

Abstract of the White Paper on International Trade 2001

By Yokota Toshiyuki

Introduction

Since 1949, the Ministry of Economy, Trade and Industry (known prior to Jan. 6, 2001 as the Ministry of International Trade and Industry) has issued an annual White Paper, which serves as an official report to the Cabinet. Although it is called the *White Paper on International Trade*, the focus of the White Paper in recent years has expanded well beyond the issue of trade, and now covers a wide range of other issues, including international economic relations, international politics and Japan's domestic structural reforms. This year's *White Paper on International Trade*, which comprises four chapters, provides an analysis of Japan's current status within the context of the trend toward globalization, and attempts to clarify the issues that policy makers will be dealing with from this point forward.

In Chapter 1 of the report, we analyze the advance of globalization and the sustained high growth rate of East Asia. In Chapter 2, we examine the

phenomenon of information technology (IT), which is considered one of the primary causes of the advance of globalization. We focus especially closely on IT strategies at the corporate level, and call attention to a number of problems that need to be addressed in Japan. In Chapter 3, we examine various issues that are now attracting considerable attention as the downside of globalization – problems related to environmental preservation, poverty, labor and deforestation. In addition to describing these problems, we also put forward our view concerning how they should be addressed. And finally, in Chapter 4 we take a look at the future direction of our government's policy concerning Japan's international economic relations within the context of globalization.

In this chapter, we review the policies that the Japanese government has adopted in the past on international economic relations. The Japanese government has expended considerable energy in dealing with the issue of trade friction, but in the future it will be

focusing more on the importance of (1) using a new World Trade Organization (WTO) round and free trade agreements (FTAs) as tools for promoting domestic structural reforms; and (2) setting about the task of rule-making to facilitate the establishment of global markets. Japan's policy on international economic relations has thus far revolved around the WTO and other multilateral forums, but there has clearly been a shift of focus. In order to stimulate WTO negotiations and promote the progress of multilateral trade liberalization, the White Paper is now also stressing the importance of pursuing FTAs and actively making use of regional forums. The future direction of policy on Japan's international economic relations is discussed by Professor Kimura Fukunari in the following article, so we do not duplicate his efforts here. Instead, we build upon the content of chapters 1 and 2 to present an overview of the dynamics driving the trend toward globalization in Japan.

Intensified Competition in East Asia

East Asian economic growth is slowing because exports have fallen in response to the recent slowdown of the U.S. economy. Nevertheless, as shown in Figure 1, the regional economy has been growing at an average annual rate of about 7% since the 1970s, and the potential exists for continued rapid growth. The rise of the Chinese economy has been especially noteworthy, to the extent that some Japanese business magazines are now even talking about the "China threat." Commentators of this ilk are concerned that China could replace Japan as the world's manufacturing nation par excellence.

In the past, observers used the metaphor of a V-shaped formation of wild geese in flight to describe the phe-

