

# White Paper on International Trade 2004 – Toward a “New Value Creation Economy” –

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## Introduction

The *White Paper on International Trade 2004* focuses on the theme of transition to a “new value creation economy.” Unlike the conventional economy, in which power resides in capital, land, equipment and other tangible assets, power will reside in knowledge, human resources, patents, know-how, brands, innovative power and other intellectual assets in the new value creation economy. In the new value creation economy, competition will revolve around how we go about obtaining intellectual assets. Japan’s economic indicators have been showing good signs since last year. To ensure that this economic recovery stays on track, corporations, communities and individuals will all have to take steps to accommodate the new value creation economy and increase the resilience of Japan’s economy. This *White Paper* argues that our national government will have to create an environment to promote this effort.

The *White Paper* is divided into three chapters. Chapter 1 starts with a description of economic globalization and changes in the associated macroeconomic mechanisms, and then goes on to argue that the activities of corporations and other microeconomic factors are playing at least a partial role in bringing about these changes. Chapter 2 argues that corporations, communities and individuals must carry out value creation that capitalizes on the intellectual assets mentioned above, and then goes on to describe the various policies needed for such value creation to take place. Chapter 3 presents a concrete analysis of intra-regional trade and the division of labor in East Asia. This chapter argues that the establishment of economic partnership agreements (EPA) and other factors are expected to bring increased East Asian economic integration, as well as greater intra-regional trade and division of labor, and further examines the expanded role for intellec-

tual assets and changes in the competitive environment, and what these mean to the competitive position of the Japanese economy and Japanese corporations in the East Asian region.

## Chapter 1: Globalization and Macroeconomic Trends

This chapter examines the macroeconomic changes taking place amidst economic globalization, focusing especially on: disinflationary trends; the weakening relationship between economic recovery and job creation; the structural trend toward increased productivity; and the occurrence of imbalances. The common denominator for all of the above, we believe, is the fact that phenomena observed at the macroeconomic level are being brought about at least in part by changes in corporate activity and other microeconomic factors.

### Section 1: Globalization and Changing Macroeconomic Mechanisms

In tandem with the expansion of market economies, cross-border corporate activity has picked up in recent years. The global movement of people, goods and capital continues to expand. Moving along on a parallel track with this economic globalization, the short-term GDP volatility of developed nations is on a downward trend. This trend, together with a sustained disinflation that has been observed over the same time period, is known as “the Great Moderation.” This section will focus especially on the relationship between disinflation and the competitive corporate environment.

One disinflationary factor has been the impact of import goods on domestic markets, i.e. large quantities of inexpensive goods that subject domestic goods to severe price competition. It can be said that the need for domestic products to compete with imports has exerted downward pressure on prices in domes-

tic markets. This phenomenon is common to both Japan and the United States, but in Japan there are other factors pushing down prices, such as deregulation and dramatic changes in the distribution sector.

Amidst the intense price competition, many corporations have taken measures to cut labor costs. Especially in recent years, corporations have refrained from rushing into large-scale hiring, despite being profitable. This is thought to have had an adverse impact on the employment situation. Economic recovery without an attendant recovery in employment has been observed in both Japan and the United States. (Figs. 1 and 2) Moreover, a sector-by-sector comparison of employment trends in 1980 and 2000 reveals a big jump in the number of sectors experiencing a structural reduction in employment unrelated to down or recovery cycles. On the whole, employment can be said to be on a downward trend.

Nevertheless, a look at individual business categories and business models reveals that there are some companies creating jobs. There is a limit, of course, to our ability to ascertain the relationship between individual business categories/business models and job creation simply by looking at the currently available statistics, but as will be discussed in Chapter 2, the first step in evaluating the role of human capital in creating value is looking at individual corporations.

### Section 2: Offshore Outsourcing in Japan and the United States, and its Impact on Employment

The relationship between GDP trends and job creation has weakened in both Japan and the United States, and microeconomic changes in the competition environment have contributed to this phenomenon. In this regard, commentators are arguing that the offshore outsourcing of business services is costing jobs in the United States. In our analy-

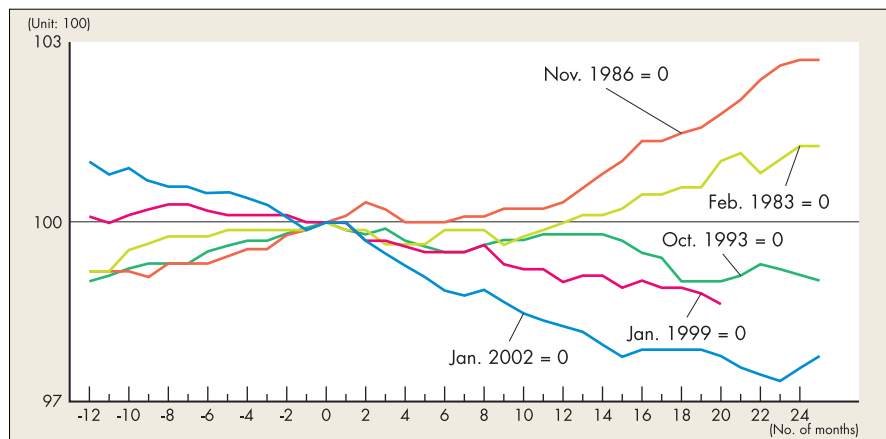
sis here of outsourcing trends, we use sector-specific data on “professional and business services” to conduct a statistical analysis of the situation in the United States and Japan. The results of this analysis indicate that “professional and business services” in Japan are in the growth stage, and there is not much off-shore outsourcing taking place. In the United States, however, “professional and business services” will be reaching maturity in the mid-term future, imports are increasing, especially among affiliated companies, and employment is falling at this point in time.

### Section 3: Rising Productivity and the Role of Personnel and Organizations

We observed that, amidst changes in the competitive environment occurring in the context of globalization since the 1990s, a worldwide trend toward disinflation has occurred, and there has been a change in the relationship between business cycles and job creation. The progress of information technology (IT) is often pointed to as having brought on this change in the competitive environment. At the same time, the progress of IT has also been a key focus in discussions relating to productivity increases in the 1990s.

First, let us examine productivity increases on the macroeconomic level. After making adjustments for differences in statistical systems, we analyzed productivity rises in Japan and the United States in the latter half of the 1990s. We discovered that total factor productivity (TFP) has risen both in Japan and the United States since the latter half of the 1990s, but the rate of increase has been greater in Japan. Similarly, the degree that IT investment has contributed to increased output since the latter half of the 1990s has risen at roughly the same rate in Japan and the United States. In contrast, the percentage of GDP accounted for by non-IT sectors has been much higher in the United States, and it can be seen that this is the reason for the gap between the two countries' GDP growth rates over this period. In particular, the contribution of labor and services has

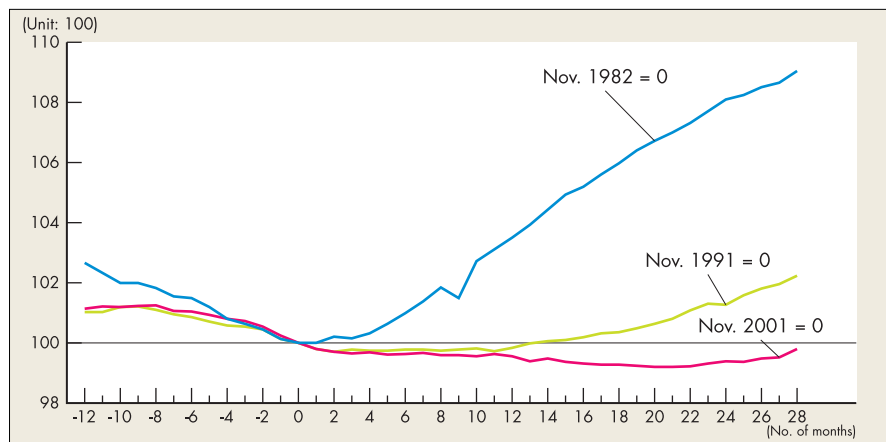
Figure 1 Regular Japanese Workforce Employment Indices (for firms with 30 or more employees)



Notes: 1. Figures for “regular workforce” represent the sum of full-time employees and part-time employees.  
2. In the “No. of months” timeline, “0” represents the point in time when the economy bottomed out.

Source: Prepared from the “Monthly Labor Survey,” the Ministry of Health, Labour and Welfare

Figure 2 Non-Agricultural Employment Indices in the United States



Notes: 1. Figures for non-agricultural jobs include part-time workers (workers employed for 35 hours or fewer per week).

