

White Paper on International Economy & Trade 2016 — Summary

By Policy Planning & Research Office, Trade Policy Bureau, Ministry of Economy, Trade & Industry (METI)

Capital Investment-driven Economic Growth in China

Although the expansion of investments in China and other emerging countries led the global economy amid the slowdown in advanced countries after the global economic crisis, excess debt has arisen as a result of capital investment-driven economic growth. In addition, excess capacity is becoming increasingly prominent. The ratio of capital investment (gross fixed capital formation) to GDP in China is 44.0% (2014), higher than the levels seen in major advanced countries in their periods of high growth. While China's share of global capital investment is 24.4%, its share of final consumption is only 9.3% (2014) (*Chart 1*).

Excess Production Capacity & Increase in Trade Restrictive Measures

The gap between production facility capacity and actual production is prominent in such sectors as steel, chemicals and liquid crystal displays, with producer and export prices falling. Compared with the rate of growth in crude steel production capacity in China, the rate of growth in production volume is moderate. Capacity utilization has been on a downtrend, falling to 71% in 2015 (*Chart 2*).

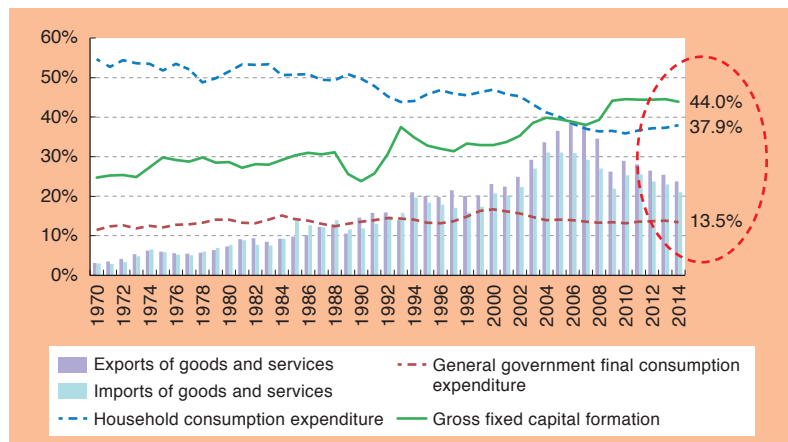
Since the early 2000s, the number of anti-dumping measures taken around the world has been decreasing as a trend, but it is starting again to increase, mainly in the base metals and chemicals sectors.

Falling Resource Prices & Economic Slowdown in Resource-producing Countries

Resource-producing economies recorded accelerated growth due to the expansion of demand for resources in emerging countries, but they are

experiencing an economic slowdown because of a steep fall in resource prices caused by an increase in supply due to such factors as the global economic slowdown and the shale revolution. Although resource-producing countries such as Russia and Brazil have

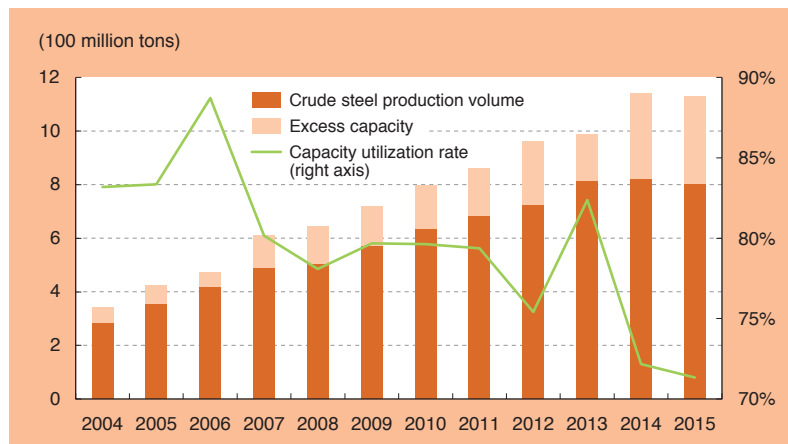
CHART 1
Changes in GDP by expenditure in China



Note: Among major developed countries, Japan and Germany saw their ratios of gross fixed capital formation to GDP peak at 36.4% in 1973 and at 30.0% in 1971, respectively.