Figure 1

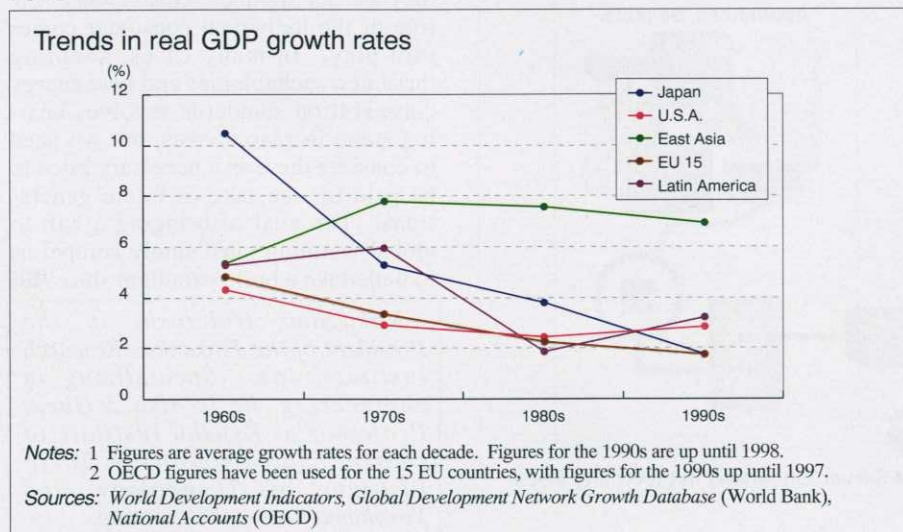


Figure 2-1

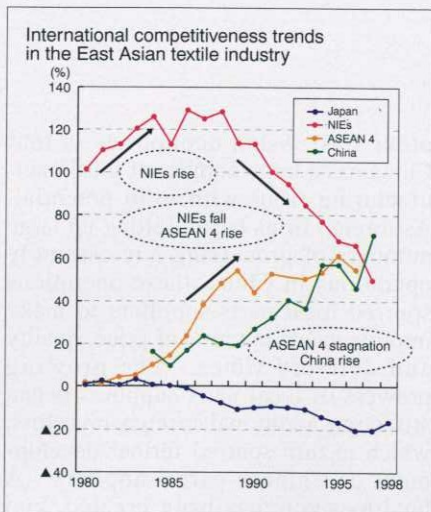
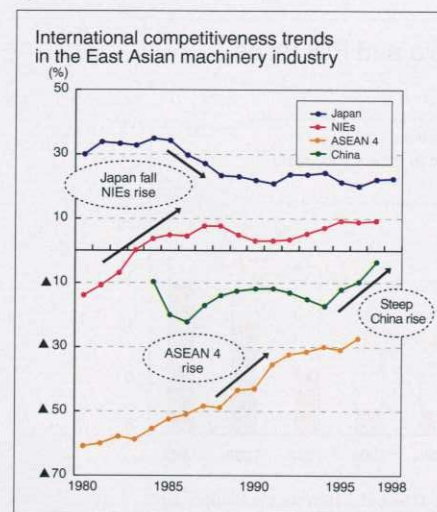


Figure 2-2



Notes: 1 Ratio: (domestic production - domestic demand) / domestic demand * 100
(domestic demand = domestic production + import - export)

2 This shows the international competitiveness of industrial sector.

Sources: AIDXT (Institute of Developing Economies), International Statistics Database (UNIDO)

nomenon of economic development in East Asia. The idea was that all the countries of East Asia were advancing, but that there was a set order to the advance, with developed nations leading the way and developing nations bringing up the rear. According to this metaphor, developed nations fly at the head of the V, specializing in high value-added industries, while less developed nations trailed along behind the leaders, focusing on industries with lower added value. All nations moved forward together, with each one occupying a different niche in the formation. Figure 2-1, for example, shows how the competitiveness of different types of countries in East Asia has changed since 1980 in the textile industry. In Japan, imports have exceeded exports in this category since 1985. At about that time, Japan was eclipsed in the textile industry by the Newly Industrializing Economies (NIEs; South Korea, Taiwan, Hong Kong and Singapore) which were in turn overtaken by the four countries from the Association of South East Asian Nations (ASEAN 4; Thailand, the Philippines, Indonesia and Malaysia), who were themselves subsequently outstripped by China. This is a classical illustration of the V-formation development pattern. By way of contrast, however, Figure 2-2 shows that this pattern has not held true in the machinery industry. Instead, Japan, the NIEs, the ASEAN 4 and China all plunged into