2. In the “No. of months” timeline, “0” represents the point in time when the economy bottomed out.

Source: Prepared from the “Current Employment Statistics (CES),” U.S. Department of Labor, Bureau of Labor Statistics

been positive in the United States but negative in Japan, which indicates that the contribution of human capital has risen since the latter half of the 1990s in the United States, while falling in Japan as a result of restructuring and other factors. These facts would show that productivity is not necessarily rising at different rates in Japan and the United States, and the gap between the economic growth rates of the two countries may be due to phenomena other than IT investment.

Next, the question can be analyzed at the level of individual industries. Let us examine the relationship between IT

and productivity increases. A survey of productivity rate increases in the United States in the first half of the 1990s (1989-1995) and the latter half of the 1990s (1995-2000) shows that productivity increases in the durable goods manufacturing sector (including IT equipment manufacturing) only accounted for 18% of the acceleration in productivity increases for the overall economy, while the other 82% was due to productivity increases in sectors other than durable goods manufacturing. It is thus apparent that the acceleration of productivity increases in the United States since the latter half of the 1990s

has not been limited to the “IT manufacturing sector.” Rather, it has been more broadly based, and can be said to have been generated by the “IT user sector,” such as the finance and insurance industries and retail businesses.

In contrast with the United States, analysis of Japan’s situation shows that the increase of productivity triggered by IT investment has been concentrated in the “IT manufacturing sector,” and there may not have been any expansion in the “IT user sector.”

A study has also been conducted of the U.S. situation at the corporate level to determine how productivity increase is affected by IT (the amount of money spent on computer procurement), human capital (the skill and educational levels of workers) and organizational capital (the degree of decentralization in corporate decision making). This study showed the following: (1) when all three of the aforementioned factors are at a high level, productivity is about 7% higher than when at an average level; (2) when any one of the three factors is below average, even if the other two are at a high level, productivity is lower than when all three factors are at an average level; and (3) when all three factors are below average, productivity is the same as when all three factors are at an average level. Using this same analytical method, we find that in Japan as

well, the same relationship exists among IT, human capital and organizational capital. It can thus be understood that in order for productivity to increase, in addition to the introduction of IT, it is also necessary for human capital and organizational capital to play complementary roles.

#### Section 4: Imbalances in the World Economy

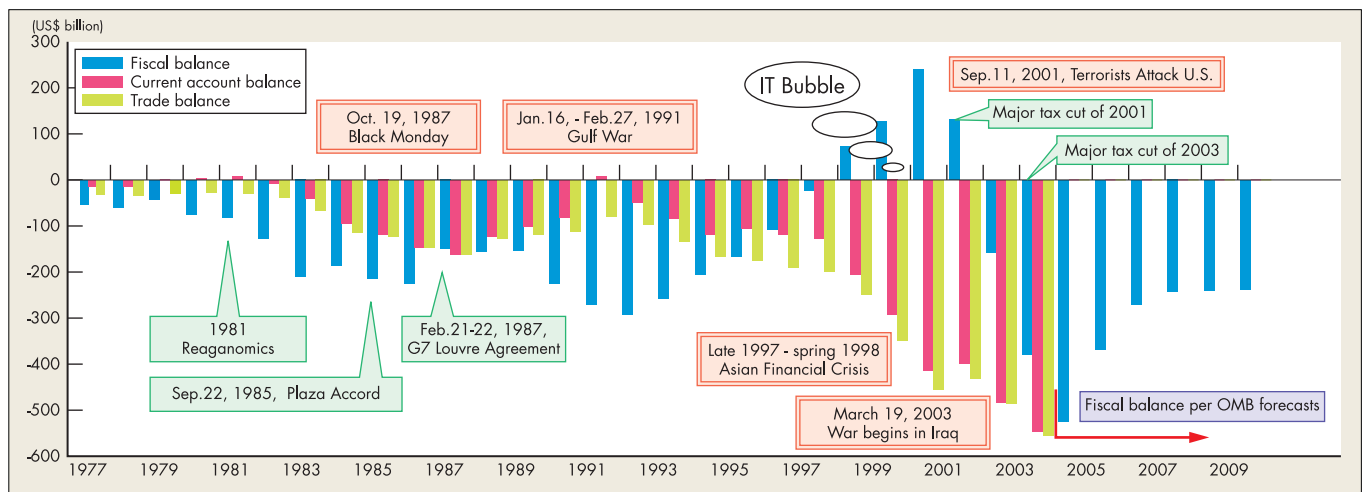
As stated in Section 1, a “Great Moderation” (decline in short-term GDP volatility and a disinflationary trend) has been observed in recent years as a phenomenon common to all developed countries. At the same time, however, expanding imbalances are in evidence in certain areas, especially asset markets.

For the past several decades, asset prices have exhibited mid-term fluctuation, especially in developed countries. There is a correlation between this asset price fluctuation and credit, and a trend toward increased fluctuation has been observed. At the same time, the world economy has been hit by a string of systemic banking crises, and some have noted that these crises have had a large impact on the real economy. It has also been noted that an increase in capital transactions due to globalization and diffusion of IT brings a greater likeli-

hood of mid-term fluctuation in asset prices, and depending on circumstances, such volatility can trigger banking crises that may wreak havoc on the real economy. To deal with this situation, financial authorities around the world have noted a need to establish a broad financial infrastructure, including proper accounting, information disclosure, disciplined governance, incentive mechanisms and supervision.

In addition, the U.S. current account imbalance is expanding. The U.S. economy, which accounts for roughly 30% of worldwide GDP, has been the engine of the global economy since the latter half of the 1990s. U.S. economic growth, driven by domestic demand fueled by low interest rates, tax cuts and active fiscal policies, has provided a source of external demand for Asia, including Japan, while funds have circulated from Asia into the United States, providing an impetus for further economic growth. However, the world’s economic engine is groaning under the weight of expanding “twin deficits” – a current account deficit and a fiscal deficit – that have reached unprecedented levels. (Fig. 3) Many observers have expressed concern about the long-term sustainability of U.S. economic growth, namely: (1) in the public sector, the growing elderly population is increasing social security pay-

Figure 3 U.S. Current Account Balance / Trade Balance / Fiscal Balance



Sources: Prepared from “Balance of Payments” (U.S. Department of Commerce) and “Budget of the United States Government, Fiscal Year 2005” (U.S. Office of Management and Budget: OMB)

outs, posing the risk of further deficit expansion; and (2) in the household section, household consumption has been supported by rising housing prices and increasing debt.

Turning our attention to China, the economy there has posted an impressive average annual growth rate of 9% since the Chinese government embarked on a broad program of reform and liberalization over 20 years ago. The growth continues today, fueled mainly by expanding fixed asset investment. Many have noted, however, that rapid expansion of fixed asset investment brings on the risk of economic overheating. If the chaotic capital investment witnessed among certain lines of businesses and in certain localities continues unchecked, overcapacity, deflationary pressures and cut-throat competition could emerge, pushing businesses into financial trouble and triggering a rise in non-performing loans. Such circumstances could severely crimp the prospects for sustained economic growth in China. Furthermore, some have noted the existence of a medium-term business cycle in China. Japan and other East Asian countries, which are becoming more and more closely tied into China's economy, must pay attention to long-term growth risks in the Chinese economy that could affect China's business cycles and their amplitude.

In order to achieve sustainable growth in the world economy, it is necessary for each country and region of the world to leave the current lopsided world economy and to build a resilient economic structure capable of intensified global competition and sharing the fruits of economic growth.

The macroeconomic phenomena discussed in Chapter 1 are thought to be at least in part the result of corporate activity and other microeconomic factors. There is a very strong possibility that disinflationary trends are affected by the deteriorating ability of corporations to set prices, and the weakening relationship between economic recovery and job creation is also affected by the declining ability of corporations to determine pricing power, along with mismatches of employers' needs and those of job seekers. In addition, it has

also been observed that IT and its applications are not the only factor contributing to productivity increases; comprehensive strengthening by corporations of their value creation capacity (including human capital and organizational reform) is also playing a role. And imbalances emerging in the global economy are at least in part a result of corporate activity at the microeconomic level, i.e. such imbalances are partially market-driven. To deal with these macroeconomic phenomena, commentators have pointed to the importance of microeconomic policy, including corporate information disclosure.

