

POLICY DISCUSSION PAPER

INVESTING FOR THE ECONOMIC TRANSITION: JAPAN

September 2024

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To inform this briefing, the following investor group has been consulted: PRI Regional Policy Reference Group for Japan. This consultation is not an endorsement or acknowledgement of the views expressed in this briefing.

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ABOUT THE PRI

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. PRI's goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into their investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate, and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are voluntary and aspirational investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system. More information can be found at www.unpri.org.

ABOUT THIS DISCUSSION PAPER

This discussion paper addresses key questions for responsible investors in Japan. First, what are the most effective economic and financial policy reforms with which to implement the transition of the Japanese economy towards the sustainability goals set by the Japanese government, including the national goal of net zero GHG emissions by 2050? Second, how can these reforms be developed in the best interests of Japan's society, economy and with the effective support of responsible investors?

This paper is intended for Japanese policymakers and investors engaged in supporting the transition process in Japan, and should be used as an input to ongoing discussions on effective policy approaches to the economic transition. The paper explores how Japanese policymakers can further the progress already made in establishing a whole-of-government approach to the economic transition. It builds on discussions with PRI signatories, Japanese policymakers and previous policy research, including a [white paper](#) that sets out how governments can take a coherent, 'whole-of-government' approach to the economic transition.

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WHY A WHOLE-OF-GOVERNMENT APPROACH TO THE ECONOMIC TRANSITION MATTERS

Achieving sustainability goals, including net zero by 2050, will lead to a substantial transformation of the Japanese economy. For this process to be both sustainable and profitable for people and businesses, a proactive, coherent, whole-of-government strategy, involving all relevant sectors and market players rather than just hard-to-abate industries, is the most effective policy approach to the economic transition.

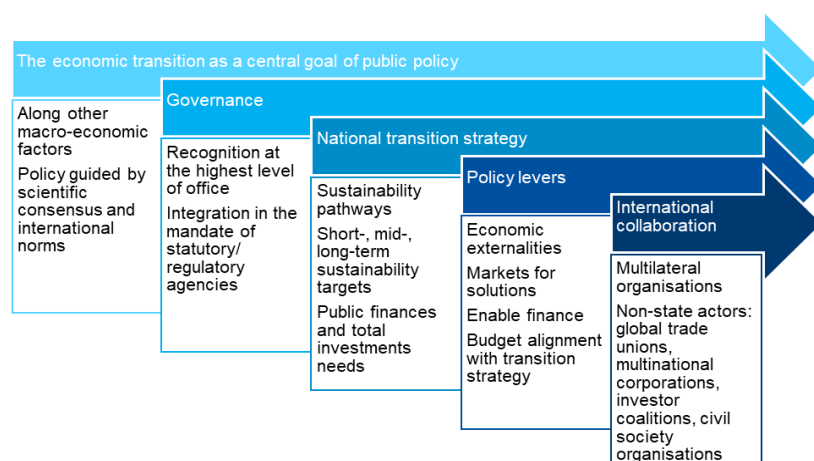
A CONCEPTUAL FRAMEWORK FOR A WHOLE-OF-GOVERNMENT APPROACH

In a changing world, with governments seeking to address system-level sustainability risks such as climate change,¹ the challenge for public policy is to be effective in addressing both sustainability challenges and traditional economic and financial policy goals such as growth, jobs, security and financial stability.

Many governments around the world have started introducing policies and regulations to address climate change, biodiversity loss, macroeconomic instability, costs of living crises, etc. However, these reforms are often pursued in isolation from each other, and with insufficient connection with business-as-usual public policy and business strategy. Moreover, while the flow of capital towards sustainability goals has increased, it has not yet reached the scale needed.

In October 2023, the PRI published a [white paper](#) about investing for the economic transition (henceforth referred to as the ‘economic transition white paper’). This paper defines the economic transition as “*the process by which the economy is transformed from its current extractive and unsustainable state to one that is sustainable and equitable, and that benefits both the economy and natural and social systems*”. It argues that an effective policy approach to address multiple policy goals, ranging from climate to costs of living needs to be the responsibility of governments as a whole and needs to be executed as such. The high-level conceptual framework of the whole-of-government approach (fig.1) outlines the key role of collaboration and consistency in policymaking.

Figure 1. A high-level policy framework for a whole-of-government approach to the economic transition



¹ Such risks are the subject of global agreements and frameworks such as the Paris Agreement on Climate Change, the Sustainable Development Goals (SDGs), the Kunming-Montreal Global Biodiversity Framework, and the International Bill of Human Rights and its ensuing conventions and guidelines.

KEY CONSIDERATIONS FOR IMPLEMENTING A WHOLE-OF-GOVERNMENT APPROACH

PRI developed the economic transition white paper's conceptual framework with the aim to start a conversation with policymakers and help investors understand key features of a whole-of-government approach (see box 1 for more resources). It reflects inputs received through external outreach, literature review² and an assessment of existing policy landscapes in six countries; however, it does not claim to provide answers to all the challenges related to the establishment of a whole-of-government approach to the economic transition.

Multiple questions remain on how to implement a whole-of-government approach to the economic transition. The PRI, following continued engagement and policy research, has identified four key considerations:

- How to establish governance structures that ensure continuity of policymaking across political cycles and facilitate collaboration across government departments;
- How to translate planetary and social boundaries into appropriate and relevant national targets that respect scientific consensus and international norms;
- How to develop and implement a balanced set of policy instruments that facilitate all aspects of achieving a sustainable economic transition (including climate, environment, social), and build support for the economic transition across different societal stakeholders; and
- How to ensure that action undertaken by financial regulators to enable finance for the economic transition is fully integrated into the whole-of-government approach

The PRI's economic transition white paper recognises that the way in which a country addresses these implementation questions *“will depend on a series of factors, including economic context, economic structure, political and institutional capacity and expertise, the sources and types of finance available to the country, domestic economic, social and environmental priorities, and the nature of the relationships between the various actors involved in the policy development and implementation processes.”*

This discussion paper is therefore informed by developments in Japan's economy, society and policy frameworks. It presents key findings and recommendations, which aim to contribute to the ongoing dialogue in Japan and other key capital markets on the transition to sustainable, net zero economies.

