

White Paper on International Economy and Trade 2007

Japan's Trade Strategy on improving industrial productivity and accelerating economic growth

-Dynamic growth of East Asia and Globalization of Service industries-

(Overview)

July 2007

Ministry of Economy, Trade and Industry

Chapter 1 Current status of the global economy and future challenges (towards sustainable growth)

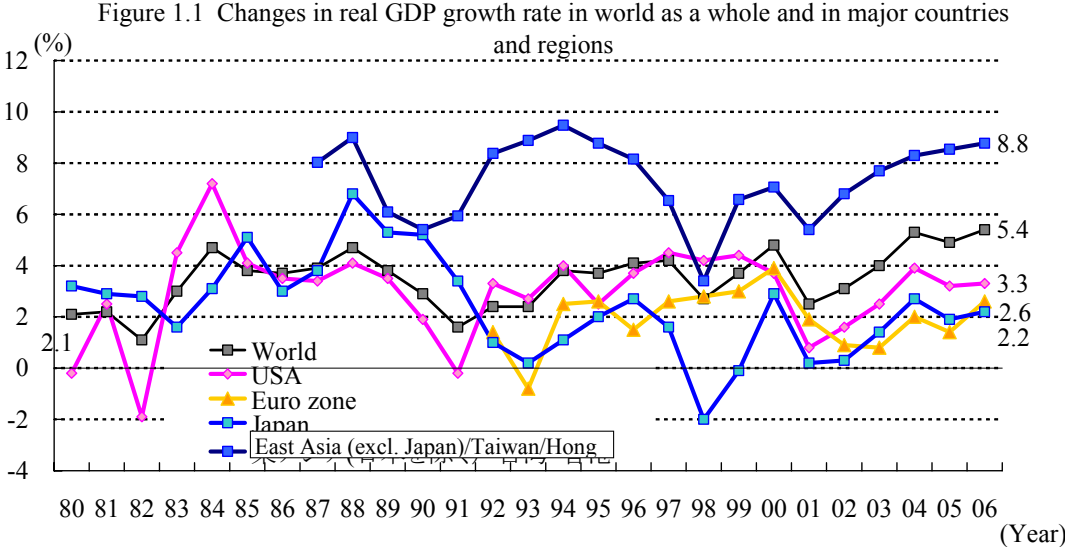
- While on the one hand the global economy continues to grow, accompanying this growth is the continued expansion of the global current account imbalance. For two consecutive years since 2005 the income surplus of the United States has shrunk. It is hoped that each country will engage in structural adjustments and that the expanded equilibrium will be achieved in the global economy.
- The Chinese economy which continues on its high growth track has an excessive dependency on exports and investment. Correcting disparities and converting to a domestic demand-led structure would support the goal of achieving sustainable growth in the global economy. The Indian economy also is currently in a period of high growth, focused on the service industries and domestic demand, and in the Indian economy industrial infrastructure improvements and enhanced transparency in the operation of the legal system are required.

1. Trends and structural changes in the international economy

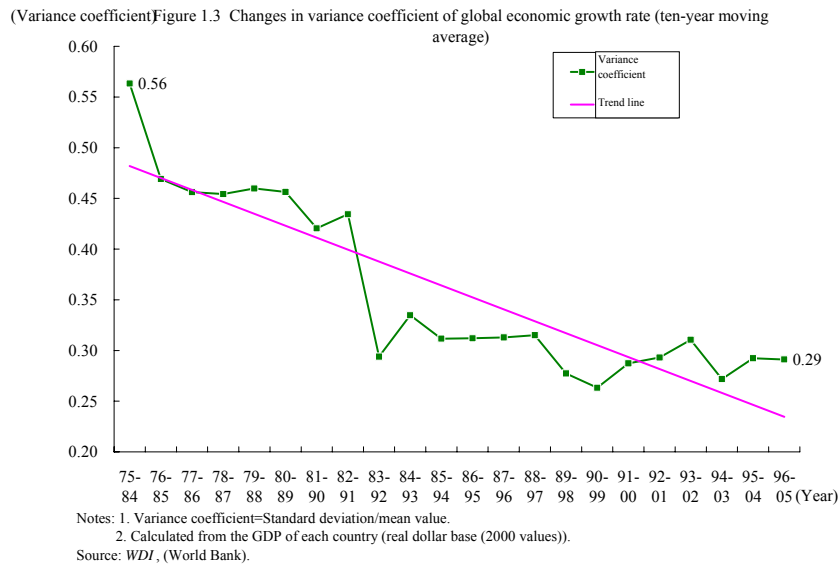
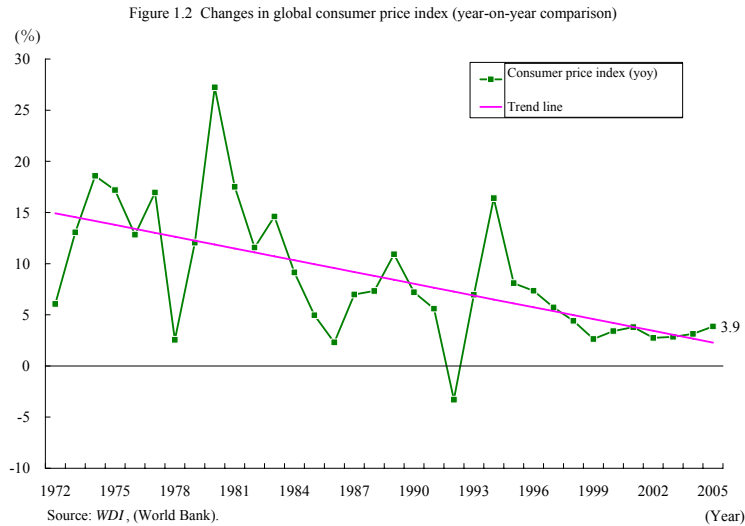
(1) Sustainable growth continuing in the global economy