But even supposing that today's new trends discussed above are the result of changes in the competitive environment at the microeconomic level, eliminating or suppressing competition is no solution. Rather, we believe that we can enjoy affluence if we respond to the aforementioned challenges by spurring an evolutionary advance in the mode of competition.

## Chapter 2: The "New Value Creation Economy" and Evolution toward a New Mode of Competition

In Chapter 1, we discussed how changing macroeconomic trends have contributed to economic globalization, and argue that these phenomena are affected at least in part by corporate activity and other microeconomic factors. Under such circumstances, in order for corporations to recover their ability to set prices and post profits, they need to distinguish themselves from their competitors by developing unique products and services. In order to reap competitive advantage from the unique character thus developed, corporations need to make use of "intellectual assets"; intellectual property, human resources, organizational processes and a broad range of other such assets. This chapter describes how value creation, achieved through the utilization of intellectual assets (in the broad sense of the term), is spreading as a new mode of competition, and how international debate is now underway regarding systemic reform tailored to this trend.

## Section 1: Determinant of Success in Corporate Competition: Value Creation through the Utilization of Intellectual Assets

### 1. Increasing Importance of Intellectual Assets as the Source of Competitiveness

In both Japan and the United States, the ratio of intangible to tangible assets has risen in recent years, and the foundation of corporate management has undergone a marked shift from tangible assets to intellectual assets. (Figs. 4 and 5) And in industries formerly structured such that those holding tangible assets were the only players capable of going into business, industrial structure has changed in recent years to the point where it has become possible to go into business as long as one has intellectual assets such as ideas and know-how.

We can understand, then, that the foundation of corporate management has shifted away from tangible assets toward intellectual assets. It is thought that this change has come about as the result of intensified global competition; corporations need to continually introduce distinctive products and services, and to do that they must rely on knowledge, which is the source of distinctive products and services.

### 2. The Range of Views on Intellectual Assets

The shift to an emphasis on intellectual assets is not occurring strictly at the corporate management level. In the Organization for Economic Cooperation and Development (OECD) and the European Union (EU), discussion of the shift to a knowledge economy is ongoing, and efforts to develop a policy response are underway. Amidst the shift from tangible assets to intellectual assets as the source of value, a growing consensus has arisen that there is a need for the proper valuation and disclosure of intellectual assets.

There are two basic approaches regarding how to value and disclose intellectual assets. One holds that intellectual assets should be established as an individual asset category, quantified and

listed in financial statements, i.e., the “assetization approach.” The other holds that intellectual assets are not stand-alone “assets” or “inputs,” or even if they are, quantification is prohibitively difficult, therefore a qualitative approach to their valuation and disclosure should be employed. This is called the “qualitative approach.”

### 3. Empirical Research on Intellectual Assets and Value Creation

The following analysis of intellectual assets categorizes them into three types: (1) intellectual assets generated through innovation (“innovation capital”); (2) intellectual assets generated as the result of a particular form of organization (“organizational capital”); and (3) intellectual assets generated by human resources (“human capital”).

In the United States, our analysis shows that research and development (R&D) investment, as a form of innovation capital, serves to create corporate value. As for non-R&D intellectual assets (a concept that encompasses both organizational capital and human capital), corporate sales are a function of such variables as capital, labor and R&D, and when non-R&D intellectual assets (which are not a function of these assets) are figured into the calculations, non-R&D

intellectual assets emerge as an important source of corporate growth.

In one study, the “personal effect” and the “experience component” are quantified, and the productivity changes at individual workplaces are examined as a function of the following variables: the personal effect, the experience component and the “human capital index” (i.e. the sum of the former two elements). According to this study, there is a correlation between the human capital index and increases in productivity, and when the human capital index is broken down into its constituent elements, both the personal effect and the experience component are correlated individually to productivity increases. This study provides an extremely valuable analysis, for it values specific human capital and then analyzes its correlation with productivity increases.

In Japan, there is sometimes a positive correlation between R&D investment, numbers of patents (an intermediate measure of R&D investment) and corporate performance. A U.S. study, however, has indicated that there is no straight-line correlation between R&D investment and corporate performance.

Increased sales of non-R&D intellectual assets are also a big contributor in Japan, and non-R&D intellectual assets constitute an important source of growth. A study of the relationship between an

index measuring corporate governance at listed companies in Japan and corporate performance shows that there is also a correlation between organizational capital and corporate performance.

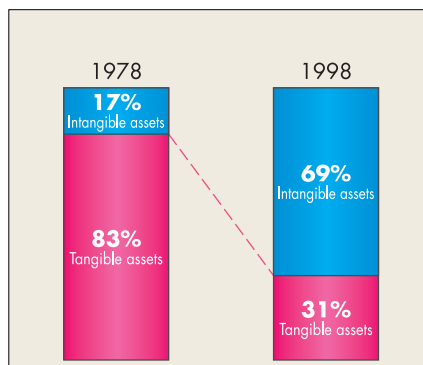
### 4. The Value Creation Capability of Corporations, and “Corporate Social Responsibility”

In recent years, there has been a growing trend to view efforts by corporations to shoulder social responsibility – i.e. the concept of corporate social responsibility (CSR) – not only as a duty that corporations undertake in order to ensure the survival of society, but also as something that corporations need to do in order to enhance their prospects for long-term value creation. The upswing in socially responsible investment (SRI) is also the result of this very same social awareness.

There are three reasons for believing that corporate profitability and CSR are compatible.

First, there is an overlap between CSR efforts and the intellectual asset investments to enhance corporate value. For example, a corporation’s internal investments in human capital and its efforts to establish good networking with customers both constitute intellectual asset investments, but from the CSR perspective they can both be seen as examples of a corporation carrying out its social

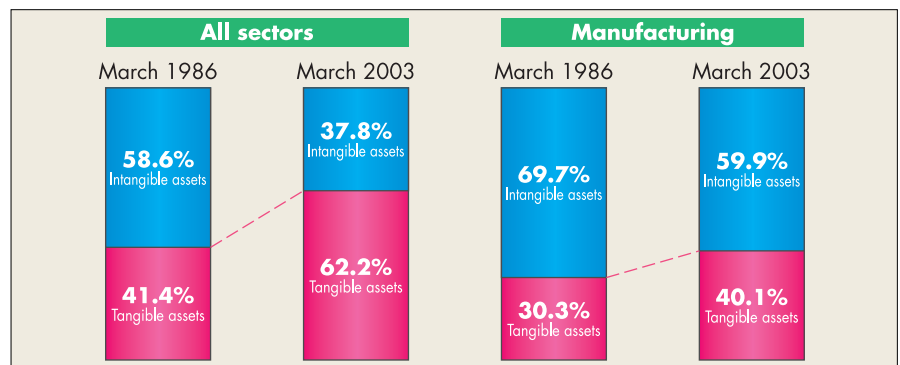
Figure 4 Intangible vs. Tangible Assets in the U.S.



Note: Figures for intangible assets were obtained by subtracting the value of plant, equipment, and other tangible assets from the total market value of firms, other than financial institutions, with shares listed on a U.S. stock exchange.

Source: Blair, et al (2000)

Figure 5 Intangible vs. Tangible Assets in Japan



Note: Figures for intangible assets were obtained by subtracting the value of tangible fixed assets from total share value at market price, corporate bonds, convertible bonds and long-term borrowing. The “All sectors” category comprises 169 Japanese corporations, while the “Manufacturing” category comprises 104 manufacturing firms.

Source: Prepared by Ministry of Economy, Trade and Industry (METI) from Nikkei NEEDS

responsibility toward its employees and customers. Secondly, when intellectual assets are viewed from the perspective of the building of processes to enhance corporate value, the same processes also contribute to CSR. For example, good corporate governance leads not only to good corporate income, but also to good environmental management and compliance, both of which are facets of CSR.

Thirdly, CSR efforts foster the emergence of a unique corporate identity, which in turn becomes a source of competitive strength. As changes in the competitive environment create a need for corporations to develop unique characteristics, a corporation can take advantage of its unique characteristics and its CSR undertakings to create value, which the corporation can then share with its customers, shareholders, employees and other stakeholders. This share of value creation in turn elicits the sustained support of stakeholders.

As for the relationship between CSR and corporate performance, a U.S. survey has found that for roughly half of all corporations there is a positive relationship between social performance and financial performance. In Japan, one empirical study shows that some firms show a positive correlation between CSR and corporate financial indicators and some do not.