² The list of policy instruments is not exhaustive, and was developed by the PRI based on a review of the following publications: Coalition of Finance Ministers for Climate Action (2023), [Strengthening the Role of Ministries of Finance in Driving Climate Action](#); G20 (2021), [Sustainable Finance Working Group Roadmap](#); G20 (2022), [Sustainable Finance Working Group Progress Report](#); GFANZ (2021), [Act now: Financial leaders urge more climate action from the G20](#); GFANZ (2022), [Call to action: One year on](#); IMF (2023), [Activating Alignment: Applying the G-20 Principles for Sustainable Finance Alignment with a Focus on Climate Change Mitigation](#); IPSF (2022), [Transition finance report](#); OECD (2023), [Net Zero+: Climate and Economic Resilience in a Changing World](#); OECD (2022), [OECD Guidance on Transition Finance](#); UN Environment Programme and World Bank (2017), [Roadmap for a sustainable financial system](#); WBCSD (2020), [Reinventing Capitalism: a transformation agenda](#); WWF (2015), [From crisis to opportunity: Five steps to sustainable European economies](#).

Box 1. PRI work to support the implementation of a whole-of-government approach to the economic transition

Resources on sustainability issues include the following:

- The PRI has embarked on a research project that explores the extent to which the social dimension informs the economic transition, including how considerations of social issues can be integrated into a whole-of-government approach. The research paper will identify the challenges of the economic transition in terms of its socio-economic aspects, and build on research in nine jurisdictions to identify policy solutions to these challenges. The research will be published in the second half of 2024, and can form a basis from which to further explore issues that are important for Japan such as how to engage an ageing society to achieve the goals of the economic transition or account for the impact of the economic transition on the viability of Small and Medium Enterprises (SMEs) in Japan.
- The above-mentioned paper will complement the [adopting a strategic approach to human rights and social issues policy paper](#), which examines the role of policy in enabling corporates and investors to respect human rights. This paper highlights two of the main issues currently facing society and policymakers; specifically, the climate crisis and the risks posed by growing economic inequalities. As a response to these crises, it calls for policy measures aimed at supporting the economic transition to consider social factors.
- The PRI is working on policy papers that outline our strategic approach for nature and climate change, similar to human rights and social issues. We are also developing views on the nexus between nature and social issues.

Resources in support of enabling finance for the economic transition include the following:

- The PRI has published a series of [policy toolkits](#) to support policymakers and regulators in implementing reforms to build a sustainable financial system. A global toolkit that provides a high-level overview of five foundational sustainable investment policies is complemented by dedicated toolkits for sustainable taxonomies and stewardship instruments.
- The PRI is in the process of updating the global policy toolkit: this version will examine – *inter alia* – how financial regulators can effectively integrate their policies into a whole-of-government approach. The updated toolkit will be published in the second half of 2024, and preliminary findings are already integrated in this jurisdiction-specific report.
- [A legal framework for impact](#) is a joint work programme from the PRI, United Nations Environment Programme Finance Initiative (UNEP FI) and the Generation Foundation. The programme's flagship report clarified how regulators in 11 jurisdictions view “investing for sustainability impact”, which involves the use of investment powers, stewardship and engagement with policy makers to produce assessable positive sustainability impacts.

WHOLE-OF-GOVERNMENT POLICY REFORM: PRIORITIES FOR JAPAN

Japan has taken important steps in establishing a whole-of-government approach to the economic transition that both targets the achievement of global goals such as net zero, and seeks to address specific national circumstances. Key strengths of Japan's approach include its provision of strategic direction at the highest level of government and its initiation of collaboration between government departments on the transition. Policymakers now need to build on this progress by:

- 1) ensuring continuity of the transition strategy's implementation,
- 2) aligning economic policy goals with planetary and social boundaries,
- 3) clarifying how different policies collectively contribute to a whole-of-government strategy for the economic transition, and
- 4) ensuring financial regulators' mandates support economic transition goals and targets.

A SUMMARY OF JAPAN'S POLICY FRAMEWORK FOR THE ECONOMIC TRANSITION

Japan has made important steps in establishing a whole-of-government approach to the economic transition since it has committed to international sustainability goals – most notably since the establishment of the net zero goal by 2050 in 2020, which was consequently enshrined in law in 2021.

The Cabinet, being the highest level of executive power in the Japanese Government, has adopted overarching strategies and action plans that provide policy direction for the economic transition. The Grand Design and Action Plan for a New Form of Capitalism (henceforth 'Grand Design'), as presented during Prime Minister Fumio Kishida's inaugural press conference and developed through three iterations (2022, 2023 and 2024) of an action plan, sets out the government's economic priorities (see box 2). The Grand Design is further supported by a dedicated climate strategy through the GX Promotion Strategy (the Strategy for Promoting Transition to a Decarbonized, Growth-Oriented Economic Structure). The SDGs Implementation Guiding Principles serve as a monitoring and implementation mechanism. These instruments are underpinned by a governance structure that ensures recognition at the highest level and collaboration between government agencies.