East Asia (see note), Taiwan and Hong Kong (not including Japan) are continuing to record high growth (real GDP growth in 2006: 8.8%)(Figure 1.1), and global business trends and changes in consumer prices are strengthening this stable growth track (Figures 1.2, 1.3), leading to sustainable growth continuing (2006: 5.4%) in the global economy.

(Note) In this White Paper, East Asia is defined as Japan, China, Korea, ASEAN, India, Australia and New Zealand, a total of 16 countries.



Source: World Economic Outlook Database April 2007, (IMF).



It is generally viewed that in the background to this sustainable growth in the global economy, there are the following compound effects from various factors.

(i) Improvements in financial policy management

As one of the factors pointed out as having helped to realize the dual achievement of high growth and stable growth in the global economy since the latter half of the 1990s, the first is thought to be that financial policy management has been accurately implemented by monetary authorities in developed countries, including the US. Doing this has helped to avoid overheating of the economy and excessive credit crunches, thereby enabling sustainable growth.

(ii) Advanced production and inventory management technologies through utilization of IT

In addition, the utilization of IT is thought to have not only heightened growth potential through drastic productivity improvements, but also has enabled companies to adjust production swiftly to changes in demand. As a result, there is a view that the volume of inventory has decreased, which in turn has reduced the potential impact of stock cycles on the business cycle.

(iii) Globalization of the economy

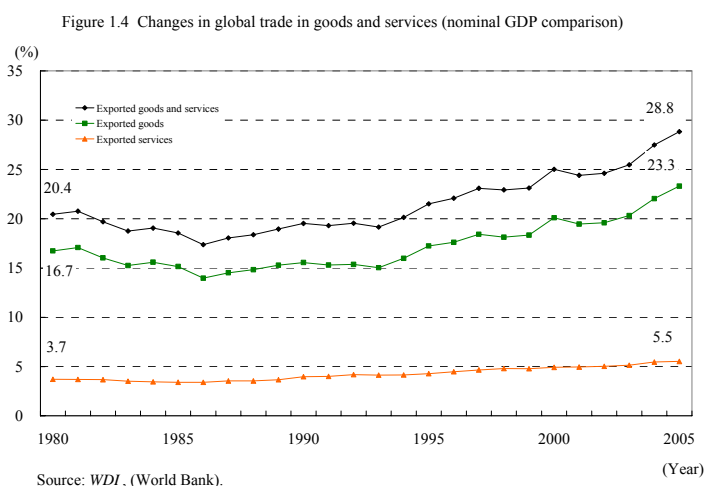
In addition, there is another view that through deregulation, various obstacles in the goods, services and capital markets have been dismantled, and, as a result, growth potential has heightened thanks to increased efficiency in the economy as a whole. In addition, the enhanced degree of freedom of action for companies has enabled them to respond flexibly and speedily to changes in the economic environment.