After-the-fact observation thus reveals an ambiguous relationship between CSR and a corporation's financial performance, but when an investing entity chooses its investments on the basis of a prior valuation of the corporation's CSR undertakings and its financial performance, it is engaging in SRI.

SRI volume has risen precipitously in recent years, especially in Britain and the United States. The governments of both countries have embraced the concept of trustee responsibility, and it is thought that this has attracted the participation of institutional investors, thereby leading to the sharp increase in SRI volume.

SRI is changing in both quantitative and qualitative terms. In Britain and the United States, where SRI is becoming commonplace, in order to imbue SRI itself with unique character and distinctiveness, more and more items are attracting attention as good elements for

SRI. Among these are human capital and other forms of intellectual assets and similar elements.

### 5. International Trends in Systemic Reforms Aimed at the Valuation/Utilization of Intellectual Assets

In an effort to encourage Danish corporations to carry out both qualitative and quantitative valuations of their intellectual assets, the Danish Ministry of Science, Technology and Innovation set a global precedent by enacting a law requiring corporations to release an intellectual capital statement. On the basis of this law, "Intellectual Capital Statements – The New Guideline," was released in February 2003. A corporation releasing an intellectual capital statement can use it as a management tool and develop a competitive strategy that makes use of its intellectual assets. Particularly in Denmark, where the economy is anchored by small and medium-sized enterprises (SMEs), a management tool like the intellectual capital statement can help top management evaluate how their companies stack up against other firms, which would hopefully result in improvement where they are weakest. Also, a corporation's top management can use the intellectual capital statement as a means of communicating to stakeholders, such as employees, customers, investors and financial institutions, the kind of value the corporation can provide. In particular, as intellectual capital statements can be used to showcase a company's strengths, it is hoped that these statements will help channel funds to SMEs.

In addition, the introduction of the "Operational and Financial Review," as contemplated under current measures to overhaul Britain's Company Law, represents an attempt to: (1) assess companies' long-term value creation by factoring in their performance in the area of social responsibilities; and (2) expose it to the evaluation of a wide range of stakeholders, including the market, through disclosure. The overhaul of Britain's Company Law explicitly entails a conscious intent to develop a vision of a "new type of corporation."

In addition, the U.S. Financial

Accounting Standards Board (FASB) has amended its standards to make goodwill an on-balance sheet item at the time of corporate takeovers. Because goodwill is reflected in human capital, organizational capital and a wide range of other intellectual assets, development of a method for valuing goodwill can be seen as a means of using an "assetization approach" to value intellectual assets.

### 6. Moves toward Valuation of Corporate Capacity for Value Creation in Japan

There is a growing appreciation for the importance of innovation capital (e.g. R&D), organizational capital (e.g. brands and processes) and human capital (e.g. the abilities of employees and top-level management) in Japan as well. The approval of pure holding companies, the reduction of procedures for business combination and the establishment of share swaps and share transfer systems can be seen as moves to create an environment that favors efforts to enhance companies' organizational capital by offering a diverse selection of organizational forms.

Moves to bring about the comprehensive valuation of intellectual assets, such as those in Denmark and Britain, are not currently under discussion here in Japan, but we are seeing the incipient signs of certain undertakings that could support an eventual comprehensive valuation of intellectual assets.

The "Intellectual Property Disclosure Guidelines" of Japan's Ministry of Economy, Trade and Industry (METI) only deals with intellectual property, and in view of the fact that these guidelines offer a comprehensive overview of corporate management, and also of the fact that the preparation of actual reports can be expected to spur corporations to take creative steps, it is hoped that the preparation of intellectual property reports on the basis of the guidelines will be a first step toward discussion in Japan of the valuation and disclosure of intellectual assets.

METI has adopted various guidelines relating to risk management, including "Internal Control for Risk in a New Age – Guidelines for Internal Control that

Functions in Integration with Risk Management” and “Enterprise Risk Management – TEXT.” These guidelines treat risk management as a comprehensive means of achieving business value creation, and the goal of the guidelines is to increase business value by maximizing returns, which is to be achieved through the rational management of business risk. Because there is an overlap between the processes required to maximize opportunities for enhancing corporate value, and the processes required to minimize the risk of corporate value loss, it is hoped that these risk management guidelines will serve as a reference in efforts to value intellectual assets and increase corporate value.

## 7. A Provisional Method for Valuing Intellectual Assets

In a recent study (Corrado, et al [2003]), publicly released data were used to carry out a quantitative macroeconomic valuation of a nation’s intellectual assets. In this study, intellectual assets are broken down into: (1) IT and information; (2) scientific and creative rights (such as R&D and intellectual property rights); and (3) economic power (brands, human/organizational capital). The study assigns indicators to each of these elements and carries out calculations accordingly. The results indicate that intellectual assets account for a growing percentage of economic output in both

the United States and Japan.

At the corporate level, one study treats intellectual assets as being composed of five elements: capacity for structural reform of business; business efficiency; technical ability; marketing ability; and organizational power. On the basis of this classification, the study carries out a provisional valuation of the intellectual assets of corporations in many different countries, seeking to identify the special characteristics of the intellectual assets of each of the corporations covered by the study.

Looking at intellectual asset components region by region, the study concludes that Japanese corporations are strongest in the areas of capacity for structural reform of business, technical ability and organizational power, while North America is strongest in the area of business efficiency and Europe is on top in marketing ability. Corporations in Asia, by contrast, had low scores in all categories. (Fig. 6) The above holds largely true when the focus of our attention is narrowed to equipment assembly manufacturers; Japan is tops in capacity for structural reform of business, technical ability, organizational power and marketing ability, while North America scores best in business efficiency.

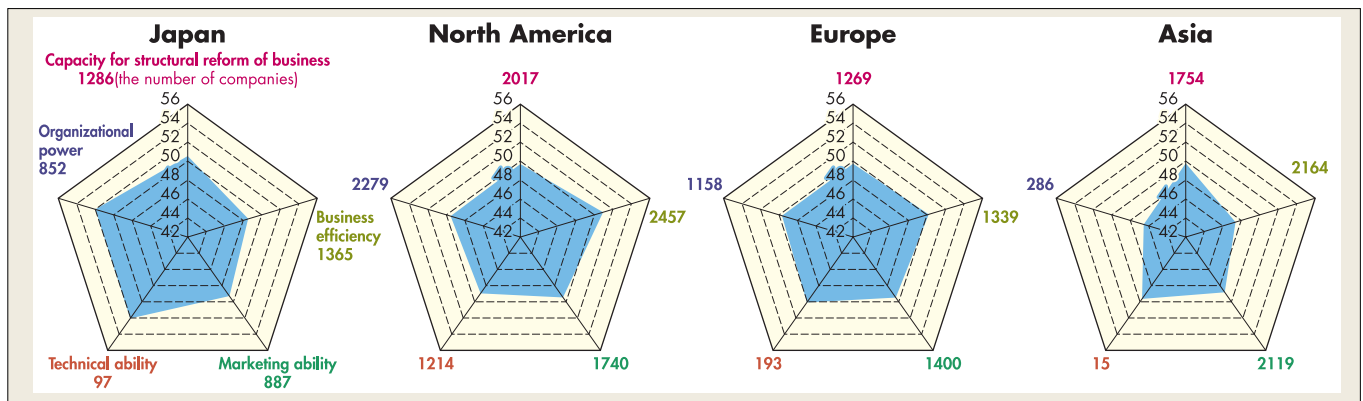
## 8. Summary of Section 1

Fig. 7 shows the special characteristics of intellectual assets. Intellectual assets

circulate on markets, making quantitative valuation difficult, if not impossible. But when viewed from the perspective of competition, intellectual assets play an extremely important role in non-price areas in which a corporation needs unique characteristics. And the quantitative evaluation of intellectual assets becomes difficult when a quantitative valuation is attempted, and the quality of the information and the valuation methods employed must be all the better. For corporations with a large quantity of intellectual assets, equity financing is more appropriate than debt financing. Also, under the present circumstances, in the fields of venture funds, mergers and acquisitions (M&A) and corporate revitalization, the valuation of intellectual asset factors is naturally carried out in determining levels of investment, and the growth of this market could establish conditions that make it possible to properly value intellectual assets in Japan.