Box 2. Priorities for the Japanese government under the Grand Design

- Wage hike for SME employees
- Labour market reform
- Promoting start-up development to transform industry structure
- Promoting investments in GX (Green Transformation), DX (Digital Transformation), AI (Artificial Intelligence) and other innovative technologies
- GX, energy security and food security
- Doubling asset-based incomes and the formation of a broader middle class
- Building economic and social systems for solving social issues
- Multipolarisation of the economy and society

Overarching goals are included in the Grand Design, and for the issue of climate there is good coverage. Climate change and labour are key topics addressed throughout the Grand Design, reflecting key trends in Japan's economy (e.g. the prevalence of high-emitting industrial sectors) and society (e.g. an ageing population, supply chains' structure, and labour productivity). A coherent set of policy instruments for climate is in place under the GX Promotion Strategy, including time-bound targets and Japan's Nationally Determined Contribution.

However, other issues such as nature and human rights remain to be explicitly addressed through granular policies which include goals, financial mechanisms and legislative action: this is needed to address the challenges that Japan is facing to reduce environmental pressures and inequalities in income and gender. The connection of social issues to the transition to net zero, and how specific aspects of Japan's society and economy will be affected by the economic transition (e.g. its ageing society, or its supply chains' reliance on SMEs) could be further clarified in the Grand Design, GX Promotion Strategy or related policies. Furthermore, the connection between the transition to net zero with other government goals has not been clearly established.

In terms of financial regulator involvement, the Financial Services Agency (FSA) has contributed to the development of several ESG-related policies (e.g. the stewardship code, transition finance basic guidelines, social bond guidelines, ESG fund name rules, and impact investment). The FSA's mandate and partial involvement in governance bodies may limit its power to *enforce* action, but its strategy and actions indicate that it intends to *guide* the financial sector in accounting for the economic transition.

POLICY RECOMMENDATIONS

Based on the above, the PRI invites the Japanese government to take in account the following considerations in its approach to the economic transition:

- **To put in place mechanisms that ensure the continuity and coherence of the government's approach towards all aspects of the economic transition.** Long-term instruments such as the GX bonds until 2032 and carbon pricing mechanisms until 2050 are good examples in terms of climate. However, all existing and upcoming sustainability-related policy priorities beyond climate require long-term commitments and strategies must be resilient to changes in government, including the Cabinet. Policies also need to be coherent across sustainability issues, to ensure all aspects of the economic transition are considered when making long-term commitments and strategies.
- **To ensure national-level outcome goals³ are visibly in line with planetary and social boundaries.** Such goals can be embedded more clearly in the Cabinet's overarching policy priorities (such as the Grand Design) and would provide direction for government departments in prioritising areas for policy making and calibrating the ambition level of policy instruments. The Cabinet can also consider further metrics to monitor progress across relevant goals.⁴
- **To clarify, at the Cabinet level, how various policies collectively contribute to an integrated strategy on the economic transition** by addressing economic externalities, building markets for solutions, and enabling finance for the transition. This should include analysis of how the net zero goal is reflected in and clearly connected to relevant public policies, either by identifying whether other policies and tools contribute to the goal of net zero, or do no significant harm to it.
- **To enable the FSA to further integrate their policies into a whole-of-government approach** by ensuring its mandate supports economic transition goals and target. This can facilitate better collaboration with other government ministries on policies such as social and environmental due diligence. The FSA can also play a role in more effectively harnessing the expertise of the financial sector in the policymaking process.

³ For example, the national goal of achieving net zero greenhouse gas emissions by 2050.

⁴ For more information on metrics and monitoring, see the section below on Monitoring.

JAPAN'S CONTEXT FOR THE TRANSITION

Japan faces multiple challenges in relation to the economic transition:

- 1) a large manufacturing sector featuring hard-to-abate industries
- 2) a significant foundation of small and medium enterprises
- 3) an ageing society, declining population and reduced public spending on training
- 4) limited domestic biocapacity, low recycling rates, and geographical challenges to the development of renewable energy capacity.

This chapter provides insights into specific challenges facing Japan by capturing the fabric of its economy and society, its progress on sustainability issues, and its decision-making structures. The PRI has collected data from authoritative international sources for a set of countries, allowing us to understand and contextualise Japan's progress in areas relevant to the economic transition.⁵ The data and analysis allow to build an understanding of areas that require policy makers' attention, and support the reform priorities identified in the chapter above.

ECONOMIC STRUCTURE

Known for the "Japanese Economic Miracle", the country is among the largest economies in the world. It had the second largest economy globally between 1968 and 2009, but economic stagnation over the past few decades saw its GDP ranking drop to fourth in 2023. Compared to other regions, Japan's economy relies more on the manufacturing sector. While this has historically contributed to Japan's economic growth,⁶ these economic activities also emit significant quantities of greenhouse gasses (GHG), and they are often hard to abate from a CO₂ emission perspective. Small and Medium Enterprises (SMEs) account for 99.7% of all Japanese businesses and approximately 70% of the total workforce in Japan.⁷

SOCIETY

Japan scores in the top 20 countries worldwide⁸ in terms of human development according to the Human Development Index. Social inequality and environmental pressures are lower compared to some other developed countries such as Canada or the United States.⁹ The OECD highlights that Japan performs well in relation to other OECD countries in terms of health, knowledge and skills, and safety; but below average in terms of social connections, working hours and gender wage gap.¹⁰ The Japanese population also assesses its own well-being as low compared to other countries of a similar developmental level according to the Happy Planet Index.¹¹

Japan also faces unique demographic circumstances, with an aging population and a declining birthrate leading to a reduction in the working population by 10% between 1970 and 2022 – although this decline was likely cushioned by governmental efforts to facilitate female participation in the work force. However, labour productivity, a metric that could compensate for a decline in working population, has also struggled to keep pace despite efforts from the government to reform work culture.¹²

⁵ We selected countries from regions in which the PRI has an active policy programme (i.e., Australia, China, the EU, Japan, the UK, and the USA), to which we added Brazil and South Africa in order to enhance the perspective on emerging economies.