Source: Prepared by METI, based on UN National Accounts Aggregates Database

CHART 2
Crude steel production capacity & capacity utilization rate in China



Source: Prepared by METI from industry data and reference materials released by the National Bureau of Statistics of China

achieved economic growth in line with an expansion of demand for resources, they have turned to negative growth as resource prices have started to decline (Chart 3).

Structural Reform Initiatives in Emerging Countries

While the Chinese government is implementing structural reforms to shift from an investment-driven economy to a consumer-driven economy and is upgrading its industries, resource-producing countries such as Saudi Arabia are also starting structural reform initiatives. R&D expenditures in China have continued to increase both in absolute amount and as a ratio to GDP. In 2015, the ratio to GDP came to 2.1%, surpassing the ratio for the United Kingdom and close to the ratio for France. Under the “Made in China 2025” strategy, announced in 2015, the Chinese government aims to upgrade the manufacturing industry, for example by promoting innovation and integrating information technology into the manufacturing industry.

Expansion of Economic Relationships Between Emerging Countries

In terms of production, China’s presence is growing. Whereas Japan, the United States and Germany were previously major export sources of value added in final demand for other countries, China’s weight as an export source of value added is increasing. Although China overtook Japan in terms of share in the value of nominal US imports in 2002, Japan continued for a while to virtually provide value added through exports of parts and the provision of licenses to China. Later, as the share of value added in China continued to rise, China also surpassed Japan in terms of share in US imports of value added around 2006.

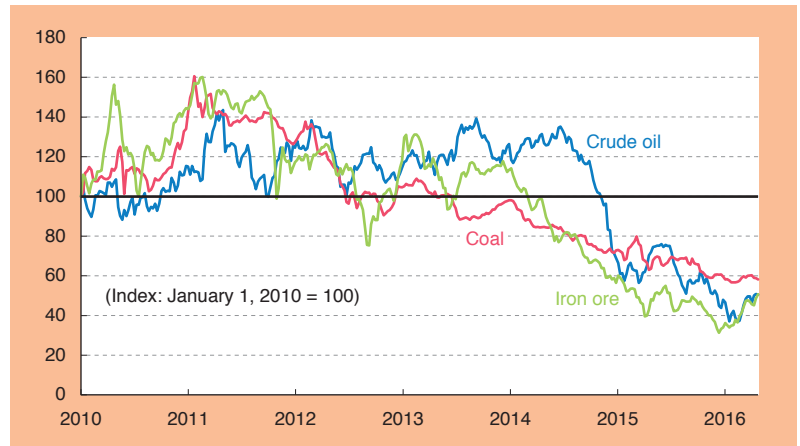
Worldwide Declines in Total Demand & Potential Growth Rate

Since the global economic crisis, advanced countries have stayed in a state of negative GDP gap, which means that the total demand is smaller than the potential supply volume, so their economic growth has slowed down. According to an estimate by the OECD, although the GDP gap in OECD member countries has gradually been turning toward the positive column, it was still in the negative column, at -1.17, in 2016. The potential growth rate also has been on a downtrend due to low investments and the aging population (Chart 4).

Toward Expansion of External Economic Relationships

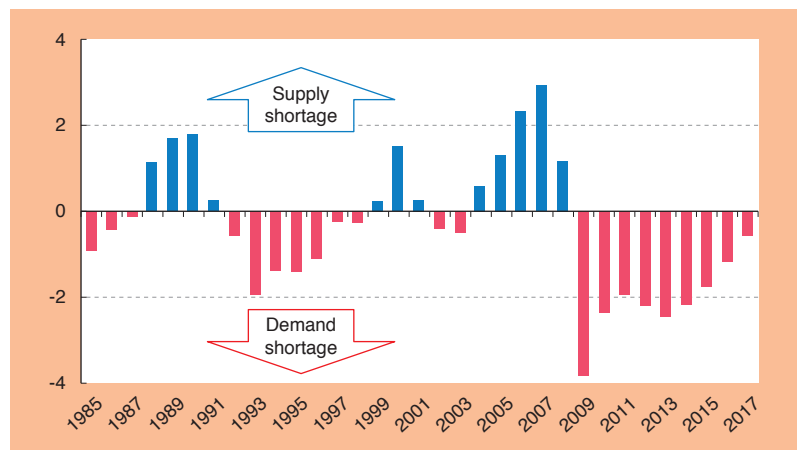
While many major OECD countries are pursuing economic growth through the expansion of exports, the ratio of exports to GDP (export ratio) for Japan is low and the growth in the ratio is also low. The goods export ratios for the Republic of Korea (ROK) and Germany are relatively high, at around 40%. In the case of Germany, the export ratio excluding exports to other EU countries is still higher than the export ratio for Japan. The ratio of services exports to GDP is high for the UK. As in the case of Germany’s goods exports, the UK services export ratio excluding exports to other EU countries is still higher than the export ratio for Japan.