While the valuation and disclosure of intellectual assets should be based as much as possible on quantitative indicators, it remains a fact that regardless of how advanced our valuation methods become, there will always be intellectual assets that cannot be sold off in the way that tangible assets can. In undertaking to evaluate intellectual assets, it is inevitable that a certain proportion will have to be valued using qualitative methods, as has been discussed in

Figure 6 Intellectual Asset Characteristics in Different Regions



Notes: 1. In the above graphs, “50” represents the average for all manufacturing firms for which data were available, and the values represent deviation from that average (see Note on Figure 5).

2. The above figures are not corrected in any way to account for imbalances in the presence of particular lines of business in different countries or regions.

3. The above figures represent the number of companies in each country or region that were used to prepare the above chart.

Sources: Prepared from materials released by the Intellectual Asset Research Society

Denmark and the Britain.

Moreover, the use of intellectual assets to achieve distinctiveness and compete on factors other than price will change a corporation's relationships with shareholders, customers and the local community. If corporations focus solely on price concerns, their relationships with shareholders, customers and employees will be transitory, existing only in the form of dividends, prices and salaries. However, when intellectual assets are put to work toward value creation, and this value is shared by means of proper corporate disclosure, the firm's value creation will be valued not only by shareholders, customers and employees, but also by suppliers and the local community, who will in this manner participate in the company's value creation; this participation will itself then become an intellectual asset for the corporation.

The utilization of stakeholders as a form of intellectual asset has certain things in common with "Japanese-style business management" – i.e. long-term shareholding and long-term employment – but in other ways, it differs. First, the relationships with such stakeholders as shareholders, employees, customers and other stakeholders mentioned here are formed within the context of global competition. Secondly, this sort of intellectual asset valuation and disclosure, and the question of what kind of corporation is most desirable in this context, are now being discussed in

connection with debates over the reform of international systems. Also, this question is not confined to the issue of corporate systems; it also touches upon a wide range of other issues, such as financial markets and national economic statistics. This sort of valuation and disclosure does not mean the "creation of a standardized system," but rather puts its main emphasis on the "evolution of private-sector practice." However, international theoretical discussions concerning company law, corporate image and information disclosure appear to be in the offing, and Japan needs to be an active participant. Toward that end, there is a need to initiate a domestic discourse on these matters.

We also need to be aware that this discourse, by bringing about the evolution of the competitive environment at the microeconomic level, could also lead to substantive rises in productivity, job creation and an appropriate disclosure of corporate information that would in turn bring about asset price stabilization.

## Section 2 From Analysis of Local Economies to Community Revitalization

### 1. Importance of Local Economies

Japan's macroeconomic indicators are showing hopeful signs, and the overall economy may be on the way to recovery. For particular localities, corpora-

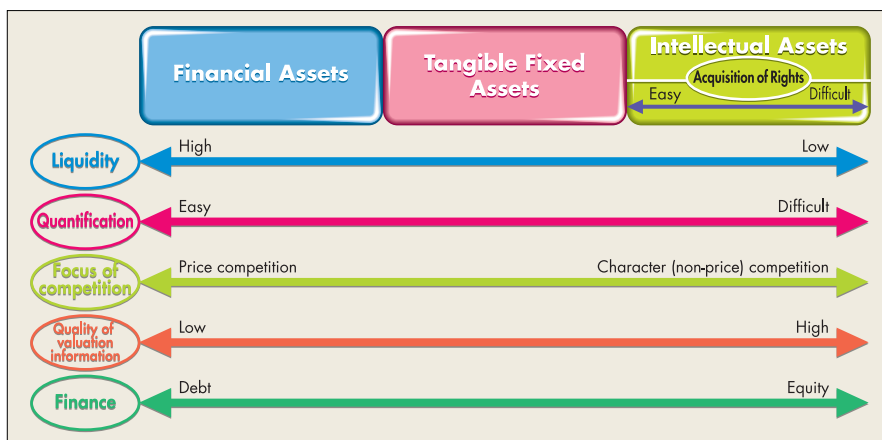
tions and lines of business, however, the outlook is mixed. Sluggishness in local economies is noted, evidenced notably by the hollowing out of city-center commerce. To overcome this situation, a new policy framework has been adopted, which includes such elements as "special zones for structural reform" and "programs for the promotion of regional revitalization." These are intended as a means of supporting the self-help efforts of local communities to come up with their own ways of revitalizing their economies and creating employment. Local economic revitalization within this type of framework has become an important policy focus.

There are a number of reasons that economic revitalization led by local uniqueness is important. First, economic globalization has triggered a rapid spread of regional economic activities that extend conventional national frameworks, and corporations are finding an increasingly wide range of choices when deciding upon new business locations. Local areas need to take advantage of their unique strengths to develop attractive communities, thereby building resilient economic structures that make sustained development possible even while the larger economic environment is constantly in flux. Secondly, under the "the reform packages of three issues" to decentralize the fiscal reforms being pursued by the Japanese government, devolution of authority will be moving forward over the coming years, so there is a need for local authorities to be active participants in the development of local economic policies.

### 2. Policy on Local Development Trends in Europe

The Structural Fund and the Cohesion Fund have been the main instruments of policy on local development in the EU. However, while low-GDP countries are catching up and the national level gaps are redressing imbalances, gaps between different localities have yet to show any contraction. It is important for local areas to take advantage of their unique fortes and adopt appropriate measures to deal with the gaps, but few are capable of doing this.

Figure 7 Characteristics of Intellectual Assets



Source: Prepared by METI



This is due to the difficulty of identifying the strengths and unique characteristics of any particular local area. The only people capable of solving this problem are the local authorities and the local people. It is important that these people think deeply about their localities and come up with their own ideas for local revitalization.

One can point to several good examples such as the “Life Improvement” program in Bilbao, Spain, the “Environment” in Freiburg, Germany, and the “Local Human Resources” program in central Italy’s “Third Italy.”

### 3. Trends in Local Development Policy in Japan

Beginning during Japan’s rapid post-war economic growth and continuing until around 1990, mainstream policy on local development focused on efforts to decentralize various functions from metropolitan to local areas. In the recession that followed the collapse of the bubble economy, however, the building of new factories dropped off, and advancing economic globalization spurred worries about a hollowing out of domestic industry. People began to worry that the reliance on conventional policies was no longer an effective way to boost local economies.

Japan has seen a number of new developments in recent years relating to the implementation of a local develop-

ment policy focusing on the utilization of unique local resources. And more recently we have seen the introduction of “special zones for structural reform” and “programs for the promotion of regional revitalization,” which involve the self-help efforts of communities to come up with their own ways of revitalizing their local economies and creating employment. To ensure that these undertakings successfully lead to sustained local development, it is first necessary to further evaluate and analyze the structure of the local economies in question, and then to develop well-conceived local economic strategies that make the most of local strengths. Local revitalization efforts are being pursued in more and more places throughout Japan, but it is argued that local revitalization strategies are rarely formulated on the basis of prior evaluation and analysis of the local economic structure.

There are two basic approaches to the analysis of local economies. (Fig. 8) The first focuses on the analysis of local economic circulation, which describes and analyzes the flow of people, goods, money and information within and among local areas. The second focuses on the analysis of an area’s existing assets, which describes and analyzes the “assets” in a given locality, such as human resource concentration, the educational level of residents and the presence of cultural assets. An analysis focusing on local economic circulation

makes it possible to develop a picture of an area’s special characteristics from an economic perspective; by applying this analysis to enterprises or industries, it then becomes possible to put forward industrial policy proposals focused on local areas. At this point in time, the “local economic circulation model” would appear to be the preferable method, but it is also hoped that statistics will be developed to make it possible to focus on the aspect of local economic circulation that will contribute to a more detailed analysis of local economic environments and structures.

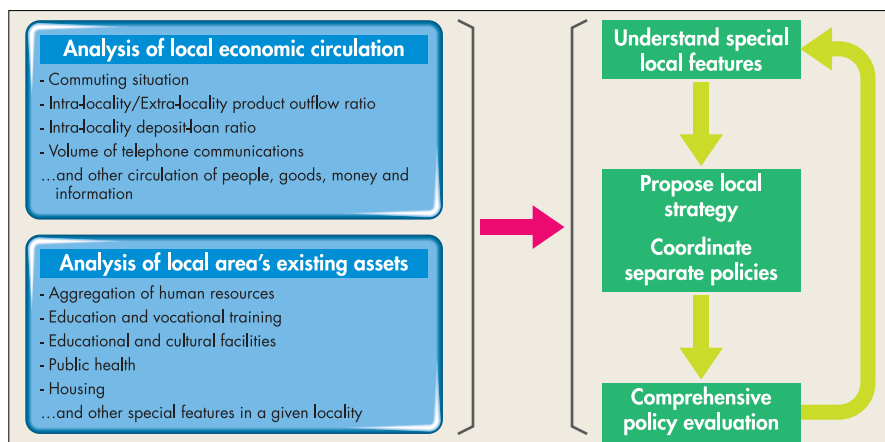
In order to carry out a comprehensive analysis of a local economy, analysis of a local area’s existing assets is also necessary, but as with the valuation of a corporation’s intellectual assets, analytical methods are rather underdeveloped in this field. It would be good if these two fields could be advanced in tandem.