⁶ During Japan's high growth period in 1960s, manufacturing sector led Japan's economy. Source: Ministry of Health, Labour and Welfare (2010), 2010 Analysis of the Labour Economy – Changes in the Industrial Society and Trends in employment and Salaries – (Excerpt, Japanese only)

⁷ Small and Medium Enterprise Agency (2022), "[2022 White Paper on Small and Medium Enterprises in Japan](#)"

⁸ Japan's [HDI](#) in 2021 was 0.920, placing the country 19th out of 191 countries.

⁹ Japan's loss due to inequality according to the Inequality-Adjusted Human Development Index (IHDI) is 8.1% compared to 11.1% in the United States. Japan's loss due to planetary pressure according to the Planetary Pressures-adjusted Human Development Index (PHDI) is 14.4%, compared to 26.6% in Canada and 24.2% in the United States

¹⁰ OECD (2020), [How's Life in Japan](#)

¹¹ Happy Planet Index (n.d.), [Japan country profile](#)

¹² Bank of Japan (2022), [Productivity Trends in Japan — Reviewing Recent Facts and the Prospects for the Post-COVID-19 Era](#).

Data from international sources about Japan's Gini coefficient, a reference indicator for income inequality, is sparse. However, domestically sourced data from 2021 show that income inequality, once public spending (notably for pensions) has been taken into account, has remained relatively stable since 2008 at a level that is close to the OECD average.¹³ In terms of gender inequality, while Japan has made progress according to the UN gender inequality index (GII), the gap between men and women in terms of labour force participation and representation in parliament remains higher than in other developed countries.¹⁴ On education, the country demonstrates strong performance in terms of educational attainment and student skills when compared to other OECD countries. Finally, Japan's public spending for job training, which is critical for the reskilling necessitated by a just economic transition, amounts to just 0.01% of GDP. This is lower than the OECD average (0.12%),¹⁵ indicating that further efforts in this field are desirable to ensure that the workforce can benefit from the economic transition's opportunities.

CLIMATE AND ENERGY

Japan has unique characteristics in terms of climate and energy. Its reliance on high-emitting manufacturing sectors poses a challenge for decarbonisation as it has a higher barrier to electrification. Its high population density, compared to other countries, implies high energy demand per land area. Alongside this relative land scarcity, Japan faces other unique barriers to increasing clean energy production. For example, there are limited shallow sea areas suitable for offshore wind, and the Fukushima nuclear power accident in 2011 has led to a reduced contribution by this technology to the energy mix. As a result, even though the share of renewable energy in electricity supply has increased from 10% in 2010 to 25% in 2022 and the amount of renewable energy produced per surface area is high compared to other countries, Japan remains heavily dependent on fossil fuels. Moreover, differing views exist on Japan's potential for renewable energy.¹⁶

ENVIRONMENT

Data from the global footprint network indicate that Japan's ecological footprint per person exceeds the *global average biocapacity per person*, which is our planet's total capacity to regenerate ecological assets (e.g. cropland, grazing land, forest land, fishing grounds, and built-up land) if it was shared equally among everyone.¹⁷ Although Japan's consumption of ecological resources is more efficient compared to some of the other highly developed nations (e.g. Canada or the USA); due to its limited *domestic biocapacity*, Japan faces a net biocapacity deficit domestically, which makes it even more urgent that it reduces its footprint to a self-sufficient level.

While Japan has made progress in protecting key biodiversity areas¹⁸ and reducing deforestation rates, OECD analysis¹⁹ indicates that challenges related to the recovery and recycling rate of municipal waste (only half the OECD average), environmental pressure from agricultural production (the highest among OECD countries), and continued pressures to and losses in biodiversity remain.

¹³ OECD (2024), [Income inequality](#)

¹⁴ According to UNDP data [here](#), the difference in the labour force participation rate between men (71.0%) and women (53.3%) is the largest among major developed countries (i.e., Canada, the UK, the USA, Australia), while the share of seats in parliament held by women (14.2%) is the lowest among those countries

¹⁵ [OECD](#) (n.d.). The value is the average of the 5 years between 2017-2021.

¹⁶ The [PRI's policy briefing](#) on Japan's decarbonisation pathways has referenced some research that says that achieving 90% clean energy in Japan's power sector by 2035 might be feasible at a lower cost than is available in Japan today. It may be that the assumptions underpinning this analysis differ from those of the Japanese government, which aims to increase the renewable energy electricity proportion to 36-38% in 2030 according to the [6th Strategic Energy Plan](#).

¹⁷ To live within the means of our planet's resources, the world's Ecological Footprint per person has to equal available biocapacity per person on our planet, which is currently 1.6 global ha. Japan's ecological footprint per person of 4.2 global ha per year far exceeds this.

¹⁸ This indicator, Protected Area Coverage of Key Biodiversity Areas, shows temporal trends in the mean percentage of each important site for terrestrial and freshwater biodiversity (i.e., those that contribute significantly to the global persistence of biodiversity) that is designated a protected area. For more please visit [here](#).

¹⁹ [OECD: "Measuring distance to the SDGs targets-Japan"](#) (page 2)

CURRENT POLICY APPROACHES TO THE ECONOMIC TRANSITION IN JAPAN

This chapter provides a description of the policy approaches that Japan has embraced with regards to key considerations for the establishment of a whole-of-government approach to the economic transition. It takes into account Japan's economic policy governance (see box 2) and provides further background to the analysis and reform priorities identified in the first chapter of this discussion paper.