CHART 3
Changes in prices of major commodities



Source: Prepared using Thomson Reuters EIKON

CHART 4
Changes in the GDP gap in OECD member countries



Source: Prepared by METI, based on OECD Statistics

Worldwide Expansion in Services Trade

While goods trade has slowed down around the world, services trade is steadily growing. Telecommunications, computer and information services, construction services, and professional services are recording particularly high growth rates, leading the entire services trade. The size of the global market is \$1.2 trillion for travel services and \$1.1 trillion for consulting and other business services (Chart 5).

in advanced countries, this may include cases in which value added is shifting from the simple sale of goods to data through the use of big data analysis. In Japan, too, it is becoming increasingly important to develop a new business model that strategically links the strengths of the manufacturing industry with data obtained from things.

Toward Expanding Japan's Services Exports (i)

Japan's services exports by sector are low compared with exports by other major countries. Although the export ratio of professional services is high for some other advanced countries, including several European nations and India, the ratio for Japan has remained low. Emerging countries such as India have increased their export ratios through outsourcing contracts with advanced countries (Chart 6).

Toward Expanding Japan's Services Exports (ii)

In many sectors, the services export value for Japan is low compared with the values for other major countries. The export ratio of financial services is high for the UK and the export ratio of transportation services is high for the ROK, while the export ratios of these services for Japan have remained low compared with the ratios for other major countries. The export value of fees for the use of intellectual property rights, including licensing fees, is high for Japan due to receipts of such fees from overseas subsidiaries.

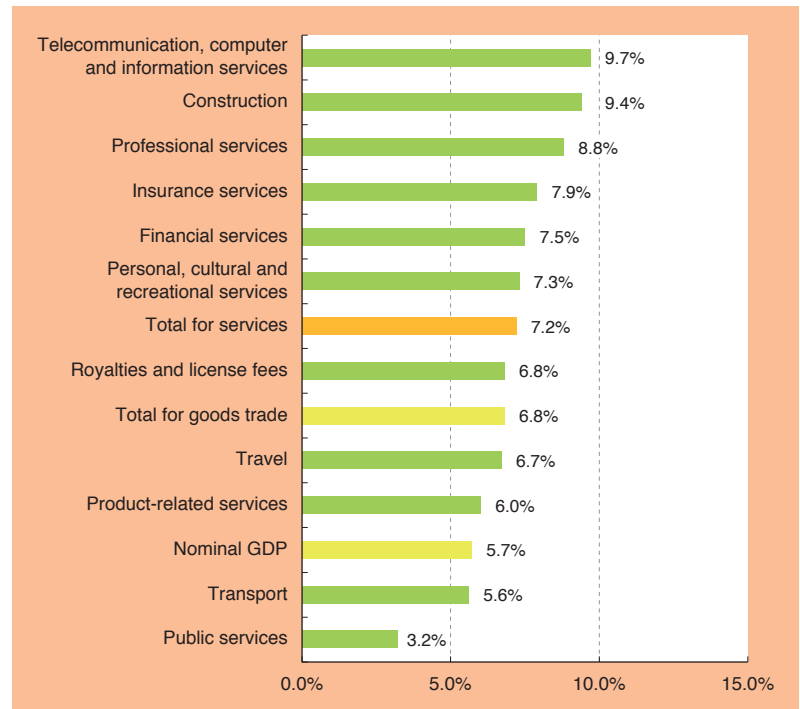
Advance of Information & Communications Technologies & New Services

In the "telecommunications, computer and information services" sector, the overall growth rate is high, with new services arriving in both developed and emerging countries against the backdrop of the advance of information and communications technologies. The export ratio of telecommunications, computer and information services to GDP is high for India and major advanced countries.