(iv) Development and advance of service economy

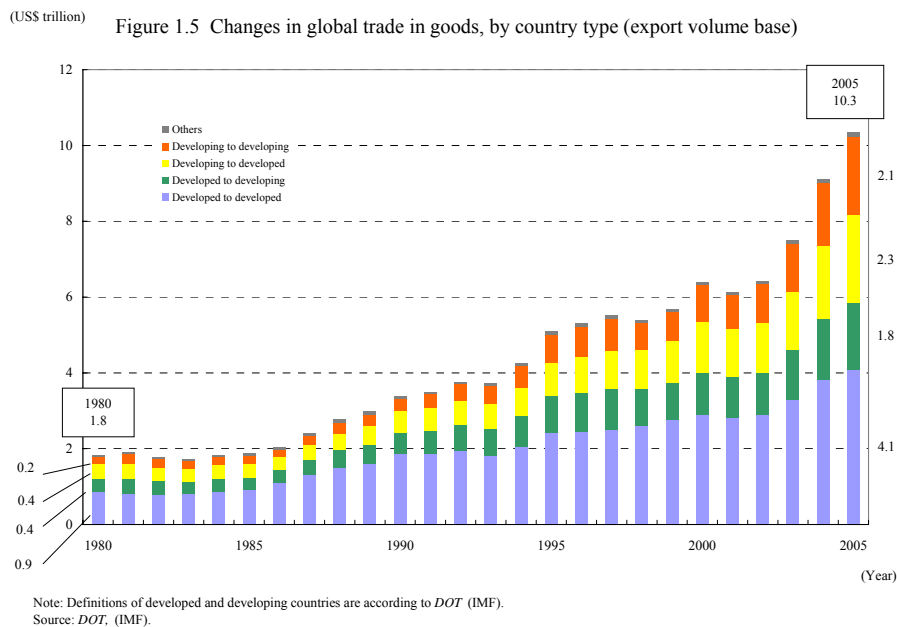
The proportion of the entire economy accounted for by the service industry is rising in every country in the world, and in 2003 the service industry accounted for 68% of global nominal GDP. It is thought that the move to a service economy on a global scale is contributing to the stabilization of the global economy. (In general, as the move to a service-based economy advances, service production has a high degree of dependency on consumption-related demand in comparison to goods production, services are also not subject to stock cycles as they do not produce inventory, and capital and output ratios for the service production sector are not as high as for the goods sector. It is for such reasons that it is thought that a service-based economy is one in which the amplitude of the business cycle is reduced, leading to stability).

(2) Trade and investment expanding in the global economy

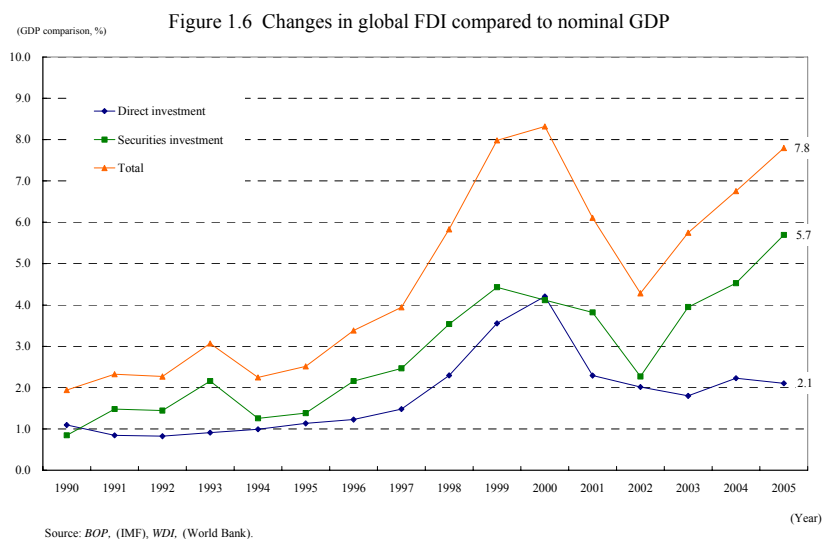
The global trade in goods and services has risen dramatically since the latter half of the 1990s and in 2005 it reached a volume of approximately US\$12.8 trillion, accounting for 28.8% of global nominal GDP. In the same period the trade in goods has strengthened its upward trend since the latter half of the 1990s and in 2005 it had expanded its share of nominal GDP by approximately 1.5 fold to 23.3%. On the other hand, the proportion of nominal GDP accounted for by the trade in services has risen steadily from 3.7% in 1980 to 5.5% in 2005, demonstrating that in comparison to the trade in goods, its share of nominal GDP and pace of increase have remained at a relatively low level (Figure 1.4).



The background to this rapid expansion of the trade in goods has been the rapid increase in the volume of trade in goods, to which developing countries have been contributing. Trade in goods between developing countries has expanded by approximately 10 fold between 1980 and 2005, rising from US\$0.2 trillion to US\$2.1 trillion (Figure 1.5).