INTEGRATION OF THE ECONOMIC TRANSITION: OVERALL POLICY APPROACH, GOVERNANCE AND MONITORING

THE GRAND DESIGN AND ACTION PLAN FOR NEW CAPITALISM

The Grand Design and Action Plan for a New Form of Capitalism sets out the strategic view and economic priorities of Japan's current government. The objective of realising a new form of capitalism was presented by Japan's Prime Minister, Fumio Kishida, at his inaugural press conference,²⁰ and subsequently developed through three iterations (2022, 2023 and 2024) of the action plan.²¹

Japan's approach under the Grand Design remains firmly fixed on securing economic growth, but it also recognises that societal challenges such as climate change, declining birth rates and aging population cannot be solved by the market or public policy in isolation. A new form of capitalism is therefore necessary, building on the principles that: i) solutions to societal challenges are to be found by both the market and the state; ii) these solutions will in turn create new markets and economic growth; and iii) that this will ultimately achieve sustainable well-being for all.

The Grand Design serves as an umbrella strategy that defines policy priorities (see box 2), some of which have their own dedicated policy programmes. As such, it can be considered **the government's main strategic approach to the economic transition, albeit with a restricted focus** on labour market reform, business innovation, supporting the middle class and tackling climate change. Broader environmental and social considerations are only tangentially reflected in the Grand Design.

GX PROMOTION STRATEGY

The Basic Policy for the Realization of GX (hereafter referred to as the GX Basic Policy)²² was approved by the Cabinet in February 2023 and is Japan's key climate policy framework. It constitutes **an integrated strategy by the Japanese government for the climate transition**. It specifies that the "act on the promotion of a smooth transition to a decarbonized growth-oriented economic structure" requires the government to implement the GX Basic Policy, issue the GX Economy Transition Bond, introduce a carbon pricing system, establish the GX Acceleration Agency, and monitor the progress of and renew the policy as needed.

Importantly, the GX Basic Policy provides an investment roadmap to enable the transition to net zero at a national level. According to this roadmap, over 150 trillion yen are required over the next 10 years to transform the Japanese economy; it consequently provides potential solutions for public-private financing.

In May 2023, the Diet approved the Cabinet's proposal of the GX Promotion Act, which was designed to implement part of the necessary legislative measures required by the GX Basic Policy. The Act introduced

²⁰ Prime Minister's Office of Japan (2021), [Policy Speech by Prime Minister KISHIDA Fumio to the 205th Session of the Diet](#).

²¹ Latest version of the action plan: https://www.cas.go.jp/jp/seisaku/atarashii_sihonsyugi/pdf/ap2024.pdf

²² [GX Basic Policy for the Realization of GX](#)

measures to formalise the carbon pricing mechanism proposals, which include a fossil fuel surcharge and an emissions trading scheme (ETS). The Act also paved the way for the issuance of the world's first sovereign Climate Transition Bonds (otherwise known as the Japan Climate Transition Bonds), which began to be auctioned in February 2024.

In July 2023, the GX Promotion Strategy (the Strategy for Promoting Transition to a Decarbonized, Growth-Oriented Economic Structure) based on the GX Promotion Act was approved by the Cabinet. Its two main objectives include 1) promoting decarbonisation initiatives towards GX, including a shift to decarbonised power sources such as renewable energy and nuclear power, which will contribute to increasing energy self-sufficiency in order to secure a stable energy supply, in addition to thorough energy conservation, and 2) realising and implementing the 'Growth-oriented Carbon Pricing Concept', which includes upfront investment support using 'GX Economy Transition Bonds', upfront GX investment incentives through carbon pricing, and the use of new financial instruments.

SDGS IMPLEMENTATION GUIDING PRINCIPLES

In May 2016, Cabinet approval formally established the SDGs Promotion Headquarters. In December 2016, the SDGs Implementation Guiding Principles were adopted by the SDGs Promotion Headquarters to guide Japan's implementation of the United Nations 2030 Agenda for Sustainable Development.

While the SDGs Implementation Guiding Principles (hereafter referred to as 'SDGs IGP') aim to “ensure a whole-of-government approach to implementing the 2030 Agenda in a comprehensive and effective manner”, they are not Cabinet-approved in themselves, and have not led to the legislative proposals by the Cabinet as the GX Basic Policy has.²³ Although (as mentioned in the Principles) the Grand Design appears to contribute toward the achievement of the objectives outlined in the Principles, broader alignment between the two has yet to be seen despite a review of both frameworks in 2023. For example, the Grand Design does not provide goals, targets and plans in respect of broader environmental and social issues, such as those regarding nature and the explicit incorporation of human rights.

As such, the SDGs IGP can be considered a tool to **coordinate and monitor policies related to the economic transition** rather than strategy and policy development instruments. Despite this, the principles are relevant to environmental and social policies that are not within the remit of the Grand Design or GX Basic Policy.

The SDGs IGP define 8 priorities, under the banner of 5Ps in the UN 2030 Agenda (see box 3).

Box 3. Priorities for the Japanese government under the SDGs Implementation Guiding Principles	
People	<ul style="list-style-type: none"> Empowerment of All People Achievement of Good Health and Longevity
Prosperity	<ul style="list-style-type: none"> Creating Growth Markets, Revitalization of Rural Areas, and Promoting Science Technology and Innovation Sustainable and Resilient Land Use, Promoting Quality Infrastructure
Planet	<ul style="list-style-type: none"> Energy Conservation, Renewable Energy, Climate Change Countermeasures, and Sound Material-Cycle Society Conservation of Environment, including Biodiversity, Forests and the Oceans
Peace	<ul style="list-style-type: none"> Achieving Peaceful, Safe and Secure Societies
Partnerships	<ul style="list-style-type: none"> Strengthening the Means and Frameworks for the Implementation of the SDGs.

²³ [SDGs Implementation Guiding Principles \(2016, page 2\)](#)

GOVERNANCE

Japan's commitments to the economic transition by means of the above-mentioned instruments are underpinned by governance structures that ensure recognition at the highest level and collaboration between government agencies.