While the growth of cross-border trade in repair and after-sale services related to goods is prominent

CHART 5

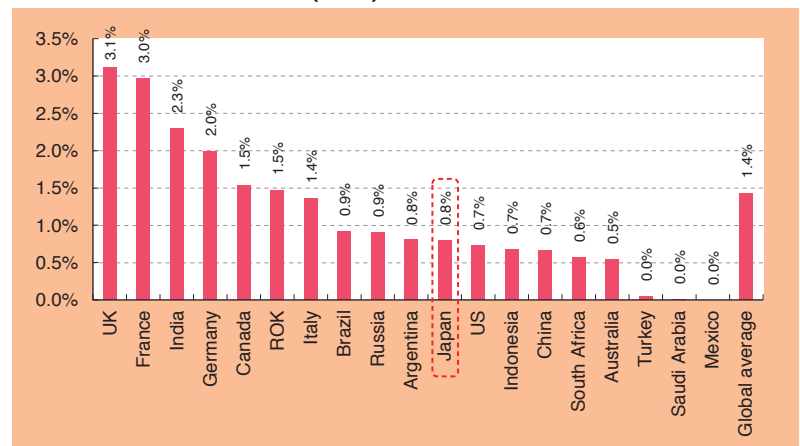
Growth rates of global services exports (2005-2014)



Note: "Professional services" refers to "other business services".
Source: Prepared by METI, based on WTO Statistics, UN National Accounts Aggregates

CHART 6

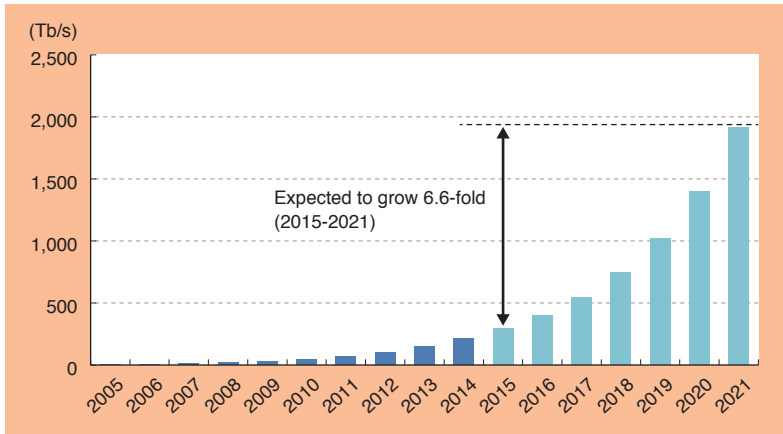
Export ratio of professional services to GDP in G20 countries (2014)



Source: WTO database, UN "The National Accounts Main Aggregates Database"

CHART 7

Rapid expansion of global data flow
(prerequisite for a digital revolution)



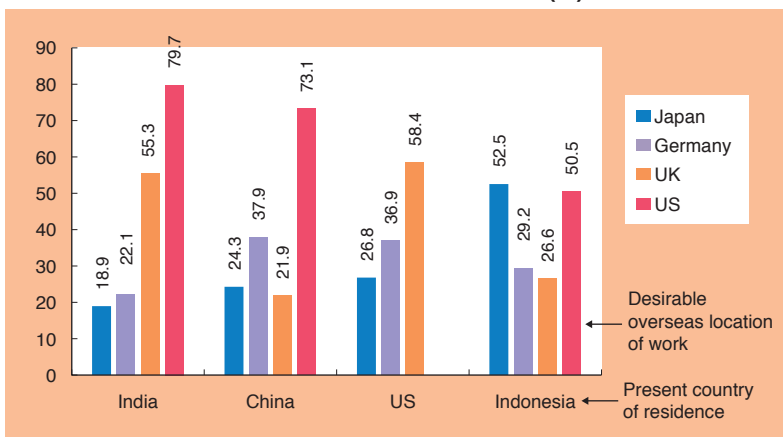
Note: The figures for 2015 and later are forecasts.
Source: Edited by METI from "Digital Globalization: The New Era of Global Flows" (McKinsey Global Institute, 2016)

Trade Policy Challenges Toward the Digital Revolution

While there are signs of change in the industrial structure, such as the entry of IT companies into such sectors as autonomous driving and financial services and the arrival of product-related services based on big data analysis, it is necessary to respond to new trade policy challenges, including the free distribution of information. As global data flow is expanding explosively due to the advance of information and communications technologies, ensuring the free flow of data has become a prerequisite for the digital revolution, as exemplified by the entry of IT companies into such sectors as autonomous driving and financial services. The TPP lays down such rules as non-taxation of cross-border electronic delivery in order to facilitate free distribution of information (Chart 7).