### Section 3 Competition among Individuals: Investment in Human Capital and the Development of Skills Standards

Individuals, no less than corporations, find themselves confronted by new challenges resulting from changes to the global competitive environment. As the ability of corporations to determine prices declines, a trend is emerging in which economic recovery doesn’t necessarily mean the creation of employment. At the same time, changes in the economy mean that the skills and aptitudes sought in individuals are changing. It is important for corporations themselves to make a transition to management that stresses the importance of intellectual assets, including human capital, but the government also has a concurrent role to play; at a time when the economic environment has changed, the government needs to build an environment conducive to a smooth employment shift.

In Europe, where countries have experienced unemployment problems, including high rates of unemployment among young people, the response goes beyond the mere distribution of unemployment benefits and other reactive measures; more and more countries are adopting “active labor market policies,”

Figure 8 Flow Chart for Analysis of Local Economies



Sources: Prepared by METI from a variety of sources

helping youth acquire skills through vocational training and internships, thereby making themselves more employable. These policies have received a degree of standing, but there have been other perceptions that these policies have not achieved job creation. Some have stated that if these active labor market policies are to lead to actual job creation, they will have to be linked more closely to corporate needs and training programs, and that an integrated approach based on corporate needs is required. At the same time, it has also been argued that there is a need at the local level to gain a clear and detailed picture of needs, implement programs and carry through on them with rigorous follow-up measures.

If we are to implement a concrete education and training program that is based on analysis of the reality of local labor markets and reflects the real needs of corporations, there is also an important need for a set of skills standards that are shared and updated to reflect real conditions. Skills standards constitute the infrastructure that makes it possible to: (1) develop the skills that will be in future demand in a changing labor

market; and (2) achieve a smooth employment shift when unemployment risks come to the fore.

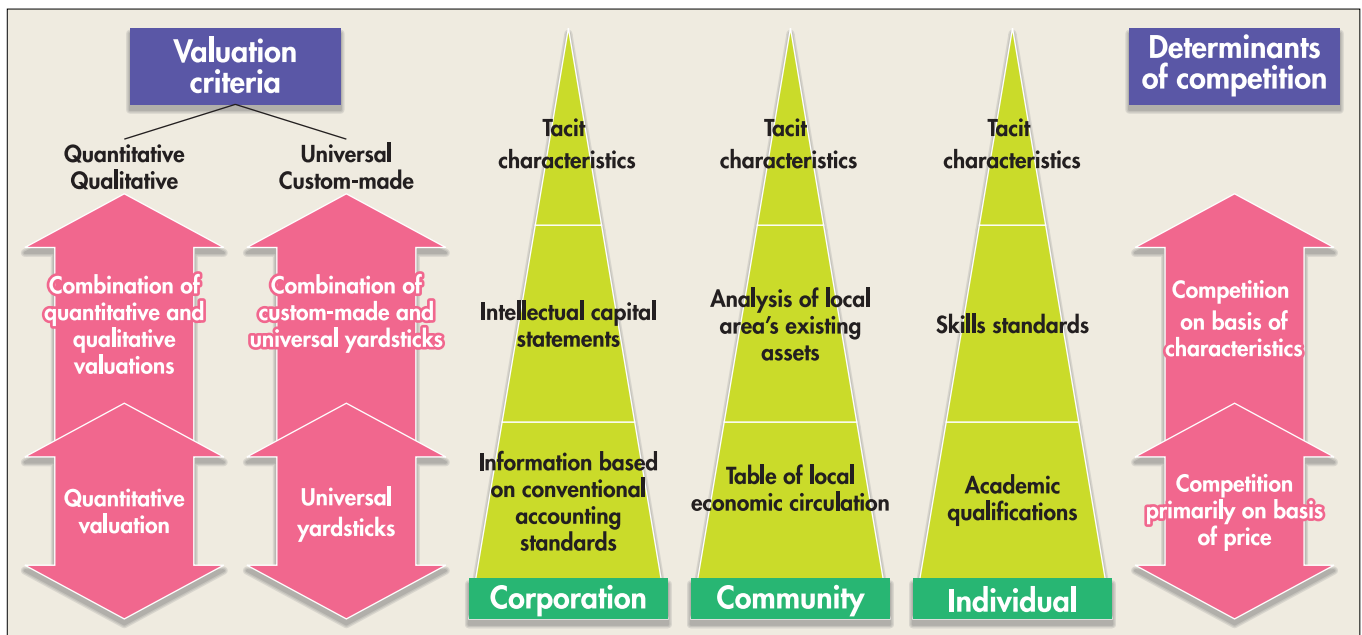
Employment shifts in Japan have been few, and there have been no job skill criteria requirements for job openings. In comparison with Europe and North America, skills standards are relatively underdeveloped in Japan. However, given the changes that have occurred in the corporate environment in recent years, development of skills standards is an important policy task in Japan that must be tackled in order to: (1) achieve economic growth and job creation; (2) enhance human capital in tandem with corporate IT investments and organizational reforms; (3) attach proper significance to the valuation of human capital investment in public policy; and (4) do a good job of training the type of human resources for particular localities given the unique characteristics of each area.

The matters discussed in Chapter 2 are outlined in Fig. 9. At the corporate, community and individual levels, valuation can be based on a relatively universal yardstick, or one that is more “custom-made.” Using the former tends not

to result in quantitative valuations; using the latter tends to result in qualitative valuations.

In order to build a resilient economic structure that will enable us to enjoy prosperity within the global economic environment, Japan needs to make a transition to an economy in which success in competition is determined by character and differentiation. We should develop a range of different valuation yardsticks that enable implementation of quantitative methods and do not rely strictly on universal methods. Development of a valuation yardstick for a certain field has the effect of spurring corporations to enhance their value creation capacity, which is not limited to price competition. (level 2, Fig. 9) Local communities can use the analysis of their economic circulation structure to achieve community revitalization using their unique local characteristics. At the level of individuals, the quality of the workforce can be enhanced by ensuring that individual skills more accurately reflect market trends, and this in turn will make possible an evolutionary leap to higher-level determinants of success in competition.

Figure 9 Three-Level Scheme for “Valuation” of Corporations, Communities and Individuals



Source: Prepared by METI

In developing the valuation yardstick for the factors in level 2, there is a complementary relationship between corporations, communities and individuals. For example, when a corporation presents a valuation yardstick for human capital, it leads to a development of standards against which community human resource strategies and individuals are measured.

If Japan were able to set a global precedent by developing a set of valuation yardsticks for the corporate, community and individual levels, and thereby move toward the establishment of a “new value creation economy,” it would represent an evolutionary transition of the Japanese economy toward higher-level determinants of success in competition, and would contribute to the building of a resilient economic structure capable of ensuring stable economic development amidst global competition.

### Chapter 3 Transition to a “New Value Creation Economy,” and East Asian Economic Integration

This chapter presents a concrete analysis of intra-regional trade and division of labor in East Asia. The execution of EPAs is expected to bring a further deepening of intra-regional trade and division of labor as East Asian economic integration proceeds. Chapter 3 examines the expanding role of intellectual assets and changes in the competition environment, and what these mean to the competitive position of the Japanese economy and Japanese corporations in East Asia.

#### Section 1 Deepening East Asian Economic Ties

World markets are expanding, and in East Asia as well, trade volume is on the

rise for both intra-regional and extra-regional trade. The share of intra-regional exports out of the total exports has changed little in recent years in aggregate terms, but in the machinery category, the figure is rising sharply.

