

# R redesigning Japan's Strategy Amid Global Shift

## A Perspective from Southeast Asian Eyes



Author Friska Parulian

By Friska PARULIAN

The Economic Research Institute for ASEAN and East Asia (ERIA) has been engaged in policy-oriented research on the Asian economy and trade since its foundation in 2008, aiming at creating policy recommendations for Asia. Assuming that Asia is now a principal source of economic growth for the world, ERIA shares the very important function of ensuring global governance with other international institutes.

It is also to be noted, just as Dr. Fukunari Kimura, chief economist of ERIA and professor at Keio University, often mentions, that ERIA provides a great opportunity for a number of promising young Asian economists to engage in policy-oriented research and thus sharpen their capacity to solve practical issues based on the application of economic theory.

The analysis below is one example of the application of economic theory to reality which, I believe, functions as a base for international policy discussions in relation to global governance.

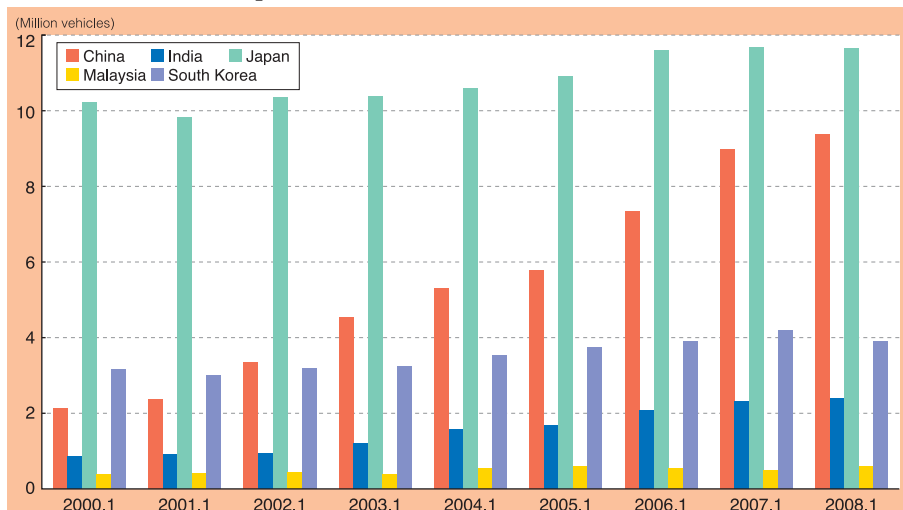
The recent crisis has caused a shift in Asia's belief in the global system of governance in its current form. There is a demand for change, especially with the rise of the Chinese and Indian economies. This phenomenon appears to call for a new approach not only in the global context but also in the regional context, requiring Japan to reconsider its strategy to maintain its role in the region.

### Winds of Change & Challenges from Neighbors

If you asked Southeast Asians what comes to mind when hearing the word "Japan," a majority of them would answer with the name of some famous motorcycle manufacturer, carmaker or electronic appliance company. There is no doubt that Japan has been the leader

CHART 1

### Motor vehicle production trends in Asia



Source: CEIC data

of industry, especially for production of some consumer goods, for the last three decades.

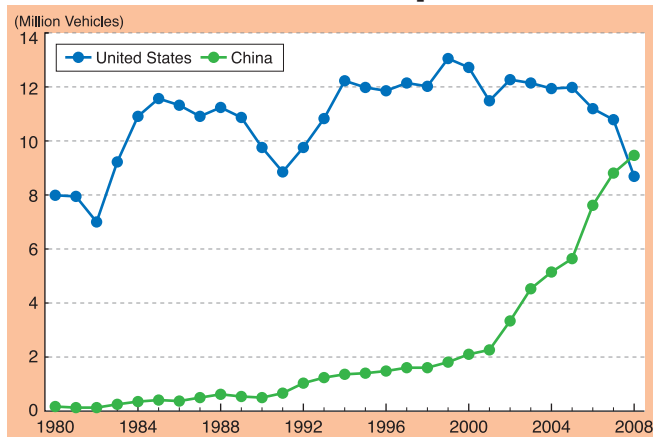
However, in recent days there is a preliminary sign that this role might be overtaken by neighboring countries and Japan might need to redesign its strategy. If you go to big cities in Southeast Asia such as Jakarta, you will see that South Korean, Chinese and Indian products are now flooding the domestic market for vehicles, electronics and electric appliances. A similar situation might emerge in a couple of years in the automobile industry given the fact that at least four countries in the region are now building this industry and selling products that are affordable for the average "Southeast Asian pocket."

