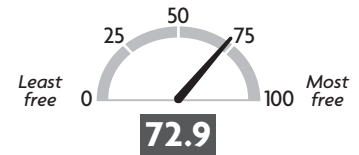


JAPAN

Economic Freedom Score



World Rank: **19**

Regional Rank: **5**

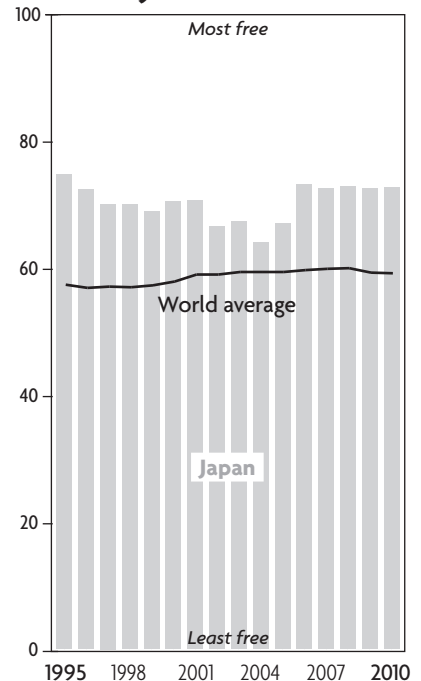
Japan's economic freedom score is 72.9, making its economy the 19th freest in the 2010 *Index*. Its score is almost the same as last year. Japan is ranked 5th out of 41 countries in the Asia-Pacific region.

The export-oriented Japanese economy has long benefited from global trade, although non-tariff barriers linger, hurting overall trade freedom. The economy scores above the world average in many of the 10 economic freedoms, including business freedom, property rights, freedom from corruption, and labor freedom. The regulatory environment is efficient and facilitates overall entrepreneurial activity. Property rights are generally well respected, and corruption is perceived as minimal.

Japan still faces a number of challenges in trying to revitalize its stagnant economy. Together with deflationary pressure, which increased during the course of 2009, a large and growing public debt (around 180 percent of GDP) has crowded out private-sector economic activity. Disparities in productivity between different segments of the economy have continued to widen. The financial sector is modern and well developed, but it remains subject to government influence and a host of restrictions. Taxation is fairly burdensome, and Japan's corporate tax rate is becoming increasingly uncompetitive.

BACKGROUND: Japan is the world's second-largest economy, but its "lost decade" of the 1990s has extended well into a second decade. The economy is smaller than it was in the first quarter of 1992. Japan's brief period of economic expansion earlier this decade under Prime Minister Junichiro Koizumi was driven primarily by reliance on exports. Market reform is now urgently needed to create domestic sources of growth. The Democratic Party of Japan won a historic victory in August 2009, capturing both houses of parliament and elevating Yukio Hatoyama to the prime ministership.

Country's Score Over Time



Quick Facts

Population: 127.7 million

GDP (PPP): \$4.4 trillion

-0.7% growth in 2008

1.4% 5-year compound annual growth

\$34,099 per capita

Unemployment: 4.0%

Inflation (CPI): 1.4%

FDI Inflow: \$24.4 billion

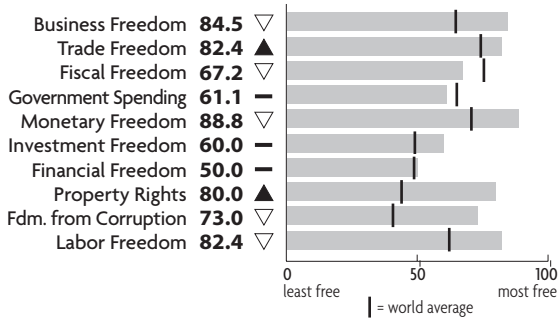
2008 data unless otherwise noted

Data compiled as of September 2009

How Do We Measure Economic Freedom?

See page 457 for an explanation of the methodology or visit the *Index* Web site at heritage.org/index.