- The Headquarters for the Realization of a New Form of Capitalism deliberates on policy measures to implement the priorities identified in the Grand Design. It is chaired by the Prime Minister, vice-chaired by the New Form of Capitalism Minister and the Chief Cabinet Secretary, and comprises all Cabinet ministers. The Council for the Realisation of a New Form of Capitalism, a subordinate body to the Headquarters, features select external experts and contributes to providing a vision for the New Form of Capitalism and developing plans.
- The GX Implementation Council²⁴ oversees the Cabinet's green transformation (GX) policies. The Prime Minister chairs the council, with the Minister of GX Implementation and Promotion (currently served by the Minister of Economy, Trade and Industry) and the Chief Cabinet Secretary leading the discussions as vice-chairs. The Ministers of Foreign Affairs, Finance and Environment are included as members, as are other key private stakeholders.
- The SDGs Promotion Headquarters has developed the SDGs Implementation Guiding Principles. This Cabinet body also oversees implementation, is headed by the Prime Minister, and comprises all government ministers.²⁵

MONITORING

Japan has put monitoring instruments in place that allow it to track the extent to which adopted policy interventions are meeting their goals.

With regards to **climate**, the GX Promotion Act requires the government to “*monitor the progress of the policy*”. No such review has yet been undertaken given the recent adoption of the law, but the government has stated that “*based on the status of implementation of GX investment, etc. and domestic and international economic trends related to carbon dioxide emissions, we will review the state of the measures and make necessary revisions based on the results of the review... detailed institutional design regarding the fossil fuel levy and emissions trading system, including specific measures for the full-scale operation of the emissions cap and trade system, will be studied, and necessary legislative measures will be taken within two years after this law comes into effect.*”²⁶

Beyond climate, there are no legal monitoring and review requirements. However, Japan has monitored progress against the achievement of the SDGs in 2017 and 2021 via Voluntary National Review (VNR),²⁷ the official monitoring mechanism under the UN 2030 Agenda. According to the latest SDGs Implementation Guiding Principles, the next VNR will be conducted around 2025.

The latest VNR includes a self-assessment by the government. It also includes an assessment by the SDGs Promotion Roundtable Meetings, in which representatives from NGOs, academia, the private sector and international organizations took part. The government reports on its progress against all the SDGs, but the lack of quantitative targets for several SDGs complicates the undertaking of a comprehensive gap analysis.

²⁴ [GX implementation Council](#) (Japanese only)

²⁵ [Minutes](#) of the meetings held by the SDGs Promotion Headquarter indicate that the chief cabinet secretary facilitates discussion, and all other ministries are equally involved by sharing their respective strategies and plans.

²⁶ The [METI's announcement](#) (Japanese only)

²⁷ [VNR \(2017\)](#), [VNR \(2021, Japanese only\)](#)

Box 4. Economic policy governance

Japan's governmental structure has three tiers: national, prefectural and local. In this discussion paper, we focus on the national level. The Japanese Government consists of legislative, executive and judicial branches, each being controlled by the National Diet, the Cabinet, and the Supreme Court respectively. The legislative branch, which is the National Diet, employs a bicameral system composed of the House of Representatives and the Councillors. The executive branch, which is the Cabinet, consists of the Prime Minister and up to 17 Ministers of State.

With regards to the creation of laws and regulations, legislative bills can be submitted by either a Diet member or by the Cabinet. Bills submitted by the Cabinet will be drafted by the ministry having the jurisdiction and be subject to an examination by the Cabinet Legislation Bureau. Cabinet-initiated bills can also be presented to either house first. Once submitted to the Diet, the bill will be referred to an appropriate committee for deliberation, followed by a plenary sitting at which the committee discussions will be presented and a vote taken. In principle, all bills must be approved in both houses for enactment. Laws are supported by administrative orders including cabinet orders, ministerial orders, and public notifications.

The Cabinet, being the highest level of executive power in the Japanese Government, sets overarching strategies and action plans that provide broader policy direction, such as the Grand Design and Action Plan for a New Form of Capitalism²⁸ and the Action Plan of the Growth Strategy.²⁹ The Cabinet also approved the SDGs Implementation Guidelines, as well as the Basic Policy for the Realization of GX (Green Transformation),³⁰ which was followed by the GX Promotion Act. Each of these policies are developed and monitored by Cabinet-level committees, such as the Council of New Form of Capitalism Realisation, the SDGs Promotion Headquarters and the GX Implementation Council.

Based on these Cabinet-approved policies, administrative organs such as ministries implement aligned policies. In Japan, principles-based policy approaches (voluntary guidance and guidelines) that do not entail requirements or penalties have been uniquely prevalent in the sustainable finance space. For example, in contrast to regulatory approaches in the EU that include the EU taxonomy for sustainable activities and the Sustainable Finance Disclosure Regulation (SFDR), Japanese ministries have developed and promoted voluntary bond and loan frameworks as well as supervisory guidelines that achieve similar objectives via voluntary action.

In relation to the economic transition, the government departments that are most directly involved in policy making are likely to be the Ministry of Economy, Trade and Industry (METI), the Financial Services Agency (FSA) and the Ministry of the Environment (MOE). All government departments have a stake in the economic transition, but other departments that are also particularly relevant to the economic transition include the Ministry of Finance (MOF), Ministry of Land, Infrastructure, Transport and Tourism (MLIT), Ministry of Agriculture, Forestry and Fisheries of Japan (MAFF) and Ministry of Health, Labour and Welfare (MHLW).