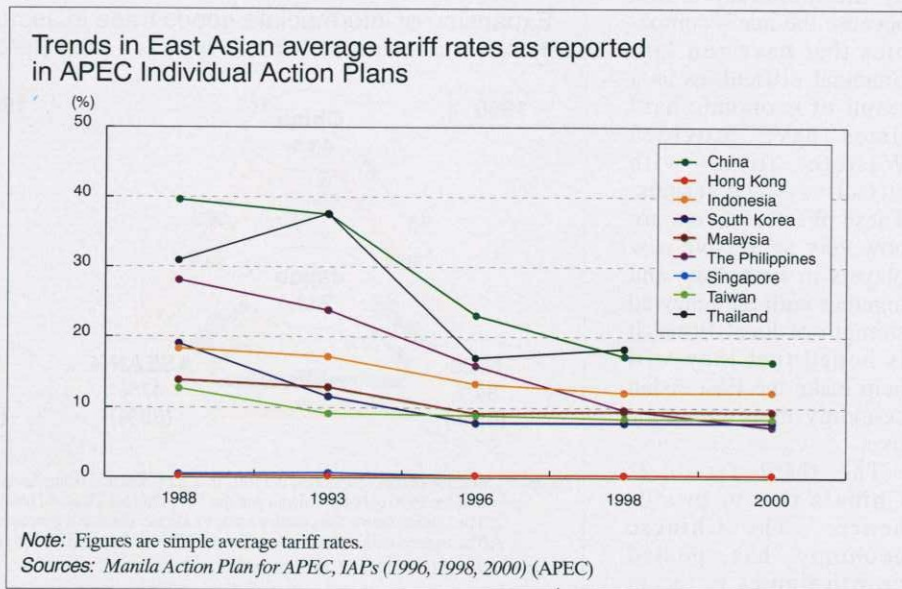
fierce free-for-all competition. Tough competition of this sort has been an ongoing characteristic of East Asian economic development for some time now. This situation has arisen primarily as the result of three main factors.

The first factor was the rapid reduction and elimination during the 1990s of barriers to trade and investment within the East Asian region. Figure 3 shows how average tariff rates for various East Asian economies have fallen since 1988, with rates for most economies down to single digits by the year 2000. This is the result of explicit

policy measures that have been adopted throughout the region in response to various multilateral agreements. One of these was the Bogor Declaration, whereby the participants at the 1994 Asia-Pacific Economic Cooperation (APEC) Leaders Meeting in Indonesia agreed to voluntarily eliminate trade barriers. Another was the Information Technology Agreement that was finalized at the Singapore Ministerial Conference of the WTO in 1996, in which the parties pledged in principle to completely eliminate duties on 200 IT-related products by the year 2000. East Asian economies have also been moving actively to eliminate non-tariff trade barriers and investment barriers. Each party to the Bogor Declaration was required to develop an Individual Action Plan (IAP), and it is reported that these IAPs have resulted in the elimination of import permits and import quotas. In addition, efforts to improve investment conditions are also making headway, with foreign direct investment (FDI) being liberalized and local procurement requirements eliminated.

In addition to these reductions of barriers to trade and investment, a second factor contributing to intensified competition in East Asia is a sharp increase

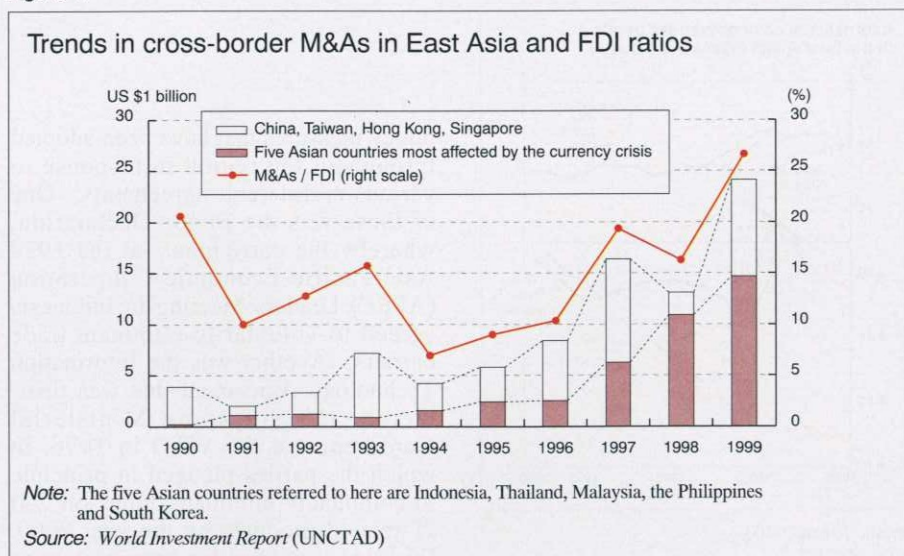
Figure 3



Note: Figures are simple average tariff rates.