If we rewind the history of Japanese cars, during the 1960s, people still considered them the second-best choice compared to their counterparts from the United States or Europe. But two decades later, Japan has overcome its competitors and become the leader of the market. Now, a similar view could be seen from neighboring countries, but sooner or later a shift might need to be anticipated. Cheaper labor costs, better education and a huge domestic market in some countries of the region will become valuable assets in enabling them to lead the market. They will be able to create high-quality products at a much lower cost in industries that involve mass production. *Chart 1* shows trends in Japan and neighboring countries in the production of motor vehicles and motorcycles. The latest figures from the US Department of Transportation show that China's production has already surpassed that of the United States. In 2008, China produced 9.5 million vehicles against the US output of 8.7 million vehicles (*Chart 2*).

Given its limited labor force and natural resources, squeezed domestic market and rigid labor market, it might be time for Japan to move to the next step in industrial strategy. It is time to reconsider either the high-end technology industry or the service industry as the next strategy to keep its industrial role and leadership in the region. Japan should not stagnate in its comfort zone of mass production of automobiles, electronics or electric appliances. When there were fewer countries able to become producers, Japan and other advanced industrial economies may have had easier access to foreign markets. However, when emerging economies are able to produce similar goods at lower cost and have the ability to absorb them domestically to some extent, it is time for incumbent producers to move to a different tier of production that complements rather than substitutes the mass-production nature of goods.

CHART 2

## China surpasses United States in domestic vehicle output



Source: China Automotive Industry Association

### Shifting to High-tech Products: German Industry & Business Style as Model?

A German model of selling high-tech products or even selling innovation (R&D) itself might be an alternative. Like Japan, Germany's economy is powered by a huge industrial sector, which makes up almost a quarter of its GDP. Its industry employs more than five million people, mostly in small and medium-sized enterprises, which account for 49% of corporate revenues.

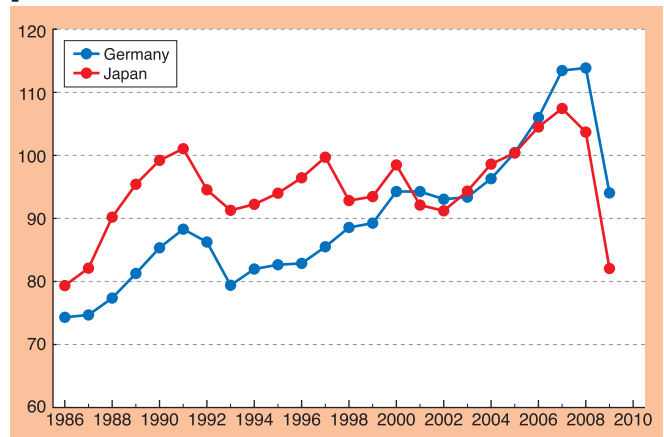
Germany is benefiting from its industrial strength and export power, pointing to the country's technological edge in growth areas such as infrastructure and green products. A different pattern we find in German industry is specialized products in high-quality market niches where its industrial products are indispensable. As a result, companies can postpone other investments, but they cannot omit the need for German products. For example, if all machines made by a German laser-cutting machine were suddenly to disappear, the global economy might easily be disrupted as all sophisticated metal-processing companies would have to close down their businesses. Germany maintains its ability to produce high-quality and technology-intensive products that are difficult to be substituted by emerging economies' products. Given the above picture, if Japan would like to maintain its position similar to that of the last five years, it should start thinking about how to gain part of Germany's share.

Another reason for German industrial competitiveness is the country's openness to the world. Germans go on holiday everywhere around the globe and thus learn about other economies' conditions and business chances sooner than their competitors do. German industrial groups are faster than others in tapping markets outside Europe. For example, Volkswagen (VW) entered China more than 30 years ago, sowing the seeds for today's market dominance by the multi-branded carmaker.