²⁸ Cabinet Secretariat (2023), [Grand Design and Action Plan for a New Form of Capitalism 2023 Revised Version](#)

²⁹ Cabinet Secretariat (2021), [Action Plan of the Growth Strategy](#)

³⁰ Cabinet Secretariat (2023), [Outline of the Basic Policy for the Realization of GX](#)

NATIONAL TRANSITION STRATEGY: TARGET SETTING AND PUBLIC FINANCE

Japan's Cabinet-approved Grand Design provides an important basis for the economic transition. However, gaps remain both in terms of issues that are covered and the level of detail of the policies that follow each priority. While climate change and labour are key topics addressed throughout the Grand Design, issues such as nature and human rights remain to be explicitly addressed.

Japan has, however, put in place a national transition strategy for climate under the GX Basic Policy. It includes:

- Mid- and long-term goals. The country has committed to net zero emissions by 2050, and submitted a nationally determined contribution (NDC) for 2030 under the Paris Agreement on Climate Change. It is not, however, sufficiently clear to all stakeholders to what extent Japan's 2030 climate target is in line with the scientific consensus on the need to limit global warming to 1.5°C.³¹
- Information on financing. The GX Basic Policy outlines that a total of 150 trillion yen is needed in private and public finance over the next 10 years to achieve net zero emissions by 2050. The government also commits to provide public investment of 20 trillion yen within these 150 trillion yen to catalyse the private market.

Japan's strategy for sustainability issues beyond climate is less clearly defined. The SDGs Implementation Guiding Principles provide a benchmark for progress:

- Japan has integrated its plan for nature conservation (The National Biodiversity Strategy 2023-2030) into the SDGs Guiding Principles: it has committed to conserve at least 30% of land and sea area by 2030 (aligned with the targets set under the Kunming-Montreal Global Biodiversity Framework) and adopted a 30 by 30 Roadmap.
- Japan formulated an SDGs Action Plan³² that collects over 500 existing policy measures and budgets across the priority areas in the SDGs Implementation Guiding Principles.³³ Quantitative targets for issues other than climate and nature (such as poverty and inequality) are less comprehensively set.³⁴ In addition, not every measure has a clear budget allocated: for instance, the budgets for gender policy measures are less comprehensively allocated than other policy areas such as science, technology and innovation.

IMPLEMENTATION: POLICY INSTRUMENTS

Japan has put in place various policy instruments to enact a whole-of-government-driven transition as outlined in figure 2. The PRI has undertaken an assessment of a wide range of policies, building on earlier work undertaken³⁵ and additional research on environmental and social policies that we have identified as relevant (nature, decent work, tax transparency, human rights due diligence) across jurisdictions worldwide or that stand out in light of Japan's domestic context and policy priorities (e.g., labour market reform or housing as a public good). In summary, we find that for:

- Addressing economic externalities: Japan has put a wide range of schemes in place. However, the government should enhance their effectiveness and review the alignment of its subsidy policies with sustainability goals.

³¹ For instance, independent assessments made in 2023 by [climate action tracker](#) and [ASCOR](#) find that Japan's 2030 targeted emission reductions are insufficient to meet the 1.5°C goal.

³² [SDGs Action Plan](#) (Japanese only)

³³ These areas are People (human rights, diversity, decent work, and health), Prosperity (GX promotion, science and technology innovation, digital transformation, and infrastructure development), Planet (climate change and biodiversity), Peace (security), and Partnership (international collaboration).

³⁴ [SDGs targets and global indicators](#) and [VNR 2021](#)

³⁵ See, most notably, [PRI's policy briefing on delivering net zero in Japan](#) and the Japan case study on pages 15 and 16 of the [economic transition white paper](#).

- Building markets for solutions: Japan has several sustainability targets, a wide range of action plans, and policy measures in place. However, supplemental information is needed to enhance the credibility of those policy strategies. Sufficient public spending for a just transition is needed to ensure the robustness of these markets.
- Enabling finance for the transition: Japanese authorities have made progress through voluntary supportive measures and a strong commitment to blended finance. However, policies to date have largely focused on climate outcomes, leaving consideration of broader environmental and social transition yet to be undertaken.
- Aligning government budgets with the transition: the commitment under the GX strategy has included a budget allocation for climate solutions over 2023 and 2024 (to be used, for example, in the construction of supply chains for storage batteries/solar cells and the transformation of manufacturing processes in the iron, chemical, and other manufacturing industries). Budget allocation for other measures in the SDGs Action Plan 2023 is less comprehensive.

While these policy instruments can be said to contribute to net zero and transition goals individually, continuing to ensure alignment and communicating this with all stakeholders will increase their overall effectiveness. Some underlying policy tools, such as the sectoral roadmaps, still permit the use of well-below-2°C scenarios (e.g. IEA SDS³⁶) alongside 1.5°C scenarios, leading investors to call for more clarity. Key policy instruments such as the roadmaps, along with the financing of the transition through the Japan Climate Transition Bond should be as transparently aligned with goals as possible.

Figure 2: The levers needed for a whole-of-government approach to the economic transition³⁷

Addressing economic externalities	Incentivising markets for solutions	Enabling finance to support the transition	Budget alignment with transition strategy
<ul style="list-style-type: none"> • Pricing instruments • Performance standards • Phase-out dates for polluting sectors • Demand-side measures for hard-to-abate sectors • Subsidy reform • Minimum social safeguards for economic actors • Highlighting good-job externalities • Regulation relative to public goods 	<ul style="list-style-type: none"> • Sustainability targets • Credible and predictable sector-specific policies, targets, and transition plans • Tax exemptions and/or subsidies for clean technologies and sectors • Measures for early-stage innovation and R&D • Public procurement policies • Up-skilling and re-skilling of the work force 	<ul style="list-style-type: none"> • Embedding sustainability outcomes in financial regulation • Providing public finance in support of sustainable finance 	<ul style="list-style-type: none"> • Using the budget and public financial management to drive transformation in all sectors of the economy