Sources: Manila Action Plan for APEC, IAPs (1996, 1998, 2000) (APEC)

Figure 4



in FDI to the region. FDI rose rapidly throughout the world in the 1990s; over the past 10 years the global FDI stock has tripled, while the FDI stock in East Asia has quadrupled. The jump in East Asian FDI has been due in part to cross-border mergers and acquisitions (M&As). As shown in Figure 4, the Asian currency crisis of 1997 triggered a sudden leap in the number of cross-border M&As. Engineered primarily by Western firms, cross-border M&As are occurring now at triple the rate prior to the crisis. The increase has been especially marked in Indonesia, Thailand and the other three countries hardest hit by the monetary crisis, because the many companies that have run into financial difficulties as a result of economic hard times have provided Western firms with attractive M&A targets. These Western firms are now very aggressive new players in East Asia, and together with the renewed strength of local firms, it is hoped that they will help make the East Asian economy more competitive.

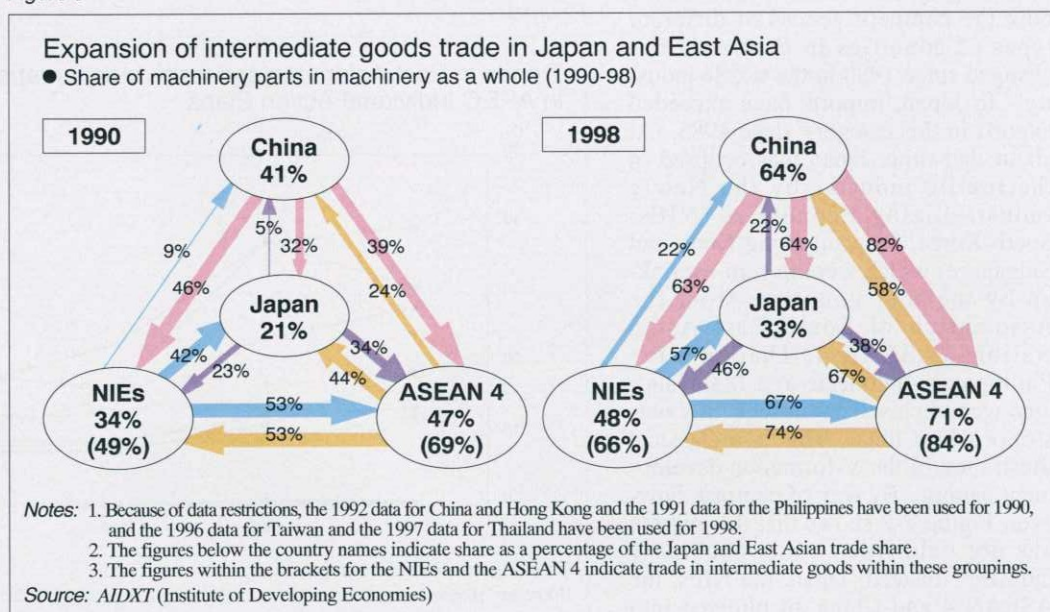
The third factor is China's rise to prominence. The Chinese economy has posted growth figures in recent

years that are outstanding even by East Asian standards, and much of the growth is due to that country's active efforts to attract investments by foreign companies. Looking just at Chinese exports, for example, we find that up until around 1985 foreign-invested enterprises in China contributed very close to 0% of Chinese exports, but by 1999 this figure had risen to about 45%. There have been many reasons for the dramatic increase in the activities of foreign-invested enterprises in China. The most notable difference between the Chinese economy and

other East Asian economies is that China has a large number of local manufacturing firms with solid potential. As foreign firms began setting up large numbers of processing and assembly operations in China, these operations spurred local parts suppliers to make improvements in terms of price, quality and delivery times. The growing prowess of local parts suppliers began attracting additional foreign investors, which in turn spurred further development of Chinese parts suppliers. A healthy cycle has been created, and continues to feed on itself in this manner, thereby fueling China's economic growth.

