

Direction of METI Policies for Revitalization of Japan's Economy

By Yuya FUKUMOTO

The environment surrounding Japan's economy and society is growing increasingly severe, with problems such as the issue of energy supply resulting from the Great East Japan Earthquake in March 2011, and the recent sudden high yen rate. Also, in the mid term, through a decrease in the potential growth rate because of population decline and the aging society, there is concern that it will be difficult for Japan to achieve the kind of advanced growth it did in the past.

In order to overcome these difficult conditions and maintain a thriving society, we need to establish measures to create new industries, after clarifying how Japan can earn revenue and how it can employ people in the future. Based on an awareness of these issues, the Ministry of Economy, Trade and Industry (METI) established the New Industrial Structure Committee in the Industrial Structure Council, which is an advisory organization to the Minister of Economy, Trade and Industry. The new committee listened to the views of experts and industry and considered the ideal state of future economic and industrial policies, and issued an interim report last December.

The interim summary indicates the creation of new industries to stimulate potential domestic demand, and the direction of measures to revitalize the Japanese economy, through steps to respond to global demand. Below I will explain the outline of the interim summary.

Japan's "Endurance" & "Diminishing Equilibrium" Economy

The Japanese economy in recent times has been a "restraint for restraint's sake" type of economy maintained by a "diminishing equilibrium" with a lowering of added value produced by corporations, a worsening of the employment environment and drop in labor income, an increase in concern about the future and in the precautionary savings of working households, a fall in domestic consumption, and a decrease in investment because of deflation.

First, as the domestic market is hitting a slump because of deflation, corporations are continuing an "endurance" kind of management that conducts price competition by controlling wages and investments, while their power to create added value is dropping. Also, in spite of the fall in employees' wages, the reality that Japan's labor distribution ratio has reached a peak, with the

added value created by companies being at a low, is the cause of the worsening employment environment and the slump in labor income.

In these circumstances, consumers' wages are not rising, and people are holding back on consumption. In particular, along with the increase in those who feel concern about their old age, the rate of savings of salaried-worker households is increasing, and the Japanese people are also holding back on consumption because of concern about their post-retirement lifestyles. This slump in national consumption lengthens deflation, and leads to further "perseverance."

In this way, as both companies and consumers earnestly continue with perseverance, the result is a vicious circle of diminished equilibrium, with the nominal GDP having shrunk to almost 40 trillion yen in three years. Indeed, Japan's economy can be described as having fallen into "a vicious circle of diminished equilibrium and dwindling."

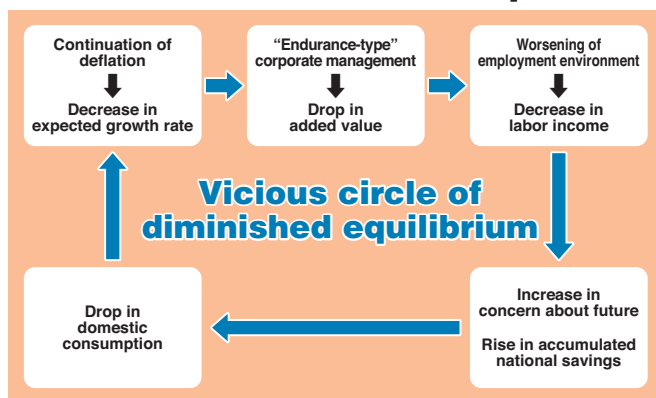
Risks Japan Faces if Current Conditions Continue – Concern that Japanese People's Daily Lives Will be Severely Affected

If the current diminished-equilibrium scenario remains as it is, there is concern that Japan risks facing: 1. a deep-rooted hollowing-out, including that of the materials manufacturing industry, resulting from the continued high yen rate, and 2. reaching the limit in domestic consumption of national debt because of the savings investment balance incurring a loss.

In the worst case, the leeway for national debt will disappear, and along with causing a rise in long-term interest (decline in bond prices), high inflation, and a dramatic low yen rate through sudden Japan-selling, there is concern that this could also result in painful effects on the daily lives of the Japanese people, such as a dramatic drop in the asset value of pensions, and a high unemployment rate.