JAPAN'S TEN ECONOMIC FREEDOMS



BUSINESS FREEDOM — 84.5

The overall freedom to start, operate, and close a business is strongly protected under Japan's regulatory environment. Starting a business takes 23 days, compared to the world average of 35 days. Obtaining a business license takes less than the world average of 18 procedures and 218 days. Bankruptcy proceedings are easy and straightforward.

TRADE FREEDOM — 82.4

Japan's weighted average tariff rate was 1.3 percent in 2008. Import and export bans and restrictions, import quotas and licensing, services market access barriers, non-transparent and burdensome regulations and standards, restrictive sanitary and phytosanitary rules, restrictions in government procurement, state trade in some goods, subsidies, and inefficient customs administration add to the cost of trade. Fifteen points were deducted from Japan's trade freedom score to account for non-tariff barriers.

FISCAL FREEDOM — 67.2

Japan has a high income tax rate and a moderate corporate tax rate. The top income tax rate is 40 percent, which rises to almost 50 percent when local taxes are included. The standard corporate tax rate is 30 percent, which local taxes can raise to around 41 percent. Other taxes include a value-added tax (VAT), a tax on interest, and an estate tax. In the most recent year, overall tax revenue as a percentage of GDP was 27.9 percent.

GOVERNMENT SPENDING — 61.1

Total government expenditures, including consumption and transfer payments, are relatively high. In the most recent year, government spending equaled 36 percent of GDP. Efforts to reinvigorate the economy and the rising cost of social welfare for an aging population have put government spending on an upward trend.

MONETARY FREEDOM — 88.8

Inflation is minimal and falling, averaging 1.0 percent between 2006 and 2008. Japan is struggling with its second round of deflation this decade, with the corporate goods price index falling at a record pace while the jobless rate rose to near an all-time high. Other product prices are also expected to drop as retailers slash prices to encourage

recession-wary consumers to spend. Formal price controls apply to rice, but major producers, backed by regulators, are able to dictate retail and wholesale prices. Five points were deducted from Japan's monetary freedom score to account for policies that distort domestic prices.

INVESTMENT FREEDOM — 60

Foreign investment is officially welcomed, and inward direct investment is subject to few restrictions. However, foreign acquisition of Japanese firms is inhibited by insufficient financial disclosure and cross-holding of shares among companies in the same business grouping (*keiretsu*). Further deterrents include public resistance to foreign acquisitions, overregulation, and a slow court system. Government approval is needed for investments in agriculture, forestry, petroleum, electricity, gas, water, aerospace, telecommunications, and leather manufacturing. There are few controls on the holding of foreign exchange accounts or on current transfers, repatriation of profits, or real estate transactions by residents or non-residents.

FINANCIAL FREEDOM — 50

Japan's modern financial system remains subject to government influence. Overall transparency is still weak despite gradual improvement. Deregulation and competition have led to consolidation in an effort to create banks large enough to be major players abroad. The government supports bank mergers and continues to update laws and regulations to facilitate them. The government-owned postal savings system is Japan's biggest financial institution by assets. In late 2007, under a 10-year privatization plan, the Japanese post office was divided into four commercial entities: a bank, an insurance company, a mail-delivery service, and a branch-management entity. Capital markets are relatively well developed. The impact of the global financial turmoil on the Japanese banking sector has been relatively modest because of its limited exposure to troubled assets.

PROPERTY RIGHTS — 80

Real and intellectual property rights are generally secure, but obtaining and protecting patents and trademarks can be time-consuming and costly. The courts do not discriminate against foreign investors, but they are not well suited to litigation of business disputes. Contracts are highly respected.

FREEDOM FROM CORRUPTION — 73

Corruption is perceived as minimal. Japan ranks 18th out of 179 countries in Transparency International's Corruption Perceptions Index for 2008.

LABOR FREEDOM — 82.4

Japan's labor regulations are relatively flexible. The non-salary cost of employing a worker is moderate, and dismissing an employee is not difficult. Regulations on work hours are rigid.