When FDI was not as frequent as it is today, it took a long time for an economy to accumulate the capital, technology and human resources needed to develop leading-edge industries. Under such conditions, the "V formation" development pattern was inevitable. With the economic globalization occurring today, however, these restrictions no longer apply, and economies with potential now have a chance to vie for industry leadership without hanging back toward the rear of the "V formation." As a result, we have now entered upon a new, intensely competitive age

Figure 5



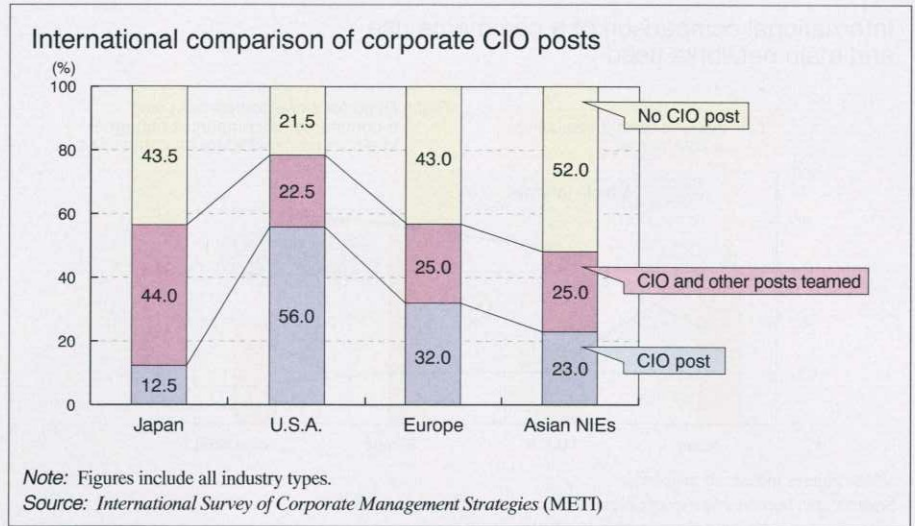
in which the development prospects of individual economies are not limited by their overall stage of development. This is spurring increased efficiency in East Asian companies and bringing further economic development to the region.

At the same time, however, as competition heats up, East Asian economies are growing more and more closely dependent upon each other. Figure 5 shows the percentages of machinery trade in East Asia (including Japan) that are accounted for by parts trade, with comparative figures for the years 1990 and 1998. Parts trade increased during this eight-year period, especially between China and the other regional economies. This increased interdependence can be attributed to the advance of globalization. The phenomenon of globalization has thus brought an increase not only in competition, but also in interdependence, and this is expected to trigger yet a further round of economic development in East Asia. It is true, of course, that the rise of East Asia is important for Japan's further development, but even more noteworthy is the fact that the reduction of barriers to trade and investment in East Asia and the continued brisk pace of FDI are now much more important than ever before in the effort to increase the attractiveness of Japan's business environment.

The IT Revolution and Its Impact on the Business World

The development of information technology is quickening the pace of globalization, and the important role played by IT in economic growth is widely recognized. Last November, for example, the Japanese government formulated the "e-Japan Strategy," which calls for development of the country's network infrastructure. At the same time, however, there is a need for manufacturing and business firms to take a critical look at how well they are implementing IT, and to ask how their performance in this area is affecting their international competitiveness. In this White Paper, we undertake a com-

Figure 6



parison of the IT strategies of firms in Japan, the United States, Europe and the Asian NIEs, and we use this comparison as a springboard for examining the distinguishing features of Japanese firms as well as outstanding issues that they need to address.

