Message in White Paper on International Economy and Trade 2007

By Yoshida Yasuhiko

The message in the White Paper on International Economy and Trade 2007 is that Japan will seek to grow its economy based on trade and investment.

It has become important for Japan to recognize anew the benefits of promoting trade and investment and the need for their further expansion, and step up external economic activities, including active corporate trade and investment. Especially significant among such activities are the building of more sophisticated and closer production networks in East Asia and globalization of the services sector. It is important in this connection for the government to adopt policies encouraging these activities, namely promoting economic partnership agreements (EPAs) in East Asia, the WTO's Doha Development Agenda, inward foreign direct investment (FDI), and bold domestic deregulation. In the rough seas of global competition, it is vital for Japan to have faith in its economy, carry out uninterrupted innovation and thus face up to ever-lasting competition.

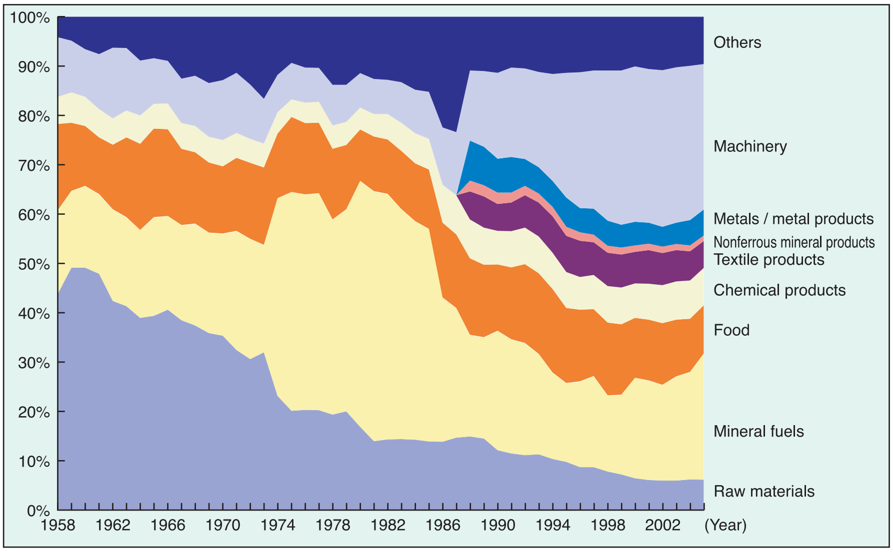
Synergy Effect of Japanese, East Asian Growth

Today, where does the Japanese economy stand in the world economy?

In macroeconomic terms, Japan is now in the longest period of sustained economic recovery since the end of World War II, thanks primarily to strong exports and plant and equipment investment. As domestic consumption remains sluggish, a great part of capital investment is made in anticipation of external demand, including surging demand from China. Thus, external economic activities are acting as a major engine of the Japanese economic growth.

On the other hand, in terms of business activities as seen from a global perspective, the Japanese economy's deep-rooted complementary relationship with the economies of the rest of East Asia has become sophisticated further. The Japanese economy has overcome its comparative disadvantage by outsourcing labor-intensive processes and production of general-purpose goods to the rest of the Asian economy, while supplying highly sophisticated parts and materials, capital goods and state-of-the art products. In cultivating East Asian markets, local subsidiaries of Japanese businesses often established a plant in each country to make the same product in the past. However, there have emerged moves to consolidate their regional supply functions primarily in ASEAN in pursuit of economies of scale by taking advantage of the regional market integration through EPAs/FTAs. Some businesses are also moving to use their ASEAN bases to tap the Indian market. Such moves represent a shift in the Japanese way of doing business in East Asia. In the past, a parent company in Japan acted as a pivot linked to individual subsidiaries in East Asia. Now, individual local subsidiaries are dynamically undertaking business operations by taking advantage of their own strength and without limiting themselves to their relationship with their Japanese parent, going even further to carry out strategic reorganizations on their own. Under the new situation, East Asia is able to use its own strength, complementing Japan and receiving technology transfer and other benefits from it. The strategic reorganization of Japanese business-

Chart 1 Changes in breakdown of Japanese imports by item



Source : JETRO

es is enabling East Asia to expect the development of business without being constrained by the size of domestic markets. Thus, it can be said that the synergy effect of Japan and East Asia developing together is entering a new dimension.