CHART 8

Countries where IT-skilled people from various nations desire to work (%)



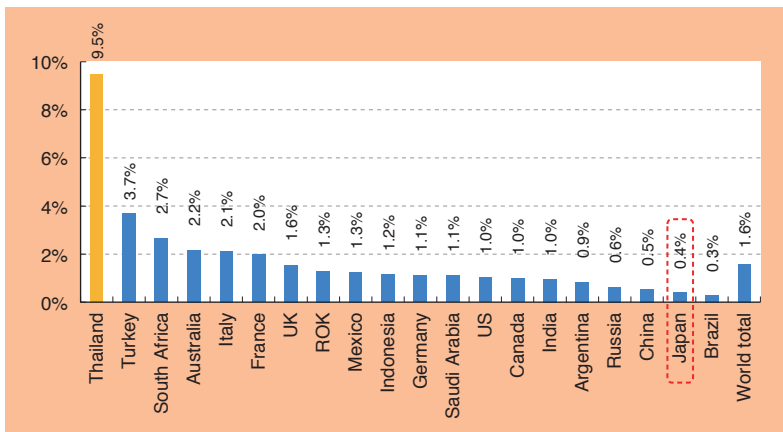
Note: The country names refer to countries where the respondents desire to work.
Source: Prepared by METI from "International Comparison Concerning IT-skilled People"

Securing IT-skilled People Essential to Digital Revolution

Although new services taking advantage of information and communications technologies require competent IT-skilled people, few foreign IT-skilled people desire to work in Japan. Possible factors behind this may be low levels of job satisfaction and salary (Chart 8).

CHART 9

Export ratio of travel services to GDP (2014)



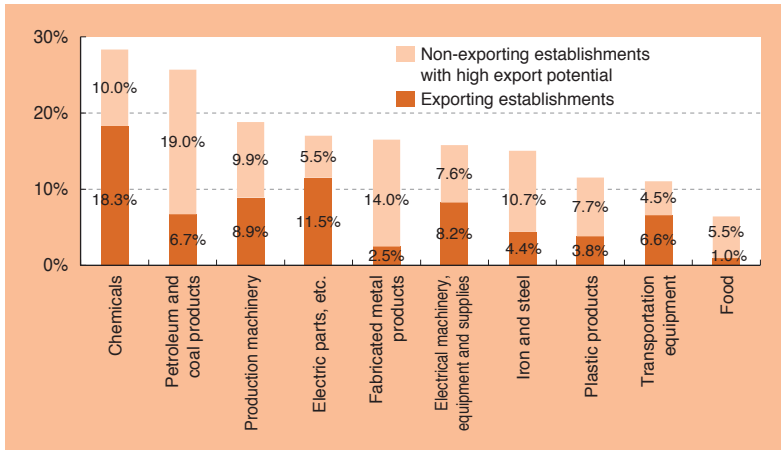
Source: Prepared by METI, based on World Bank, Japan National Tourism Organization, World Tourism Organization

Global Trend in International Travel & Tourist Visits to Japan

Despite the recent increase in visits to Japan, the ratio of travel service receipts to GDP for Japan is low. The challenge for Japan is to attract many long-term stay visitors from various regions, as Thailand is doing, in order to increase tourism revenue. As already mentioned, tourist receipts are the largest item of services trade, whose market size is \$1.2 trillion. However, the export ratio of travel services to GDP for Japan is lower than the ratios for other major countries. Thailand, which has been successful in attracting tourists, has been increasing tourism revenue by attracting more long-term stay visitors. For example, a comparison of UK tourists to Thailand and Japan shows that the average number of days of overnight stay per person as well as the number of tourists is larger for Thailand, contributing to an increase in tourism revenue (Chart 9).