Figure 6 shows the percentages of firms in these four regions with a Chief Information Officer (CIO). The percentage of firms with a full-time CIO is nearly five times higher in the United States than in Japan, an apparent indication that there is not a strong mechanism in Japanese corporations for allowing top management to show any initiative in this area. Although more than 40% of Japanese firms have someone who acts as CIO in addition to full-

filling other duties, about eight in 10 of these adjunct CIOs actually spend less than half of their working time dealing with IT-related matters.

Secondly, we examine some of the concrete ways in which different companies are utilizing IT. In Figure 7 we present comparative figures showing the percentages of firms in the four aforementioned regions that have implemented the use of seven key types of computer applications. A relatively high percentage of Japanese firms make use of computer-aided design (CAD) systems, which are used for the design of industrial products and the like, but Japanese firms lag behind in the use of enterprise resource planning (ERP) software (which cuts across the

Figure 7

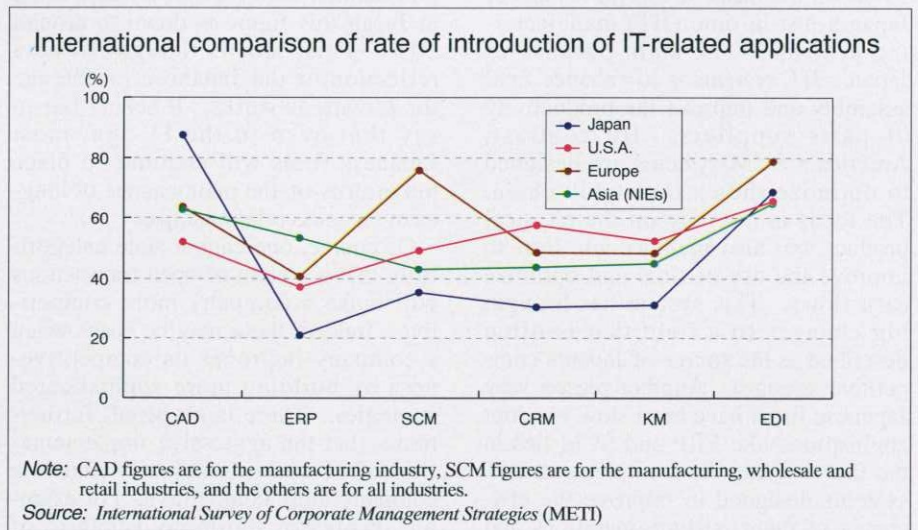
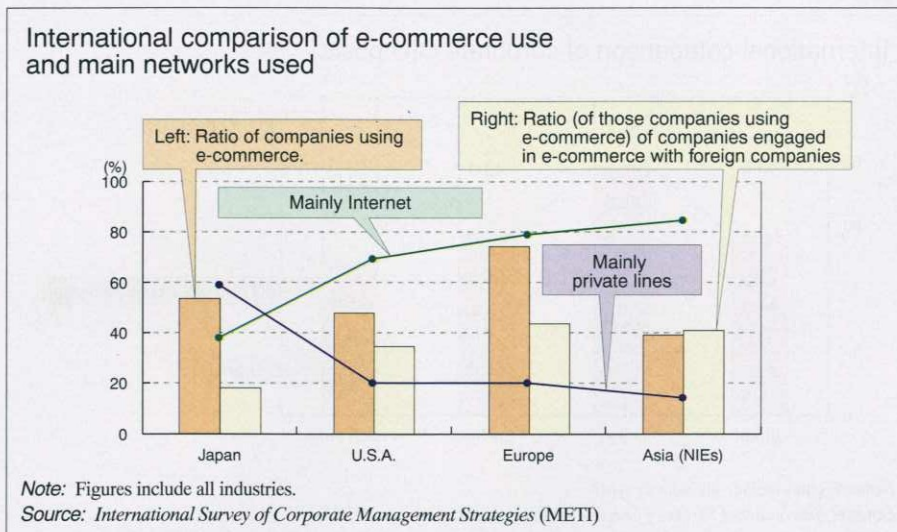