East Asia Closer Woven Than NAFTA, EU

A major difference between the East Asian economic sphere and NAFTA or the EU is the fact that East Asian trade in intermediate goods is much greater than that of finished products. In this region, each country brings its own local specialty and puts it in a pot and all countries together cook a pot dish, so to speak. On the other hand, in NAFTA or the EU, there is division of labor with each member acting as a chef, pastry-maker, baker or what-have-you to produce its own dish. With this division of labor, each kitchen shares the menu to prepare a full-course dinner.

As it is well known, Japan has achieved economic growth always as a trading nation. This has been making up for the shortage – that is, being a resource-scarce country, it had no choice but to depend on imports for resources and energy. Until the mid-1980s, raw materials and fuels accounted for approximately 60% of Japan's imports. The weight of resources and energy in Japanese imports was extremely high. The Japanese economic and industrial structure has become more sophisticated, shifting from a manufacturing-led one to a services-oriented one and from a manufacturing / processing-led pattern to a knowledge-intensive one. Amid such a change, the scope of Japanese trade has expanded, though securing the supply of resources and energy is still an important priority. Since the mid-1990s, the share of raw materials and fuels in Japanese imports has been on the decline, staying in the 30%-40% range, while the share of industrial products has been on the increase. *(Chart 1)*

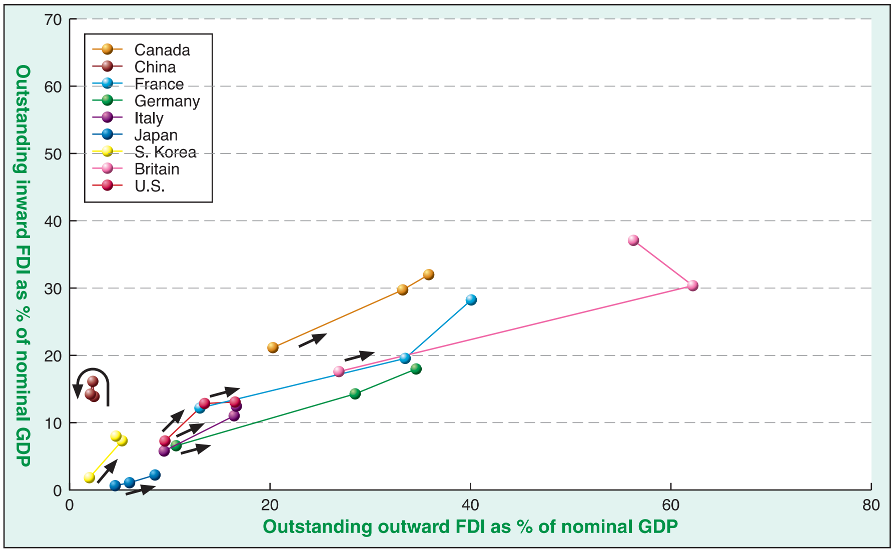
Japan Should Stick to Basic Principles

Given a multi-layered complementary relationship with overseas economies through various economic activities, including trade and investment, the Japanese economy is moving in the direction of a more broadly defined "new trading- and investment-bolstered country." This is being achieved through trade, which is used to spearhead Japanese economic development by increasing the value added and productivity of the economy and offering consumers a chance to choose high-quality yet less expensive products, and through increased outward and inbound FDI for Japanese businesses to operate worldwide dynamically, taking into account both strengths and weaknesses of this country. The ratio of trade in goods and services to GDP climbed to the highest level in the postwar period, reaching 16.1% in 2006. When compared internationally, however, South Korea and EU countries (when including intraregional trade) are using trade more aggressively than Japan. Therefore, Japan should accelerate trade more aggressively for its own development. Japan faces basically the same situation in investment. *(Chart 2)*

Within this context, the services sector taken up in this year's White Paper on Internaitional Economy and Trade 2007 is to be the next leading player in this trade/investment-based country. While the services sector is fast becoming a global industry rather than a local industry, Japanese service industries are expected to develop their businesses internationally and display synergy effects on their own while nurturing their competitiveness.

By doing away with protectionist philosophy, which does not take into account self-innovation, and by realizing its full potential through unfettered activities, the Japanese economy will be able to take its mechanism of productivity improvement and growth to a higher level. JS

Chart 2 Ratio to nominal GDP of outstanding outward / inward FDI of major countries



Note : Dots indicate 1995, 2000 and 2005 in this order in the direction of the arrow.
Source : World Development Indicators, World Bank; UNCTAD

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