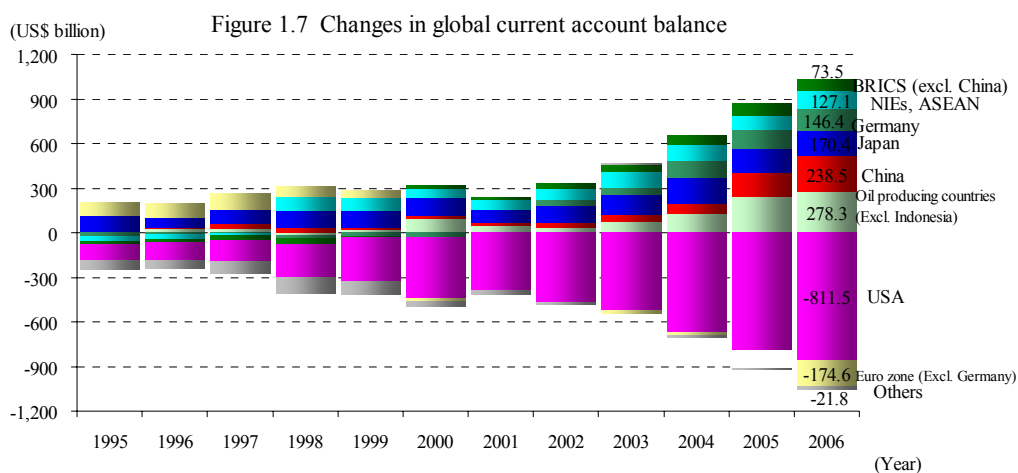


At the same time, looking at investment trends, we see that with a backdrop of the globalization of corporate activities in recent years the global movement of capital has rapidly developed and this has meant that global external investment as a proportion of nominal GDP has expanded rapidly since the latter half of the 1990s. Moreover, looking at the trends in external investment as a proportion of nominal GDP and splitting it further into FDI and investment in foreign securities, we see that since 2003 while the growth of FDI has slackened somewhat, investment in foreign securities is the engine that is currently driving external investment as a whole (Figure 1.6).



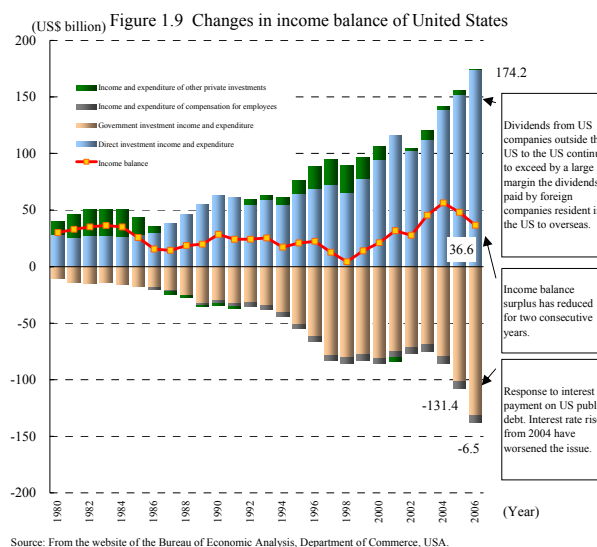
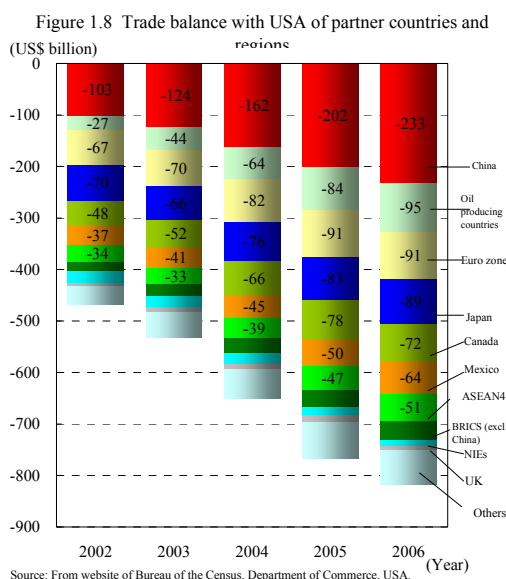
2. Expansion of global current account imbalance

The expansionary trend of the global current account imbalance is continuing (Figure 1.7). In 2006 the US current account deficit expanded to 6.1% of GDP. The current account surpluses of China, buoyed by robust exports, and the oil producing countries, which are benefiting from the high price of crude oil, have continued to expand. There have been no significant changes in the current account surpluses of Japan, the ASEAN4 or the NIEs.



Looking at the US balance of trade with a number of trading partner countries and regions, we see that the largest trade deficit is with China, which accounts for approximately one-quarter of the entire trade deficit (Figure 1.8).

In addition, since 2005 the US income balance surplus has shrunk for two consecutive years, given the deterioration in government investment income and expenditure which has been brought about by increased interest payments on national bonds to overseas (Figure 1.9).



Accompanying the expanding current account deficit has been the continued expansion of the balance of external debt of the US, which at the end of 2005 had reached US\$2.5462 trillion (20.4% of GDP). It is important for the US to stabilize the ratio of its net external debt balance to GDP by reducing the trade deficit by a fixed degree.

In the background to the global current account imbalance is the emergence of a bipolar structure, with a large-scale lack of savings (over-investment) focused on the household and government sectors in the US (Figure 1.10), coupled with the situation in China (Figures 1.11 and 1.12), ASEAN4 (Figure 1.13) and NIEs (Figure 1.14), in which household consumption has remained flat or has decreased, and also in oil producing countries, in which the investment environment remains stagnant, where there are excessive savings (under-investment) (Figure 1.15).