³⁶ [International Energy Agency, Sustainable Development Scenario](#)

³⁷ The list of policy instruments is not exhaustive, and was developed by the PRI based on a review of the following publications: Coalition of finance ministers for climate action (2023), [Strengthening the Role of Ministries of Finance in Driving Climate Action](#); G20 (2021), [Sustainable Finance Working Group Roadmap](#); G20 (2022), [Sustainable Finance Working Group Progress Report](#); GFANZ (2021), [Act now: Financial leaders urge more climate action from the G20](#); GFANZ (2022), [Call to action: One year on](#); IMF (2023), [Activating Alignment: Applying the G-20 Principles for Sustainable Finance Alignment with a Focus on Climate Change Mitigation](#); IPSF (2022), [Transition finance report](#); OECD (2023), [Net Zero+: Climate and Economic Resilience in a Changing World](#); OECD (2022), [OECD Guidance on Transition Finance](#); UN Environment Programme and World Bank (2017), [Roadmap for a sustainable financial system](#); WBCSD (2020), [Reinventing Capitalism: a transformation agenda](#); WWF (2015), [From crisis to opportunity: Five steps to sustainable European economies](#).

ROLE OF THE FINANCIAL REGULATOR

The FSA's mandate is stipulated in Article 3 of the Act for Establishment of the Financial Services Agency (FSA), as below:

- The FSA has a mission to secure the stability of financial functions in Japan and protect depositors, policyholders, securities investors, and any equivalent persons, and facilitating financing.
- Beyond what is specified in the preceding paragraph, the Financial Services Agency has a mission to assist with affairs of the Cabinet concerning specific important policies of the Cabinet relating to the mission referred to in that paragraph.
- The Financial Services Agency is to assist the Cabinet Secretariat in carrying out the mission referred to in the preceding paragraph.

The FSA actively promotes sustainable finance, with climate-related economic transition being a key theme. This is likely because, despite their mission not explicitly requiring promotion of sustainable finance and climate-related economic transition, the FSA identified these themes as important to delivering on fundamental missions such as securing the stability of financial functions and facilitating finance. It is also noteworthy that their mission also requires them to assist the Cabinet on policies relating to their aforementioned mission. This reflects the FSA's leadership on sustainable finance policies recognized or devised at the Cabinet level such as:

- **Establishing the Basic Guidelines on Impact Investment.**³⁸ These guidelines aim to promote investments that address social and environmental impacts in light of the increasing importance of relevant issues. More specifically, they provide guidelines on how investors and companies can leverage impact investments (impact finance) as a means to raise and supply necessary capital.
- **Promoting Japan as a Leading Asset Management Center,**³⁹ **along with the Doubling Asset-Based Income Plan.**⁴⁰ These policies are based on priorities presented in the Grand Design, and both consider policy options to enable investments in sustainability outcomes.
- **Making progress on sustainability reporting.** Listed companies have been required to disclose sustainability information in their annual reports since March 2023⁴¹. The Sustainability Standards Board of Japan (SSBJ) is currently developing Japan's reporting standards based the International Financial Reporting Standards (IFRS) S1 and S2,⁴² and concurrently the FSA is considering how to embed the standards into the mandatory reporting requirements.

The FSA also influences and works alongside other government departments on relevant policy instruments, including:

- **Formulating the Basic Guidelines on Climate Transition Finance** in conjunction with the MOE and the METI. While equity-based transition finance is not addressed as comprehensively, these guidelines cover bonds and loans and are a clear support for the mobilisation of private finance for the climate transition.

The FSA is also a member of the SDGs Promotion Headquarters.⁴³ While the lack of legislation underpinning this governance body limits the FSA's power to *enforce* action on this topic, it facilitates its work with other government departments in the establishment of relevant policy instruments such as those mentioned above.

³⁸ FSA (2024), [Basic Guidelines on Impact Investment](#)

³⁹ Council of New Form of Capitalism Realization (2024), [Policy Plan for Promoting Japan as a Leading Asset Management Center](#)

⁴⁰ Council of New Form of Capitalism Realization (2023), [Doubling Asset-based Income Plan](#)

⁴¹ [FSA's webpage on sustainability disclosure](#) (Japanese only)

⁴² SSBJ (2024), [The SSBJ issues Exposure Drafts of Sustainability Disclosure Standards to be applied in Japan](#)

⁴³ Cabinet Secretariat (2016), [Member of SDGs Promotion Headquarters](#) (Japanese only)

THE PRI'S NEXT STEPS

The PRI's immediate priorities are to engage with policy makers at the international and national levels so that they identify the economic transition as a central goal of all their activities, adopt a whole-of-government approach in their respective organisations and strategies, and develop transition plans that explain how they plan to implement their commitments to the economic transition.

This thorough regional exploration is the first in a series covering jurisdictional challenges and opportunities in economic transition. Other jurisdictions covered will, in the first phase, include Australia, Canada, China, the EU, the UK and the USA. This report's focus has been on the overarching priorities of the Japanese government regarding the economic transition, maintaining a high-level overview, but we recognise that this discussion paper has not fully investigated the social dimension of the transition.

The PRI has embarked on a research project that explores the extent to which the social dimension informs the economic transition, including how considerations of social issues can be integrated into a whole-of-government approach. The research paper will identify the challenges of the economic transition in terms of its socio-economic aspects, and build on research in specific jurisdictions to identify policy solutions to these challenges. The research will be published in the second half of 2024, and will focus on the social dimension of the climate transition. Following this paper, further research may look to address technological and demographic changes and could form a basis to further explore issues that are important for Japan such as how to engage an ageing society in achieving the goals of the economic transition or account for the impact of the economic transition on the viability of SMEs in Japan.