CHART 10

Proportion of non-exporting establishments with high export potential in all manufacturing establishments



(Concept) Establishments which are not engaging in exports but which have higher productivity (value added per employee) than exporting establishments in each

Source: Prepared by METI, based on "Census of Manufacture" (METI)

Current Status of Germany, Where Exports by Regions Are Robust

In German states, the manufacturing industry has a higher export ratio than in Japanese regions, indicating a stronger inclination to capture foreign market shares. Among all prefectures in Japan, Hiroshima has the highest export ratio, but it is lower than the ratio in Thüringen, which has the lowest export ratio of all German states. In Japan, exports declined in 33 prefectures, around 70% of all prefectures, around the time of the global economic crisis, while in Germany, exports increased in all states but one. In Germany, there was no region where exports declined steeply.

Increase in Exporting Establishments in Japan

In Japan, too, the proportion of establishments engaging in exports is rising in most major business sectors and regions, indicating that export competitiveness is expanding towards a wide variety of business firms, including small and medium-size enterprises (SMEs).

Value-Added Tourism Exploiting Local Resources

As tourists make repeated visits to Japan, the focus of expectations is shifting from shopping to cherry blossom viewing, skiing, hot spring bathing, and other cultural experiences. The challenge for Japan is to develop tourism with higher value added by exploiting local resources through guided tours of historical buildings, for example.

Japanese Exports Concentrated in Some Specific Sectors

Goods exports in 2015 amounted to 75.6 trillion yen, the largest value since 2009. However, the contributions made by transportation equipment and exports to the US were particularly large. The breakdown of Japanese exports by product item shows that while the shares of transportation equipment, general machinery and electrical machinery are large, transportation equipment has made the largest contribution to the growth rate of overall exports in the most recent five years. Among Japan's export destinations, Asian NIEs, the US and China have relatively large shares of 20% each, while the US has made by far the largest contribution to the growth rate of overall exports in the most recent five years.

The breakdown of the manufacturing industry's exports by domestic region shows that the growth rate is high in Hokkaido and Hokuriku. However, in terms of contribution to the growth rate of overall Japanese exports, the manufacturing industry's exports depend heavily on the Tokai-Koshin region, whose share of exports is large.

Non-exporting Establishments with High Export Potential

In addition, there are many non-exporting establishments with high export potential, mainly SMEs, so there is ample room for further expanding the export base. One of the challenges for Japan is making use of a newly-established "Consortium for New Export Nation". By sector, there are many such establishments in the petroleum and coal product manufacturing industry and the metal product manufacturing industry. As a ratio to exporting establishments, there are also many such establishments in the food manufacturing industry. By region, there are many non-exporting establishments with high export potential in Hokkaido (Chart 10).

Development of Overseas Sales Channels by SMEs

Making use of trading companies and online platforms, and cooperating with designers are effective for SMEs in developing overseas sales channels. In some cases, SMEs are promoting overseas sales of traditional craft products by developing design-oriented products that meet foreign customers' needs or by making use of online platforms. Many enterprises replied that they have saved necessary costs, including the costs of local information gathering and marketing, by using trading companies or wholesalers, so using such intermediaries is presumed to be effective in promoting exports. On the other hand, many enterprises are unable to find suitable trading companies or wholesalers, so the

challenge is promoting business matching by supporting the development of overseas sales channels, for example (Chart 11).

Challenge of Exploring New Frontier of Emerging Countries

While the proportion of the working-age population is starting to decline in East Asia, it has yet to peak in South Asia and Africa, indicating the high probability that the latter regions will take over the role of growth driver. With the advance of urbanization, demand will expand for both the development of new infrastructure and the maintenance and repair of existing infrastructure. While the urban population has grown rapidly in China since the 1990s, urbanization has yet to start in India and sub-Saharan Africa. With the advance of urbanization, demand will rise for both the development of new infrastructure and the maintenance and repair of existing infrastructure, mainly in the electricity and transportation sectors. The challenge for Japan is making further contributions to economic and social development through the export of “high quality infrastructure” and providing further support for Japanese companies’ overseas expansion (Chart 12).

Establishment of New Rules in TPP

The TPP was signed in February 2016. It establishes new rules in a wide range of fields in addition to tariff elimination in the market which covers approximately 40% of global GDP and approximately 30% of export value from Japan. The TPP provides various benefits to SMEs in a wide range of fields; such as elimination of tariffs, accumulation in rules of origin, liberalization of investment and cross-border trade in services, strong enforcement systems against counterfeiting and a new set of rules for e-commerce.