Figure 1.10 Changes in the US savings investment balance by

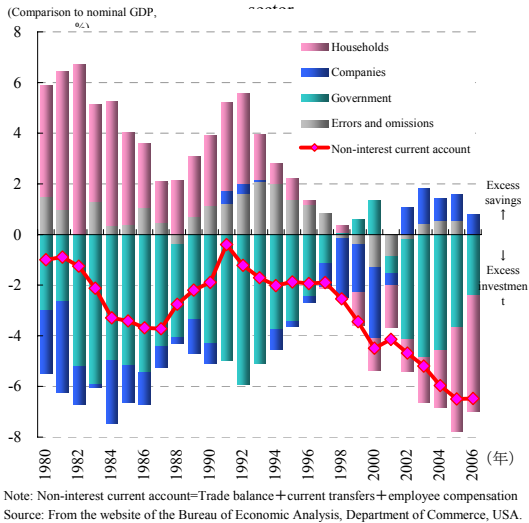


Figure 1.11 Final household consumption expenditure for Japan and China

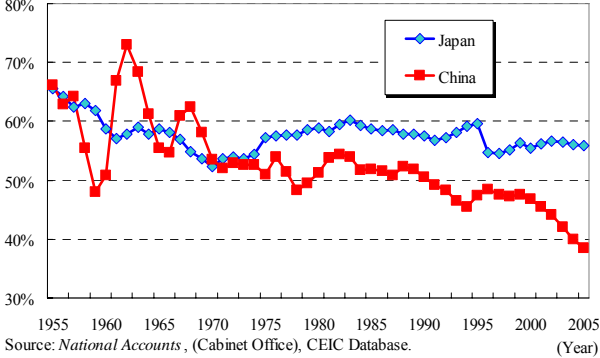


Figure 1.12 Balance of China's savings and investment

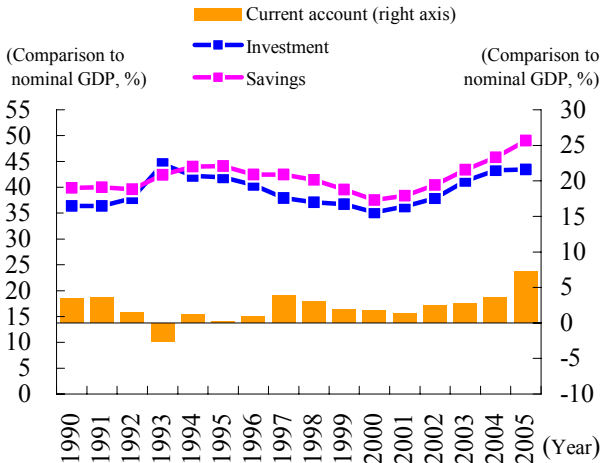
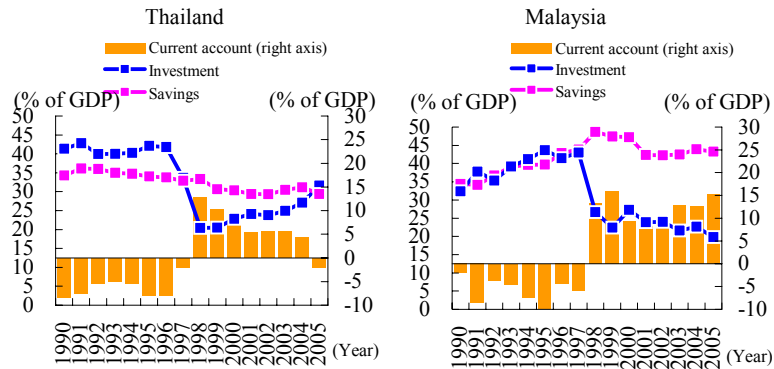
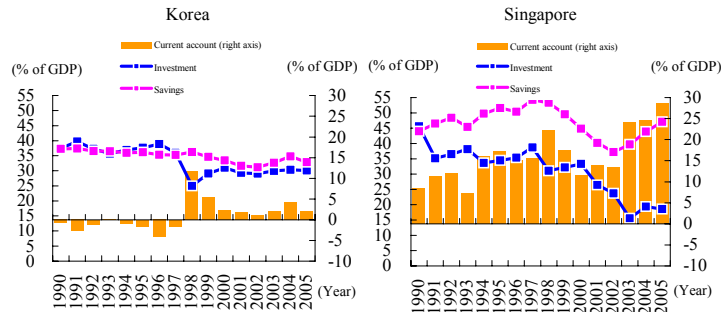


Figure 1.13 Changes in current account and savings and investment balance of ASEAN countries