The twin German focus on high-quality market niches and exports has of course left German industry exposed to volatility. At the same time, however, German industry has been able to strengthen its competitiveness and radically improve its workforce flexibility. Germany did a great job during the recent crisis due to the consen-

CHART 3

## Germany vs Japan in industrial production index



Source: IMF

sus between employers and employees that allowed management to concentrate on business, as well as the government-sponsored short-time working scheme *Kurzarbeit* where the state contributed two-thirds of the wages lost when working hours are reduced.

Flexibility measures such as *Kurzarbeit* helped deal with most of the supply problem in the initial stages of recovery. Comparing trends in the industrial production index during the last two decades, *Chart 3* shows overall improvement in Germany's performance.

### Pharmaceutical Industry

Another alternative sector to be considered by the Japanese business community is the pharmaceutical industry, given that it requires significant R&D and is less labor-intensive. Asia's pharmaceutical market was approximately \$106.8 billion in 2006, with Japan making up about half the market with domestic consumption of about \$58 billion. Asia today is a net importer of pharmaceutical products, mainly from Europe. In 2004, the major net exporter of drugs in Asia was India with net exports of about \$2 billion.

The rise of Singapore after the crisis is an example of a success story in pharmaceutical industry development in a highly industrial economy. The existence of some new diseases such as H1N1 avian flu has been a blessing in disguise for this country. Recently, India's position as the main net exporter in Asia is being contested by Singapore, which has shown a strong record backed by years of substantial government investment. Singapore achieved exports of \$2.4 billion in 2005.

Given Japan's position as one of the world's largest markets, it comes as no surprise that the country is also Asia's largest net importer – \$3.5 billion – with the majority of imports from Europe. In addition to the potential domestic market, the different disease profile in developing economies in Asia creates more diversified markets for the pharmaceutical industry. Developing Asia has a lower incidence of lifestyle diseases such as cardiovascular or central nervous system (CNS) diseases. Antibiotics are the main therapeutics consumed in neighboring developing economies, most of which are generics. However, the growing middle-income class in these devel-

TABLE 1

**Generic pharmaceutical market: market age by country (Asia)**

Country/region	Market age	CAGR* (% , 2001–2007)
Malaysia	Growth	12.5
Philippines	Growth	19.7
Singapore	Growth	10.6
Taiwan	Mature	4.0

Note: \*compound annual growth rate  
Source: Frost & Sullivan

opening economies creates a new class of affluent consumers who can afford and demand novel patented treatments in addition to treatments from the generic pharmaceutical market.