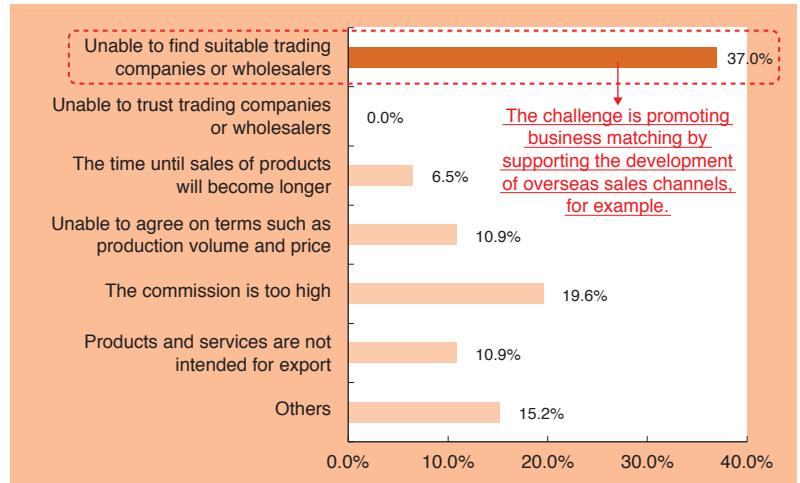
Pushing Ahead with Economic Partnership Negotiations & Utilization of WTO

It is important to push ahead with ongoing negotiations such as the Japan-EU EPA, the RCEP, and the Japan-China-Korea FTA to conclude comprehensive and high-level EPA/FTAs. There is a need to tackle new issues such as e-commerce in the WTO, and a need to conclude the negotiations on the Environmental Goods Agreement and Trade in Service Agreement as soon as possible, building on the momentum of the successful conclusion of ITA expansion negotiations.

Improvement of Investment Climate Through Promoting Conclusion of Investment-Related Agreements

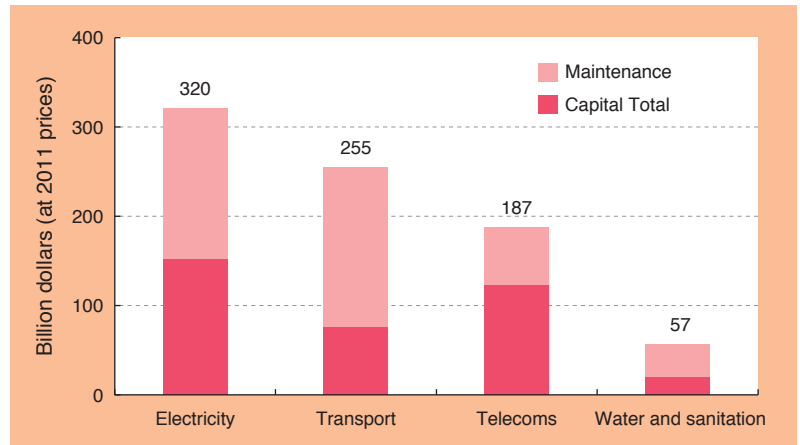
The “Action plan for improvement of the investment climate through promoting the conclusion of investment-related agreements” was formulated on May 11, 2016. The plan stipulates that the government i) aim for signature/entry into force of investment-related agreements with 100 countries/regions by 2020, and ii) consider inclusion of such sectors as trade in service and e-commerce in investment-related agreements. **JS**

CHART 11
Reasons for not using trading companies or wholesalers in exporting (manufacturing industry)



Note: Multiple answers
Source: Prepared by Teikoku Data Bank (2015) from “Questionnaire Survey Concerning Growth and Investment Behavior of SMEs”.

CHART 12
Forecast demand for infrastructure by sector in emerging & developing countries



Notes: Discounted present value of demand between 2014 and 2020
Source: Edited by METI from “Urbanization Prospects” (United Nations Population Prospects), “Infrastructure Investment Demands in Emerging Markets and Developing Economies” (Fernanda Ruiz-Nuñez and Zichao Wei, 2015)