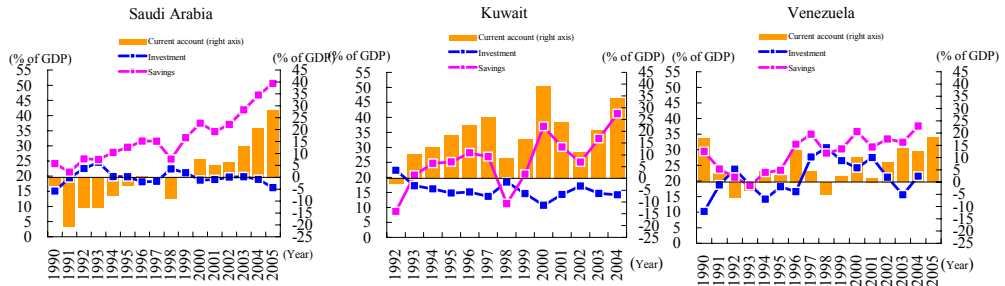
Source: *Key Indicators 2006*, (ADB).

Figure 1.14 Changes in current account and savings and investment balance of NIEs countries



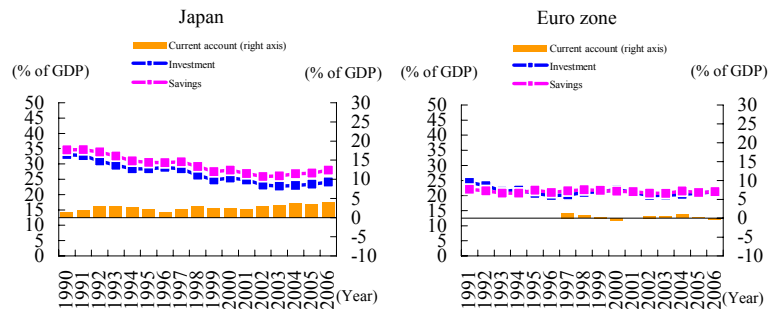
Source: *Key Indicators 2006*, (ADB).

Figure 1.15 Changes in current account and savings and investment balance of oil producing countries



Source: *WDI*, (World Bank).

Figure 1.16 Changes in current account and savings and investment balance of Japan and Euro zone countries



Note: Euro zone consists of 13 countries. Data for current account balance starts from 1997.
Source: *WEO*, (IMF).

In order to reduce the global current account imbalance it is necessary that efforts be made to ensure that foreign exchange, including the yuan, is brought to a level that reflects economic realities. However foreign exchange alone can only play a limited role in reducing the current account imbalance. To correct the global current account imbalance it is essential that efforts be made to bring savings and investment into balance, through reducing the US fiscal deficit and improving the savings rate, etc. (Figure 1.17).

Figure 1.17 Challenges facing various countries that have been pointed out in efforts towards reducing global current account imbalances

	Statement of G-7 Finance Ministers and Central Bank Governors (Attached statement) Apr. 21, 2006	13th APEC Finance Ministers' Meeting Joint Ministerial Statement Sep. 7-8, 2006	International Monetary and Financial Committee (IMFC) Communique Sep. 17, 2006
USA	Further action is needed to boost national saving by continuing fiscal consolidation, addressing entitlement spending, and raising private saving.	greater national savings	to boost national saving, including fiscal consolidation
Europe	further action is needed to implement structural reforms for labor market, product, and services market flexibility, and to encourage domestic demand led growth	stronger domestic demand growth	further progress in growth-enhancing reforms
Japan	further action is needed to ensure the recovery, with fiscal soundness and long-term growth through structural reforms	further structural reforms including fiscal consolidation	further structural reforms, including fiscal consolidation
Emerging Asia	(Particularly China): greater flexibility in exchange rate is critical to allow necessary appreciations, as is strengthening domestic demand, lessening reliance on export-led growth strategies, and actions to strengthen financial sectors.	greater exchange rate flexibility for some economies as appropriate	reforms to boost domestic demand, together with greater exchange rate flexibility in a number of surplus countries
Others	Oil producing countries: accelerated investment in capacity, increased economic diversification, enhanced exchange rate flexibility in some cases. Other current account surplus countries: should encourage domestic consumption and investment, increase micro-economic flexibility and improve investment climates.	APEC region: More dynamic growth in domestic demand	increased spending consistent with absorptive capacity and macroeconomic stability

Source: Ministry of Finance website, compiled by METI.

3. Sustainable development required in Chinese economy through acceleration of efforts for harmonization of domestic economy

(1) Over-dependence on investment and exports—balanced growth is now required

- The Chinese economy has continued with high, double-digit growth for four consecutive years and is excessively dependent on investment and exports. Huge fixed asset investment (more than 52% of GDP) has resulted in excessive production capacity, and exports have grown to the equivalent of 37% of GDP (Figures 1.18, 1.19). The trade surplus in 2006 also stood at US\$177.5 billion, the highest ever recorded.