Figure 8



entire scope of a company's operations, including production, marketing and accounting) and supply chain management (SCM) software (which pulls together all the links in a supply chain, from product suppliers to delivery firms, for the purpose of exercising coordinated management of information related to materials procurement, products, sales and inventory). It is often said that Japanese firms have been behind the curve in this area because top corporate leadership has not shown the strong initiative that would be required to push through the operational and organizational reforms that are needed in order to implement ERP and SCM systems.

SCM systems were reportedly first developed by U.S. corporations in the 1990s on the basis of careful studies of Japan's just-in-time (JIT) manufacturing systems. The main purpose of Japan's JIT systems is to enhance final assembly and improve the productivity of parts suppliers. By contrast, America's SCM systems are designed to optimize the entire supply chain. The focus is not only on the physical product, but also includes an effort to improve the use of time and optimize cash flows. This system has brought big changes to a field that is often described as the source of Japan's competitive strength. Another reason why Japanese firms have been slow to adopt applications like ERP and SCM lies in the fact that they have implemented IT systems designed to improve the efficiency of their existing operations and

transaction methods, while relatively few firms are carrying out IT-inspired reforms of their operations, organizations, or transaction methods.

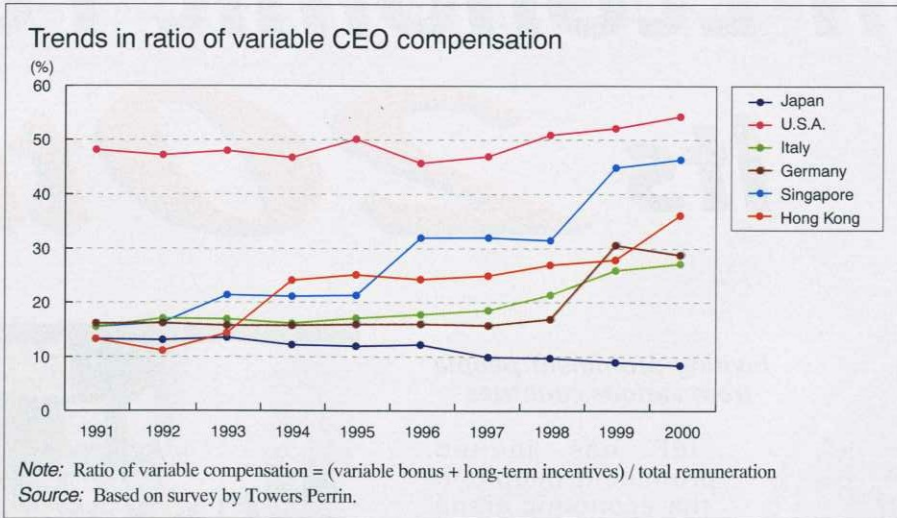
This trend is also seen in the expansion and globalization of sourcing partners. Figure 8 presents a comparison of the level of involvement in e-commerce among companies in the four regions. Firstly, while Japanese companies tend mainly to engage in e-commerce via their own private networks, overseas firms operate primarily via the Internet. This is thought to be a reflection of the fact that Japanese firms mostly build networks in order to facilitate transactions with stable, long-term clients. Among firms active in e-commerce, about 40% of the firms outside Japan use e-commerce to engage in transactions with foreign clients, while in Japan this figure is down to around 20%. This, too, is thought to be a reflection of the Japanese preference for private networks. It seems fair to say that even in the IT age, most Japanese firms will continue to place top priority on the maintenance of long-term business relationships.

