in the energy and environmental field and a record of successful work on behalf of some of the world's leading renewable energy companies and major environmental organisations. It is the largest part of the GR Group, with 50 government relations specialists in Japan and extensive national and local government networks. The team includes former officials from key ministries, former Diet members, former local government assembly members, industry specialists, former diplomats and trade advisors. GR Japan enjoys excellent working relationships with all of the major energy, environment and industry-related entities in central government and with politicians from across the political spectrum.

E3G is an independent climate change think tank accelerating the transition to a climate-safe world. E3G builds cross-sectoral coalitions to achieve carefully defined outcomes, chosen for their capacity to leverage change. E3G works closely with like-minded partners in government, politics, business, civil society, science, the media, public interest foundations and elsewhere.



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# ANNEX

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For all other citations, please contact E3G.