Figure 1.18 Changes in ratio of investment and exports to nominal GDP in China, Japan and USA

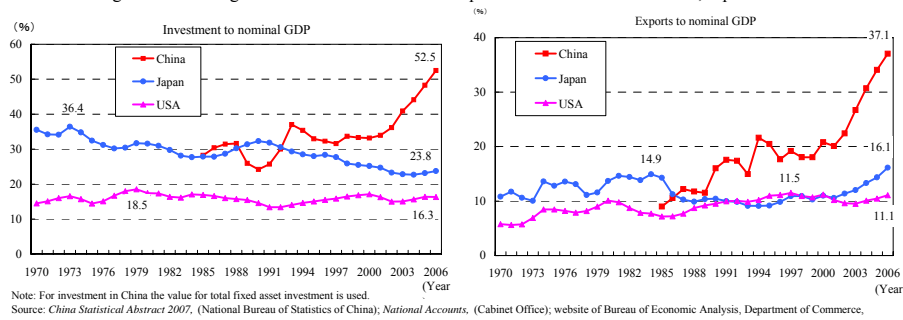
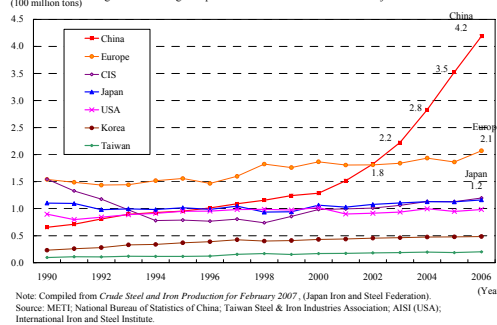


Figure 1.19 Changes in production volume of crude steel in major countries



- The Chinese government has implemented foreign exchange intervention, buying dollars and selling yuan in order to control the upward pressure on the yuan brought about through the expanding trade surplus and continued capital inflow. As a result foreign currency reserves at the end of 2006 stood at more than US\$1 trillion, the highest in the world. The yuan's appreciation against the dollar has been gentle thus far (Figures 1.20, 1.21).

Figure 1.20 Changes in China's foreign currency reserves

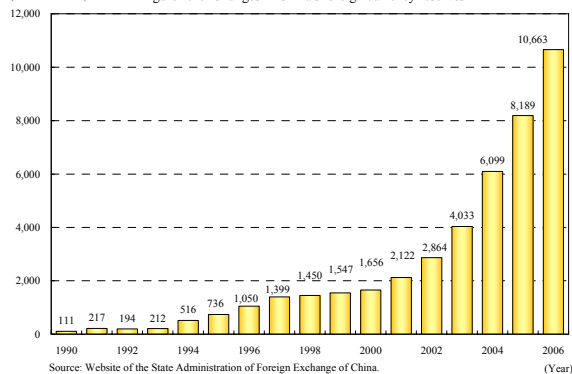
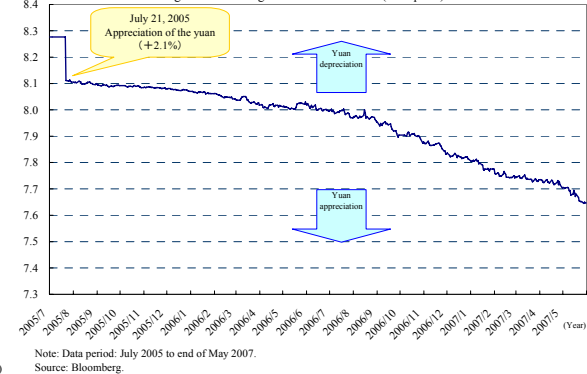
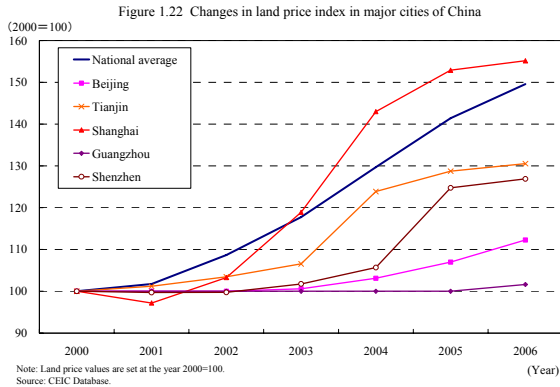


Figure 1.21 Changes in Yuan-dollar rate (final price)