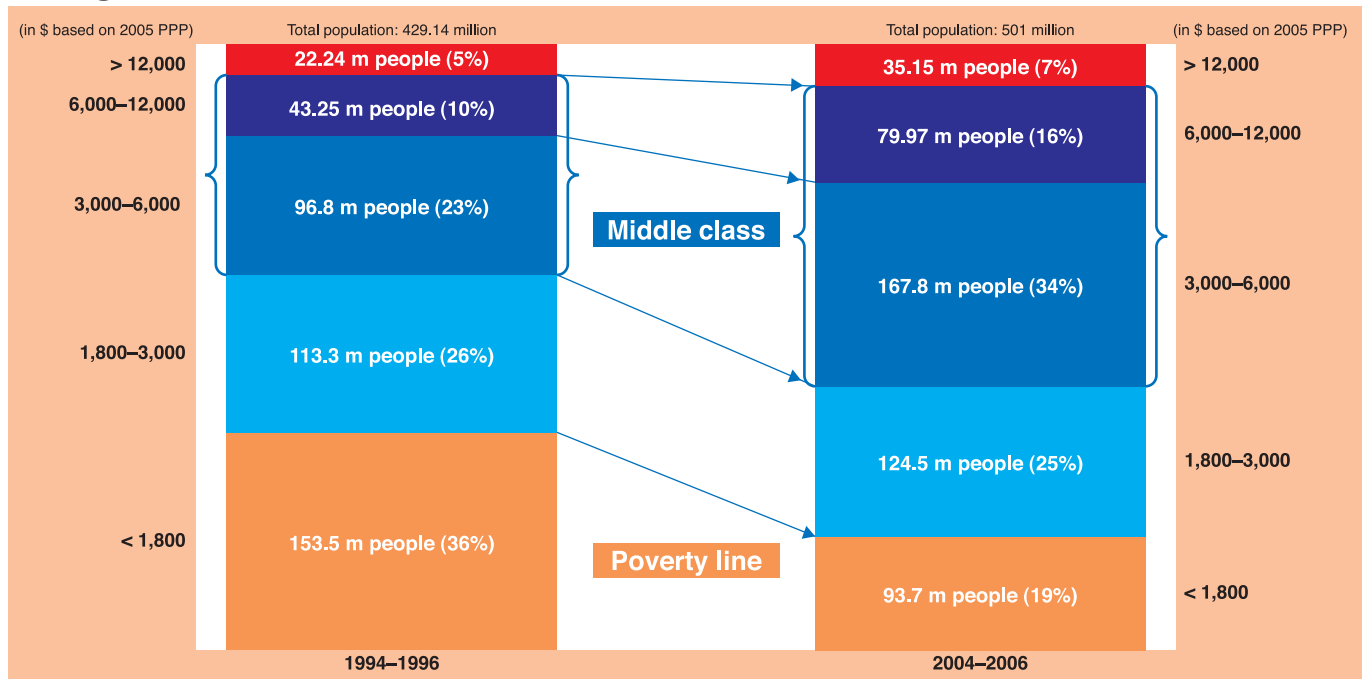
Table 1 shows the generic pharmaceutical market and its level of development. If Japan could take over from 25% to 50% of the Asian pharmaceutical market, this could compensate for a decline in other industry revenues such as from the automobile or electronics sector that has been captured by other competitors.

**Opportunities in Other Sectors: Finance, E-commerce & Shipping**

In the service industry, there are at least two business opportunities. The first is financial services where the abundant cash needs to be further utilized. From the Southeast Asian point of view, Japanese banks and other financial institutions are characterized by being risk-averse and conservative. This image might become an asset when the financial-sector entities create private-pension and health-insurance products for the middle-income layer in Southeast Asia. Defining the middle-income class as people who earn from \$3,000 to \$12,000 per year,

CHART 4

**Rising middle-income class in ASEAN\***



Note: \*ASEAN excluding Singapore, Brunei & Myanmar  
Source: World Bank PovcalNet (cited from Fukunari Kimura, 2009)

the middle-income class size in ASEAN (excluding Singapore, Brunei and Myanmar) has reached 248 million people, an increase from 33% to 50% of the population in the respective countries (Chart 4).

Not every country in Southeast Asia has a universally covered healthcare or pension system. And even if the system exists, benefits for retirees and insured persons are insufficient. In most developing Asian countries, the coverage of pension systems recently varies only between 10% and 35% of the labor force (Hinze and Pallares-Miralles, 2009). The low coverage of social security and the undeveloped financial market in some Southeast Asian countries result in a high household savings rate in the region and bring the middle-income class to invest in property assets as a substitute for nonexistent pension or health insurance.

The nonexistence of adequate social protection and the fact Southeast Asia will also enter an aging era in the next decades create business potency for financial institutions that are able to innovate financial instruments for this market segment. The image of Japan's financial sector as conservative and less aggressive might be attractive in the potential market in Southeast Asia. This is also a chance for risk diversification by pooling risks from countries with different profiles.

E-commerce-based trading services might become another business opportunity for Japan. Southeast Asian Internet penetration recently has developed faster than expected (Table 2). International Data Corp. (IDC) estimated the value of global e-commerce in 2000 was \$350.38 billion and climbed to as high as \$3.14 trillion by 2004. This means that in four years, there was an increase in Asia's share of worldwide e-commerce revenue from 5% in 2000 to 10% in 2004. The undeveloped e-commerce system and market size in Southeast Asia may become a golden opportunity for Japan to become a pio-