In order to examine how close East Asian trading relationships have become, we can look at trade intensity figures for various binational combinations within the region. These figures show that in over half of the combinations, a high trade intensity index has played a role in bringing about a substantive deepening of economic ties, and that trade intensity indices have been rising since 1995. In order to examine whether intra-regional export and import items in East Asia are complementary in nature, we can look at trade complementarity indices. Trade complementarity for East Asia as a whole (Japan included) is already at the same level seen in the EU (the former EEC) and NAFTA at the time of their formation, and is on the rise. (Table 1)

In addition, one-way trade accounts for 70% of all East Asian intra-regional trade. Vertical intra-industry trade, which reflects differences in quality, accounts for roughly three-quarters of all intra-industry trade in East Asia, and in recent years the share of vertical intra-industry trade has been rising. Several factors are pointed to as causes for the emergence of this pattern. First, there are more barriers to intra-regional trade in East Asia than there are in the EU. Secondly, huge income differentials between different countries and regions within East Asia generate factor cost differentials that have encouraged vertical intra-industry trade. Thirdly, as there is a lack of uniformity in consumer preferences, horizontal intra-industry trade, which involves goods with discrepant product attributes, does not take place in any great volume. Within the East Asian region, overseas direct investment by Japanese corporations has spurred the formation of a division of production processes to take advantage of the differences among countries and regions. This description is particularly applicable to the machinery sector.

A hallmark trait of the East Asian region is that components are manufac-

Table 1 Trade Complementarity Indices by Region

	Trade Complementarity Index	Founded
EEC	53.4	1958
U.S.-Canada	64.3	1989
NAFTA	56.3	1994
(Reference)		
East Asia	68.0	2002

Note: The figure for East Asia was derived from “UN Comtrade” and also making reference to the World Bank (2003).

Source: Yeats, Alexander (1998), “What can be expected from African Regional Trade Arrangements?”

	Trade Complementarity Index (All Tradable Goods)			+/-	
	1992	1997	2002	1997	2002
East Asia	62.5	66.8	68.0	4.3	5.5
EU	75.0	80.6	81.0	5.6	6.0
NAFTA	65.2	70.1	71.6	4.9	6.4

	Trade Complementarity Index (Finished Machinery)			+/-	
	1992	1997	2002	1997	2002
East Asia	62.0	64.3	65.8	2.3	3.8
EU	78.9	82.4	81.4	3.5	2.5
NAFTA	67.3	68.7	72.9	1.4	5.6

	Trade Complementarity Index (Machinery Components)			+/-	
	1992	1997	2002	1997	2002
East Asia	77.6	82.5	83.1	4.9	5.5
EU	85.0	87.6	89.2	2.6	4.2
NAFTA	81.8	84.5	83.4	2.7	1.6

Notes: 1. A trade complementarity index shows the degree of similarity between the export product mix of one country and the import product mix of another. Where the index is 0, none of the export products of one country are imported by the other. Where the index is 100, the export products of one country and the import product mix of the other are identical.

2. The trade complementarity indices here were obtained using the following formula:

$$C_{ij} = 100 - \sum (|m_{ik} - X_{ij}| \div 2)$$

$m_{ik}$ : Product item  $i$  as a percentage of the total imports of country  $k$

$X_{ij}$ : Product item  $i$  as a percentage of the total exports of country  $j$

Sources: Derived from “UN Comtrade” and also making reference to the World Bank (2003)

tured primarily in Japan and then assembled into final products in China, Thailand and Indonesia. Within the East Asian region, it would seem that an international division of processes has formed along the axis of component production.

## Section 2 International Division of Functions, and the Factors Bringing it About

The signing of EPAs will further accelerate East Asian intra-regional integration and give Japan a more open economy. Given such circumstances, there is a need in all industries and corporations, regardless of size, to cultivate and strengthen the ability to create value. Toward that end, intellectual assets such as human capital and capacity for innovation have an important role to play.

A digital camera manufacturer, for example, draws a clear distinction between the functions played by China and Japan. Japan is an R&D base where “added-value is developed,” while China is a manufacturing base where “added-value is produced.” Corporations maintain their competitive advantage by concentrating resources on their core competencies.

One SME, for example, has established an international division of processes along the axis of component production. By entering into a tie-up with a Taiwanese firm, the SME has been able to turn its partner into a stable source of demand, and at the same time has provided its partner with indispensable technology, thereby achieving a “tie-up of complementary functions.” In addition, the SME has also established a division of labor between Japan and China, involving design and prototype operations in one country and mass production in the other. The arrangement offers meaningful insights into how we should be approaching with the splitting up of the functions in East Asia.

Some non-manufacturing firms are also using their intellectual assets to expand overseas. A certain retailer, noting China’s rapid economic growth, deregulation of its distribution sector and developing infrastructure, took its

domestically developed comprehensive information network system, made appropriate modifications and introduced it to the Chinese market to meet the challenge of stiff competition there.

Each of these companies, regardless of their different lines of business and scale, is proceeding with the split up the functions between domestic and overseas locations in a flexible, strategic manner, taking into account the characteristics of intellectual assets in both locations. Japanese corporations with operations in China are keeping production of high value-added components, R&D, systems design and other innovation functions in Japan, and opening up new manufacturing and sales bases by applying the technologies and systems generated thereby in China. This suggests that it is becoming more and more difficult to fix the bilateral technology gap at a particular level, and that Japan must continually maintain a domestic innovation function in order to remain competitive.

Taking a statistical look at patterns in the division of labor, we find that the value-added ratio and R&D ratio of corporations located in Japan are much higher than those of Japanese-invested overseas firms. (Fig. 10) An analysis of the effect of intellectual assets on corporate location shows that, in Japan, corporations are more likely inclined to locate new investment in areas where there is an intra-regional diversification of industry and a relatively high degree of intra-industry job type convergence. In effect, it is important that there be a functioning intellectual interchange and labor pool, and the presence of an agglomeration effect.

A look at intellectual assets on a country-level basis shows that Japan, Europe and the United States are all at a very high level, and Japan is considerably ahead of other East Asian countries and regions in this regard. (Fig. 11) However, looking at the production factors for tradable goods, we find that the non-production worker inputs in imports are at a low level relative to exports, but when we narrow our focus to imports from other East Asian nations, we find they are climbing rapidly. In fact, human capital inputs

in imported goods from East Asian countries and regions now equal the level of such inputs in Japan’s exports. Under such circumstances, it seems clear that Japan needs to take steps to make itself more competitive in areas where human capital and intellectual assets feature most prominently.

## Section 3 Economic Integration and Liberalization: The Tasks They Impose on Japan

The execution of EPAs promises to increase the openness of both intra-regional and global trade. It is quite likely that Japan will need to improve its capacity for value creation that takes advantage of intellectual assets, not only in the machinery sector. To highlight the task that faces Japan, it is useful to make a comparison between Japan and the United States, looking at how corporations in the two countries have enhanced their competitiveness by exporting products with high value-added content generated by high inputs of skill and knowledge-intensive factors.

When we look at the issue from the perspective of the value-added content of exports, we find that over the past decade, the product overlap between Japan and the United States has been increasing, just as it has between Japan and the rest of East Asia. In trade relations between Japan and the rest of East Asia, the degree of export product overlap has shown a very significant rise both in ordinary products and high value-added products. In terms of the distribution of high value-added export products, Japan’s high value-added export product items tend to be in a much more highly concentrated group of fields than in the case of the United States.

Accordingly, once a high degree of economic integration, which is accelerated by EPAs, takes hold in the East Asian region, Japan will face the need to establish the prerequisites for vigorous participation in trade across various business types, defined by product attribute and quality. And considering that corporations will become increasingly active in establishing overseas production bases, an increased degree of

product overlap with high value-added content would therefore seem inevitable. Japan must do more than merely develop distinctive and characteristic export products, as our corporations move forward with the international division of functions described earlier. The nation must build an environment to support corporate efforts to leave their innovation functions in Japan. It is necessary to establish a more prominent role for intellectual assets and existing assets at the corporate and community levels. To put it another way, both at home and abroad, Japan needs to bring about the formation of an economy possessing value creation capacity by taking advantage of intellectual assets.

The more open an economy is, the more sophisticated are the quality of its intellectual assets. This observation does not contradict the following hypothesis: When regional integration makes economies more open to the outside world, intensification of competition spurs the adoption of measures to build up a nation's domestic intellectual

assets, and the adoption of measures to build these assets amounts to the taking of preparatory steps for greater economic openness to the outside world.

In this sense, then, East Asian economic integration is spurring measures aimed at building up intellectual assets. And in order to achieve economic integration, it will be necessary to enhance Japan's competitiveness by building up the nation's intellectual assets. It is a transition to a "new value creation economy" through a buildup of the country's intellectual assets amounts to a preparatory step toward East Asian economic integration, and economic integration in turn spurs the transition to a "new value creation economy." There is thus a synergistic relationship between the two factors.

