

The Service Sector Is Key to Revitalizing the Japanese Economy

By Naoyuki Haraoka



This issue highlights JEF's recently published study report on Japanese service sectors, their challenges and opportunities. This study was started due to concerns that the Japanese economy would decline with the current trend of economic growth and continuing depopulation. With rising geopolitical risks in today's world, a smaller economy means a smaller political presence, which could lead to security risks as well, and a loss of political impetus. Our initial question in starting this study was whether the service sector in Japan could allay these concerns with its high potential growth. Our answer is yes, as far as the four sectors examined in this study are concerned.

This story can be also applied to the context of the balance of payments, another critical economic indicator showing a risk of crisis. The balance of payments is an indicator of the stage of economic development. It mainly consists of the trade balance of goods and services and the income balance of direct investments and portfolio investments. At a primary stage of economic development, starting with agriculture and other primary commodities as sources of growth, a country's current balance is in deficit, with a heavy trade deficit in goods and services and no FDI. With the beginning of industrialization, a country's trade deficit decreases and eventually its trade balance turns into a surplus, as progress in industrial development continues and its manufacturing industry's exports increase with its competitiveness

enhanced. Towards the end of the country's industrial development, it would enjoy a high trade surplus in goods offsetting any deficit in the income balance caused by the low FDI at the early stage, thus creating a high current surplus eventually.

This was particularly seen in the period from the 1970s until the 1990s in Japan. As a country moves towards a more mature developed stage, its current balance changes. Japan's trade balance of goods and services is at present in deficit, but its current balance records a tremendous surplus, since its income balance is significantly higher due to the increase in Japanese subsidiaries abroad earning growing income in their host nations.

This trend will continue for a while. But with declining competitiveness in their goods and services and declining overseas business activity due to an incapacity to attract host countries, their income surplus would decline and their current balance would fall into deficit. In the case of Japan, this would be a critical outcome, since it would mean they have twin deficits, one in the fiscal balance having already reached a tremendous amount and the other in the current balance. A twin deficit would truly be a warning of economic catastrophe.

The Japanese service sector has a good potential to avoid this crisis, as it has a great capacity for sustainable competitiveness that could turn Japan's current trade balance into a surplus. All four sectors



which this issue highlights could contribute to this: IT software, tourism, entertainment, and medical services. Our policy recommendations from the study report show that each of them has a great potential for internationalization. As these sectors in Japan have been in essence domestic businesses and have failed to interact with the world, they have missed a great global business opportunity until now. Through enhanced trade, investment, and business collaboration with overseas counterparts, they could earn great benefits and contribute to a current surplus. Our experts discuss how to achieve this through business efforts and public policy in this issue. I think the key is how to develop human resources in each sector with international capabilities, such as speaking English and knowing how to adapt themselves to global communities.

Following the introduction of policy recommendations for building up a competitive service industry and a roundtable on the recommendations by several experts who helped in drafting the report, our invited authors argue about further details on how to tackle the challenges faced by the various service sectors and make them competitive. Dr. Masayuki Morikawa from Hitotsubashi University is the most distinguished academic leader in this domain and his article focuses on how to raise productivity in the Japanese service sector. Dr. Yuji Yoshimura from the University of Tokyo discusses

how a digitalized city building plan could be devised in advance to promote sustainable tourism and stop overtourism. Dr. Nobuko Kawashima from Doshisha University discusses how to follow up and complement the “Cool Japan Strategy” to boost Japanese entertainment services, and Dr. Fumiaki Ikeno from Stanford University highlights the role of entrepreneurship in turning the Japanese medical device industry into an internationally competitive one.

Overall, it should be noted that we must give up our received ideas in order to achieve great success in the service sectors. For example, in Japan, vegan and vegetarian restaurants are not popular yet, though they would be a key to attracting many more tourists to Japan. With more allowance for private medical insurance to cover foreign patients who are not covered by the Japanese public insurance system, we could expand medical tourism. A slight change of mindset could lead to great business success.

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