TABLE 2

**Internet users & population statistics for selected Asian countries**

ASIA	Population (2010 est.)	Internet users, latest data	Penetration (% population)	User growth (%) (2000-2010)	Users (%) in Asia
Brunei	395,027	<b>318,900</b>	80.7	963.0	0.0
Cambodia	14,753,320	<b>78,000</b>	0.5	1,200.0	0.0
China	1,330,141,295	<b>420,000,000</b>	31.6	1,766.7	50.9
Hong Kong	7,089,705	<b>4,878,713</b>	68.8	113.7	0.6
India	1,173,108,018	<b>81,000,000</b>	6.9	1,520.0	9.8
Indonesia	242,968,342	<b>30,000,000</b>	12.3	1,400.0	3.6
Japan	126,804,433	<b>99,143,700</b>	78.2	110.6	12.0
South Korea	48,636,068	<b>39,440,000</b>	81.1	107.1	4.8
Laos	6,993,767	<b>527,400</b>	7.5	8,690.0	0.1
Macao	567,957	<b>280,900</b>	49.5	368.2	0.0
Malaysia	26,160,256	<b>16,902,600</b>	64.6	356.8	2.0
Myanmar	53,414,374	<b>110,000</b>	0.2	10,900.0	0.0
Philippines	99,900,177	<b>29,700,000</b>	29.7	1,385.0	3.6
Singapore	4,701,069	<b>3,658,400</b>	77.8	204.9	0.4
Thailand	66,404,688	<b>17,486,400</b>	26.3	660.3	2.1
Vietnam	89,571,130	<b>24,269,083</b>	27.1	12,034.5	2.9

Source: [www.internetworldstats.com](http://www.internetworldstats.com)

neer and leader in this sector. The Rakuten B2C e-commerce system is a good example of a business model that may also fit the Southeast Asian market.

Another sector that could help dampen the decline of industrial revenue is shipbuilding and shipping. With several neighboring maritime countries and only South Korea as a main competing player in the region, this sector might become another alternative to compensate for the decline in the automobile industry.

### Foreign Workers as Complements, Not Substitutes

With the recent phenomenon of a declining birthrate combined with the aging problem in Japan, actions to actively encourage and welcome foreign workers with professional and technical expertise must not be hindered if the Japanese economy is to be sustained. The number of foreign workers in Japan recently accounts for only 1.5% of the population, the lowest among industrialized economies.

Manufacturing had the highest number of foreign workers and businesses employing foreign workers, accounting for 250,000 people. These foreign workers act, however, more as substitutes to fill the demand for cheap labor that can be laid off easily during a bad time. This can lead to other problems such as competition between domestic and foreign workers, particularly during the recent crisis. When it is necessary to lay off workers, the simple economic principle of productivity and cost will be implemented thoroughly; for example, more Japanese temporary workers are let go because their hourly wage is higher.

To maintain the sustainability and competitiveness of the current strategic industries, a system of job allocation and diversification between domestic and foreign workers might need to be considered.

Recruiting foreign workers for both lower-tier and upper-tier jobs may help Japan to maintain its industry while creating a new strategic industry.

Lower-tier or less skilled jobs for foreign workers may become an alternative to an international outsourcing system of production. If some part of the production process can be returned home, it may add and revive Japan's domestic economic activity and consumption at the same time since foreigners seem to have a higher propensity to consume than Japanese do. Meanwhile, highly skilled foreign workers could be utilized to support the innovation and R&D needed for creating new strategic industries. Singapore's recent strategy to hire and provide an unlimited research budget for the best researchers around the world is a good example of a strategy to search for new industries for the economy.

Fierce competition in the midst of globalization has pushed every country to continue updating its strategy. This is not to say that Japan has to move completely from its current strategic industries such as automobiles or machinery. In my opinion, however, a shift into a more aggressive management style, active innovation and a less duplicable high-tech product-oriented industry seems to be unavoidable. Maintaining the strength and sustainability of recent strategic industries while preparing for a higher level of economic activity or industry is the key. Regaining the previous glory of the mature industrial economy might be very challenging, but, in any case, redefining the strategy for self-repositioning and efforts to maintain the level of nations' welfare should never end. **JS**

*Friska Parulian is associate researcher, Economic Research Institute for ASEAN and East Asia (ERIA). She has a Ph.D. in public finance from Hitotsubashi University, Tokyo.*