CHART 1

Vicious circle of diminished equilibrium

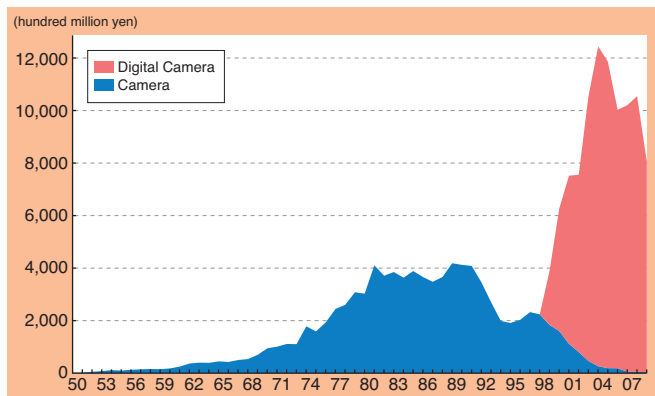


Source: Interim Report of New Industrial Structure Committee, Industrial Structure Council, METI

CHART 2

Discovering potential digital camera market

Value of shipped cameras



Note: Camera Data, from 1967 onward, 35 mm or above.

Source: Compiled Based on "Product Innovation & Economic Growth," Ando et al, RIETI Policy Discussion Paper. Original Data from Industrial Statistics, METI

Accordingly, for a while, to get through this period until the transition to a low yen rate, it is essential to implement "protective" anti-hollowing-out measures and appropriate macroeconomic management. Especially, we need to pay attention to the increase in the short-term public burden, the worsening of the euro debt problem, and the increase in fuel imports because of curtailment of nuclear power production.

Specifically, when implementing countermeasures for such a "protective" hollowing-out, including addressing the high yen and domestic location of businesses, along with measures for the long term (in units of several years) such as reducing corporate tax rates and promoting economic ties with major countries, there is a need to clearly state a time frame for their implementation. In addition, it is also important to implement appropriate macroeconomic management, starting with conquering deflation and resolving the issue of the high yen rate.

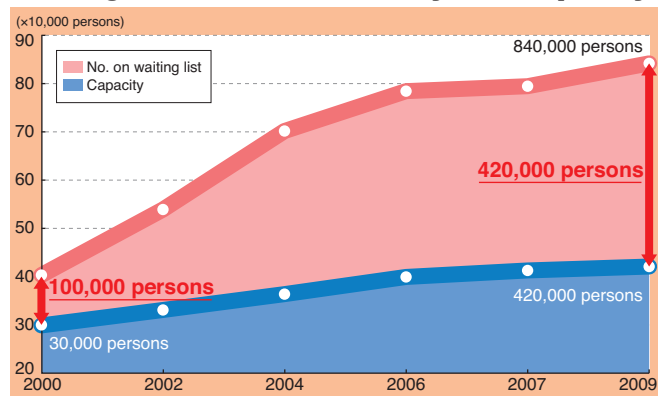
Transformation to "Value Creation Economy" – Direction of Economic & Industrial Policies

However, if we use only these "protective" measures, we will be unable to escape from the vicious cycle of diminished equilibrium in the Japanese economy. While conducting appropriate responses to the risk of hollowing-out because of an excessively high yen, we also need to create new domestic industrial fields through countermeasures over the mid and long terms, and to create new added value and transform the Japanese economy into one of expansion.

In the postwar era, the Japanese economy has realized rapid economic growth by implementing mass production and competition at low cost, establishing Japan as an economic powerhouse. However, today, when we are experiencing the rapid catching-up of newly emerging economies (NEEs) with their dramatic growth, Japan is now facing the end of the period when it could compete simply through mass production and low pricing. We must aim for transformation to a "value creation economy" that develops by creating new added value, such as competing in non-price areas (selling goods even if they are expensive), or by creating new industries that are able to respond to the needs of people within and outside of Japan. To this end, we must proceed with discovering potential domestic demand and responding to global demand, thus focusing on both domestic and international demand, through "aggressive" policies.