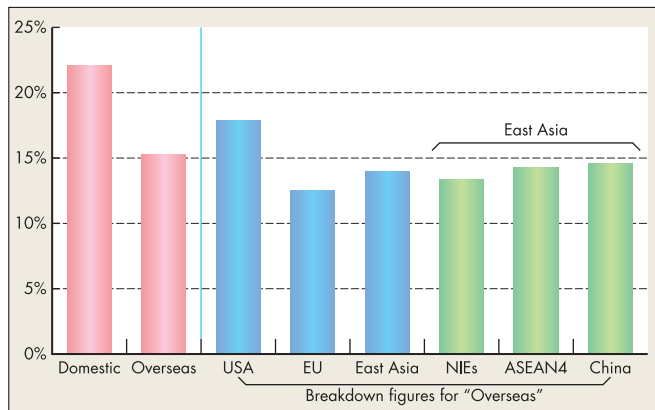
#### Section 4 Agriculture Moves to Value Creation: Toward the Creation of New Business Models

In Japan's agricultural sector, as well, aggressive steps are being taken to

achieve a switch to new business models. An apple farmer, for example, correctly gauged demand in Britain and established a new export channel. In that case, the farmer was able to comply with Britain's demand for the track record on production, and the ongoing implementation of production history management systems in Japan could possibly rebound to the benefit of domestic marketing strategies. Another new business model was introduced at a farm stand. The proprietor installed a point-of-sales (POS) information system to create a direct link between a producer and customers, so that local produce could be sold locally. This case suggests that value creation in the agricultural sector resulting from the implementation of a new business model need not be sought after merely with global markets in mind; such value creation can also be a shot in the arm for community revitalization efforts.

From the standpoint of the "differentiation" of Japan's agricultural products, protecting Japan's geographical

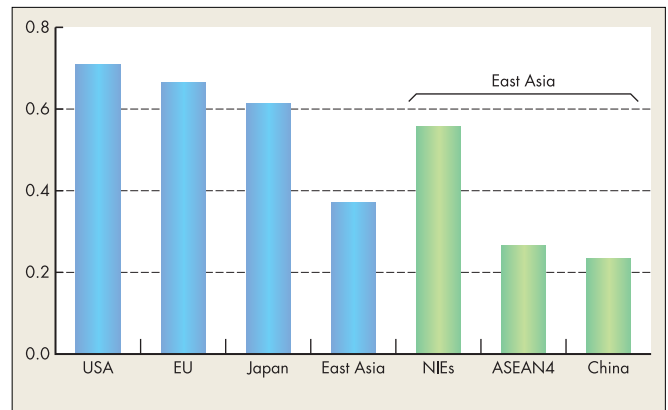
Figure 10 Value-Added Ratios for Japanese Corporations (Manufacturing Sector)



- Notes: 1. Value-added ratio = Total value-added/Sales  
Total value-added = Operating profit (Sales – Cost of sales – SGA expenses) + Gross pay + Rent expense + Depreciation cost (In Japan, however tax and public dues are included.)  
2. Figures represent the totals for corporations currently in business that responded to the all the following six survey items – sales, cost of sales, SGA expenses, gross pay, rent expense and depreciation costs.  
3. Figures in the "Overseas" category are for corporations in which a Japanese investor holds a stake of greater than 10% (overseas subsidiaries), or corporations in which an overseas subsidiary holds a stake of greater than 50%.  
4. All figures are averages for the period 1999-2001.

Sources: Prepared from METI's "Basic Survey of Overseas Business Activities of Japanese Companies" and "Basic Survey of Japanese Business Structure and Activities"

Figure 11 Levels of Skill Intensity by Region



- Notes: 1. Figures for skill intensity here are calculated by the following formula:  
Value-added output by skilled labor / Value-added output by unskilled labor.  
2. The distinction here between skilled and unskilled labor follows the ILO definitions for skilled labor (professional workers and other occupations requiring specialized knowledge) and unskilled labor (production workers and other manual laborers).  
3. The figures in this graph are based on GTAP Version 5 data for labor intensity, which were calculated using the above definitions.

Source: Prepared using data from the "Global Trade Analysis Project (GTAP) Version 5 Data Base"

attributes could serve to strengthen the competitiveness of Japanese agriculture as the East Asian economy continues to grow. By drawing a connection between the characteristics of a producing sector and product quality, geographical attributes can distinguish products in the market from mass-produced agricultural products from elsewhere. And protecting geographical attributes is not just done in order to strengthen the competitiveness of agricultural products; it also contributes to community revitalization by protecting producers and consumers, and by facilitating the establishment of local brands. Government studies on protection policy are carefully addressing the following questions: If a new system of protection were implemented domestically, what kind of systemic undertakings would be the most appropriate, and what agricultural products are there for which latent demand exists?

### Section 5 Strategies for a “New Value Creation Economy”: Thailand’s Dual-Track Policy

Thailand’s “Dual-Track Policy” on economic growth strategy seeks both to promote domestic demand and to attract increased foreign investment. It is based on an analysis of the Thai economy, and is quite different from economic development models pursued in Europe and North America, or the “V formation” model practiced by Japan and South Korea in East Asia.

The Dual-Track Policy is characterized, where export strategy is concerned, by an intent to develop “niche export demand.” The Thai authorities have concluded that conventional price competition based on mass production is a difficult way to compete, and instead, they have decided to analyze and take advantage of Thailand’s own strengths and develop a unique character to achieve differentiation. The Dual-Track Policy also seeks to spur sustained domestic demand by strengthening the nation’s economic underpinnings (e.g. rural society) and by tapping into unique local characteristics for the benefit of community revitalization, thereby breaking free of an

economic structure characterized by excessive reliance on external demand. In concrete terms, to spur consumption, the Thai government has developed the necessary legal infrastructure for recognizing the asset value possessed by owners of land, intellectual property, machinery and food stalls, thereby making it possible for the owners to pledge those assets as security and tap into capital markets. As for the provision of funds, the government is lending support in this regard through public-sector financial institutions. This process of “capital creation,” as it is known, is bringing large numbers of low-income people into capital markets and spurring increased consumption in the lower income brackets.

Individual communities will have to analyze the issue of economic circulation (i.e. intra-community and inter-community flows of employment, capital and goods), and then link this to analysis of the area’s existing assets, so as to pursue an integrated policy for sustained local economic development. This is basically the same as Thailand’s approach, which has been to formulate an economic development strategy and, upon this basis, analyze the domestic economy, identify strategic sectors (especially in connection with niche export demand) and set about the task of developing local specialty products.

Amidst continuing economic globalization, community economies are becoming more easily affected by the global economy than ever before, through the vehicle of investment and development. In developed countries, as well, government policy for local economies calls upon communities to develop independent means of achieving growth, and to actively engage in economic activity outside their own areas. In setting about these tasks, they would do well to take heed of Thailand’s example.

East Asia has seen the development of vertical intra-industry trade involving the division of processes and trade in components (particularly in the machinery sector). Within that context, Japan is bringing about an international division of functions through its

intra-regional foreign direct investment, exhibiting the trend of keeping innovation functions in Japan. Success with this type of international division of functions is one reason why the Japanese economy has recently been showing positive signs.

Once Japan opens its economy through East Asian regional economic integration, spurred by the signing of EPAs, it will become necessary for Japan to establish a division of functions across a fairly wide range of sectors. Strengthening value creation through better utilization of intellectual assets at the corporate level, and the transition to a “new value creation economy” by means of a shift toward competition, where success and failure are determined by a different set of determinants, constitute the infrastructure for such a division. Incipient signs of a transition to such a “new value creation economy” can be seen in many different sectors, but when we compare Japan with the current situation in the integrated European economy, or with the highly competitive United States, we can see that any “new value creation economy” in Japan is still very fragmentary in nature. In this sense, pushing forward with the transition to a “new value creation economy,” and progress toward East Asian regional economic integration, will serve in a complementary manner to propel Japan toward the achievement of a prosperous and resilient national economy.

In addition, the idea of a transition to a “new value creation economy” is much the same as the concept behind Thailand’s “Dual-Track Policy” for economic development. Efforts to bring about a transition to a “new value creation economy,” will do more than create a Japanese economy characterized by prosperity and resilience; they can also serve as a focus of the deepening debate in pursuit of a new form of coexistence with East Asia and the rest of the world. **JS**

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