Of course, one cannot state categorically that a system of open transactions will make a company more competitive. Indeed, there may be cases when a company improves its competitiveness by building more sophisticated strategies. There is no proof, furthermore, that the aggressive implementation of IT systems actually makes a company more competitive. For example, Professor Fujimoto Takahiro of

Tokyo University offers a very interesting analysis of the competitiveness of the Japanese and American auto industries. Fujimoto notes that although U.S. auto makers have invested more in IT systems than their Japanese counterparts have, Japanese makers require a lead time of less than 20 months for product development, while the lead time for American makers is still around 30 months. Japanese makers are winning the race because the product development systems used in the West are not as good as the Japanese method known as "front loading." With the front loading method, auto makers make heavy use of computer simulation in the early stages of product development in order to identify as many problems as they can early on and solve them promptly. On the other hand, when we use profitability as the yardstick for comparing the performance of Japanese and U.S. auto makers during the 1990s, we find that it is actually the American makers who have achieved greater profitability, their long product development lead time notwithstanding. This is due primarily to the fact that U.S. auto makers have aggressively developed such products as mini-vans and sport utility vehicles, which offer high profit margins, while Japanese makers have been slow out of the gate in these categories.

These facts tell us that the implementation of IT systems does not necessarily make a company more competitive in the area of product development, and that strong manufacturing prowess does not necessarily translate into strong profitability. It is thus apparent that there is no merit to the argument that IT systems must be adopted as quickly as possible in order to enhance the competitiveness of manufacturing and business firms. The important thing is to develop the ability to formulate more sophisticated strategies. In addition, it is important that top management show strong initiative, not only regarding the use of IT systems, but also in the effort to develop the ability to formulate more sophisticated strategies. We believe that the future success of IT systems apparently depends on companies' abil-

Figure 9



ity to formulate sophisticated strategies. What must be done to improve the initiative of top management? In the White Paper, we discuss three ideas regarding this question.

The first of these concerns executive compensation systems. In Figure 9 we compare the four regions from the perspective of the percentage of executive salaries that come in the form of incentive-style compensation, such as bonuses or stock options, and we track these percentages through the 1990s. As the figure shows, roughly 90% of the compensation paid to Japanese executives comes as base salary, which is unaffected by a company's performance. Incentive-type compensation has always been high in the United States, but it is interesting to note that incentive-type compensation for top executives has also been on the rise during

the 1990s at companies in Europe and the Asian NIEs. What does this mean to top executives? It means that when a company does well, its executives can be very handsomely compensated. At the same time, if top management makes mistakes and the company takes a drubbing from the competition, executive salaries go down. Executives working under such conditions are personally exposed to the risks of a competitive marketplace, and this spurs them to show greater initiative. In Japan, as well, there is a need to establish tough market competition to elicit greater initiative on the part of executives, thereby bringing about an environment that is conducive to innovations in corporate management.

Finally, it is important to have a system that provides for the smooth replacement of executives who do not

achieve positive results. In Figure 10 we provide a comparison among Japan, the United States and Europe in terms of the average ratio of total M&A takeover costs to total equity assets. In the United States, for example, as M&As became increasingly frequent in the latter half of the 1980s, more and more companies began replacing top executives and undertaking bold reforms. These changes have played a role in the strong economic growth that the United States enjoyed in the 1990s. EU firms have also been going through M&As and management restructuring in recent years. Japan has also been moving in this same direction over the past few years, but still lags well behind Europe and America, and it is thought that Japanese companies are in need of further infusions of new blood. Progress is being made toward the elimination of cross-shareholding in Japan, but it is important that further steps be taken to build M&A-related systems and other elements conducive to corporate restructuring.

Conclusion

The increasing globalization of today's world has greatly facilitated the international movement of people, money, goods and information. Nations are growing more and more interdependent on many different levels. At the same time, however, competition is also growing in intensity. While individual economies and companies have many opportunities to achieve success, companies that fail to embrace change face an increased risk of being eliminated. As we head into the age of globalization, it seems clear that both nations and individual companies will have to develop the ability to formulate strategies and compete, and will need their top leaders to show strong initiative.

UJI

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Figure 10