CHART 3

Trends of people on waiting lists for special nursing homes for the elderly and capacity



Source: Interim Report of New Industrial Structure Committee, Industrial Structure Council, METI

Creation of New Industrial Fields to Discover Potential Domestic Demand

First, there is a need to create new industrial fields to discover potential domestic demand. For sustainable economic growth, it is essential to expand while maintaining a good balance between domestic and foreign demand. Especially, although exports and foreign investment are important ignition points for economic recovery, it is only when these measures to respond to global demand tie in to expansion of domestic demand, such as through growth in workers' income, revitalization of individual consumption, and stimulation of domestic demand, that economic growth that achieves prosperity for every citizen can be realized.

Although Japan succeeded in conducting measures for the international market, particularly Asia, in the 2000s and expanded exports and domestic investment, the slump in worker income and private consumption continued, and the positive international demand did not lead to expansion of domestic demand. I believe that this was because, as I mentioned earlier, companies and individuals cut back on investment and consumption, and the economy as a whole fell into a "perseverance for its own sake" kind of vicious circle of diminished equilibrium.

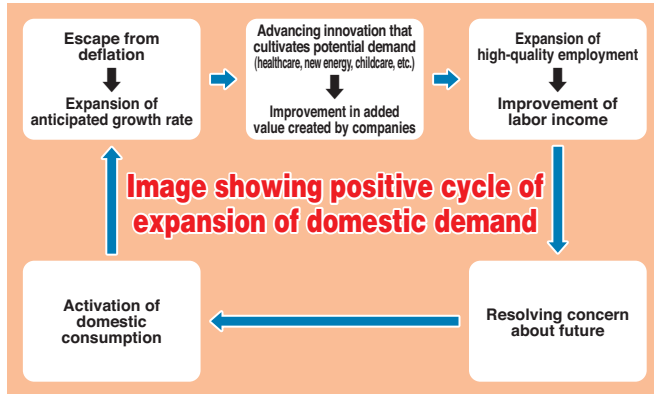
In order to break out of this vicious circle, it is important for companies to create value, in other words, to discover potential demand and provide new products and services. Some hold the view that Japan's economy and society have achieved maturity, and its people no longer desire things, but there are not a few cases where even markets that at first glance appeared saturated have been revitalized as a result of corporate efforts.

For example, in the earlier years of this century, through the advent of revolutionary products such as crystal display televisions and digital cameras, the already-saturated television and camera markets expanded dramatically. Also, as a result of the removing of a ban on sales of health drinks in general retail stores in 1999, the overall health drink market expanded hugely. These are both good examples of the stimulating of potential domestic demand through innovation.

From now on Japan is expected to become a society with a declining population and an aging society. In these circumstances, a large potential demand can be expected in products and services for older people and working women. For example, in the fields of care-giving and child care, because of regulations and financial limits, the

CHART 4

Positive cycle of domestic demand expansion



Source: Interim Report of New Industrial Structure Committee, Industrial Structure Council, METI

supply can be seen as too little in relation to the potential demand. In the care-giving field, the number of people on waiting lists for special nursing homes for the elderly increased from 100,000 in 2000 to as many as 420,000 in 2009. In the childcare field, the number of children on waiting lists is officially about 26,000, but the potential number is said to be actually about 850,000 to 1,000,000.

In fields where, although there is a large demand, supply is unable to keep up, where it is difficult for new entrants to provide services to meet the demand because of regulations, and where there are social issues such as fewer children, greater aging and energy supply and demand restrictions, there is likely to be a considerable potential domestic demand.

The Japanese government, through regulatory reform and support of innovation, will assist the creation of new growth industries that discover potential domestic demand. In particular, fields that have large potential domestic demand include health care, child-rearing services, new energy industries, and creative industries.

Specifically, we will advance measures that promote lifestyles and innovation, such as reform of regulations and systems in order to achieve healthcare and child-rearing support services that meet diverse needs; enhancing practical use of care-giving and welfare robots; and establishing tie-ups between medicine and industry and implementing regulatory and systemic reforms to strengthen the

international competitiveness of the pharmaceutical goods, medical products, and regenerative medicine industries.

Concerning the creation of new energy industries, we will advance measures such as raising the minimum energy-saving performance of residences and buildings through improving the Energy Saving Law, considering a review of the location regulations related to wind-power generation and geothermal power generation, and promoting smart communities. By advancing stimulation of potential demand through measures such as these, a “positive cycle of expansion of domestic demand” featuring ① improvement in the added value created by companies, ② expansion of good-quality employment and increase in worker income, ③ resolving of concerns about the future, ④ activation of domestic consumption, and ⑤ escape from deflation will be realized, enabling the realization of sustainable economic growth in the future.

Global Demand Measures

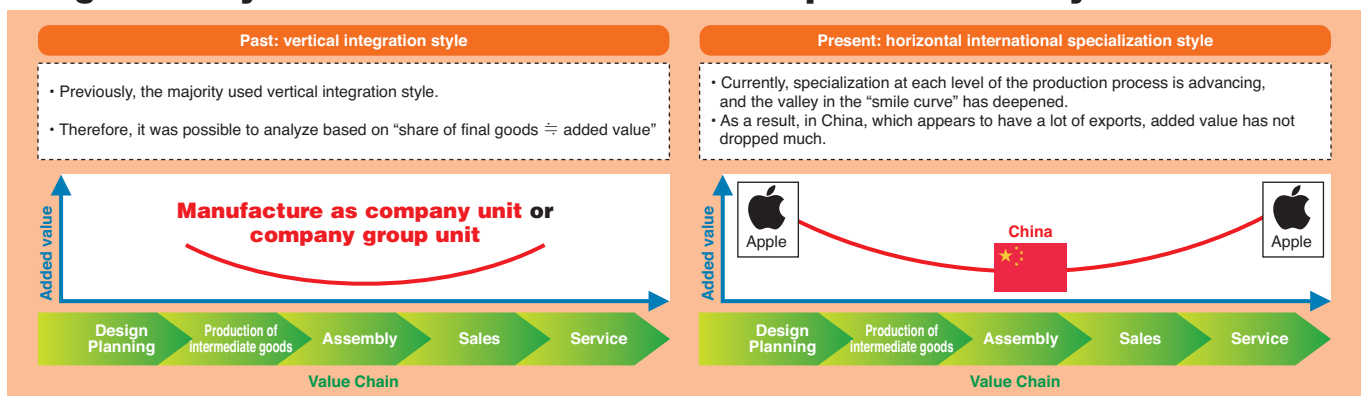
Secondly, we must create measures to meet global demand. It is important to ensure high-quality employment, by tackling global demand in fields where Japan has an edge, and feeding the resulting profits back to Japan.

In recent years, along with globalization and the spread of IT, international specialization that crosses national boundaries has been progressing. Business models are changing dramatically, from the vertical integration style that Japanese companies excelled in before, to the horizontal international specialization style whereby specialization takes place at each stage of the production process. In these conditions, the pivotal point of the competitive strategy of companies and industries lies in the extent to which they can obtain high added value. For example, Apple can introduce specialized processes that produce high added value, while for manufacturing processes with low added value, by outsourcing to Japanese, South Korean and Chinese companies, high added value can be gained. The upstream/downstream parts of the value chain play an important role, and the valley in the “smile curve” is deep.

Among Japanese companies there are several that are responding to these changes and creating high added value. Even with the


CHART 5

Comparison of weight of source of high added value between vertical integration style and horizontal international specialization style



Source: Interim Report of New Industrial Structure Committee, Industrial Structure Council, METI

“Cool Japan” spreads through the world

| Anime, manga | Food culture | Delivery services | Ryokan (traditional Japanese inns) | Traditional crafts |
|--|---|--|---|---|
|  <p>About 200,000 people attended the Japan Expo held in Paris from June 30 to July 3, 2011.</p>  <p>The New York Anime Festival, held in New York, October 8-10, 2010, had about 18,000 visitors.</p> |  <p>Pork soup noodles (tonkotsu ramen) from Kumamoto has entered China, and is currently in 63 cities there.</p> |  <p>Thoroughgoing Japanese service, including features such as choice of delivery time and special service for refrigerated items, is highly regarded in China.</p> |  <p>A ryokan from Ishikawa has opened in Taipei, showing the Japanese “spirit of hospitality” in Taiwan.</p> |  <p>Make-up brushes from Kumano (Hiroshima) are very popular overseas, including in Hollywood, and have many fans.</p> |

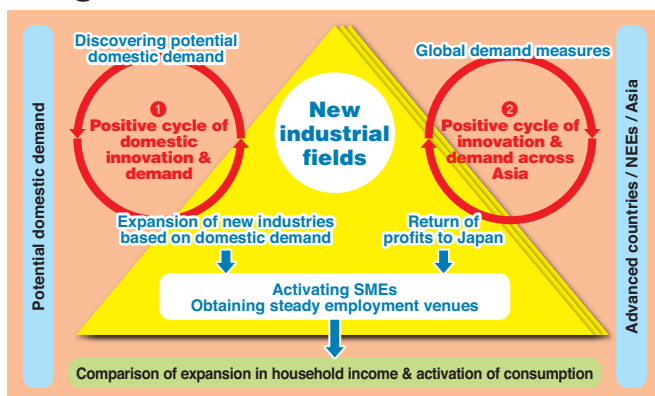
Source: Materials from 1st Meeting of New Industrial Structure Committee, Industrial Structure Council, METI

sudden high yen rate and severe international competition, there are many “active companies” that are gaining high profits and providing a venue for high-quality employment. Ways of earning money vary from company to company, and it is difficult to categorically describe their types. However, what they have in common include many examples of business development that features thorough responses in relations with customers and clients, such as at the stage of planning and development and in post-purchase maintenance, that is, business operations that build on Japanese strengths.

Examples include system-type infrastructure and second-generation cars, branding, and niche-type high-function materials, all business areas that have achieved high added value within international specialization. In this way, exporting as packages infrastructure and systems that are competitive not because of their low prices but because they have high reliability overall, is one possible way to achieve global demand.

Also, Japanese anime, manga and fashion have a high degree of popularity throughout the world, and considerable global demand can be expected in this field of “Cool Japan” by exporting such elements of Japanese values and lifestyles. Cool Japan is also a good example of a new Japanese industry field that has established value on its home ground as well, and that earns inbound profits.

Image of economic vitalization



Source: Interim Report of New Industrial Structure Committee, Industrial Structure Council, METI

The Japanese government, in order to encourage Japanese corporations to create global demand and improve added value, will provide support for the overseas development of Japanese companies, not only those in manufacturing but also in the service industries. It will also help in the domestic location of R&D bases to encourage the flow of profits earned overseas back into Japan. We will also advance the export of public-private joint infrastructure and systems, a comprehensive international standards strategy, and measures for establishing bases in Asia.

Through such steps we can better respond to global demand, including growth in Asia and NEEs, and so the added value produced by corporations will increase. Returning the resulting profits made overseas to Japan will result in attracting investment in facilities and in R&D as well as increased domestic employment and higher wages, stimulating consumption and reactivating the Japanese economy.

Conclusion

In order to draw out the potential of SMEs, which support the Japanese economy, along with advancing support for their active overseas development, we will promote the strengthening and transmission of the technological strength of manufacturing SMEs. We will promote through both by the public and private sectors R&D in second-generation technology that focuses on the practical use of basic research, in particular material and technological R&D that strengthens cutting-edge industries such as next-generation vehicles, airplanes, and the space industry. Also, we will further innovations that utilize IT and the training of personnel who can support the transition to a corporate structure appropriate to globalization.

In the above ways, working towards the revitalization of a strong Japan, METI will advance economic and industrial policies that focus on both domestic and international demand. In conjunction with related ministries and agencies, we will do our best to see that all Japanese people can experience growth.

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