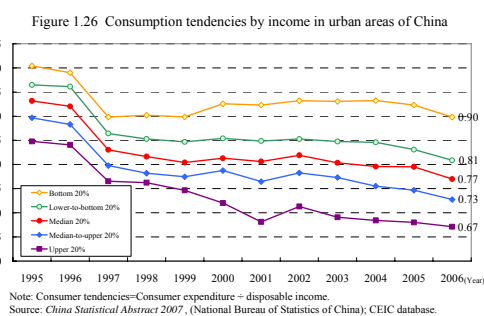
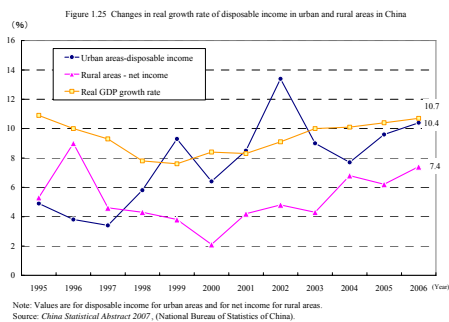
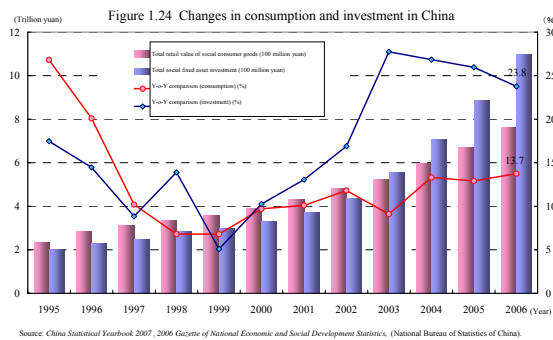


- The undervaluation of the yuan lifts the export competitiveness of domestic industries and leads to increased exports, as well as bringing about investment overheating and a real estate bubble through inflows of speculative capital, and this is an element on which inefficient companies have come to rely. In order for the Chinese economic to develop in a healthy manner, it is essential to strengthen macroeconomic and financial policy, and it is therefore necessary to steadily advance the strengthening of the financial sector, liberalization of capital movements and introduce greater flexibility into the foreign exchange structure (Figures 1.22, 1.23).

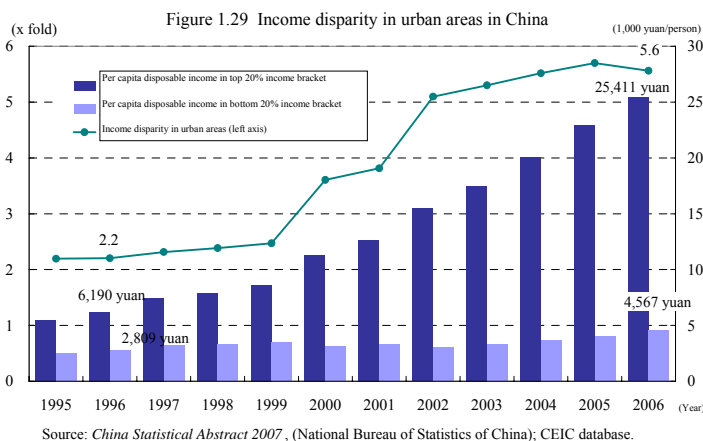
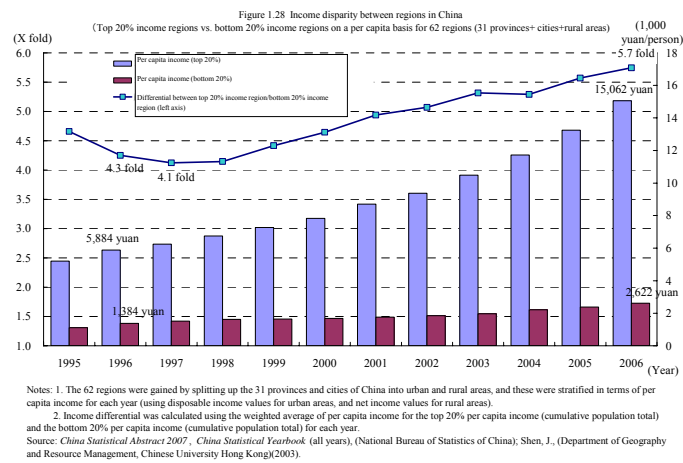
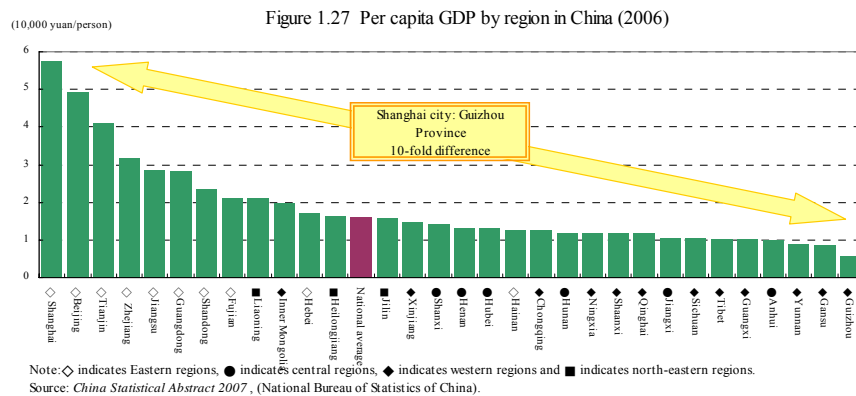


(2) Problem of expanding disparities—towards a stronger base for growth through expanded consumption

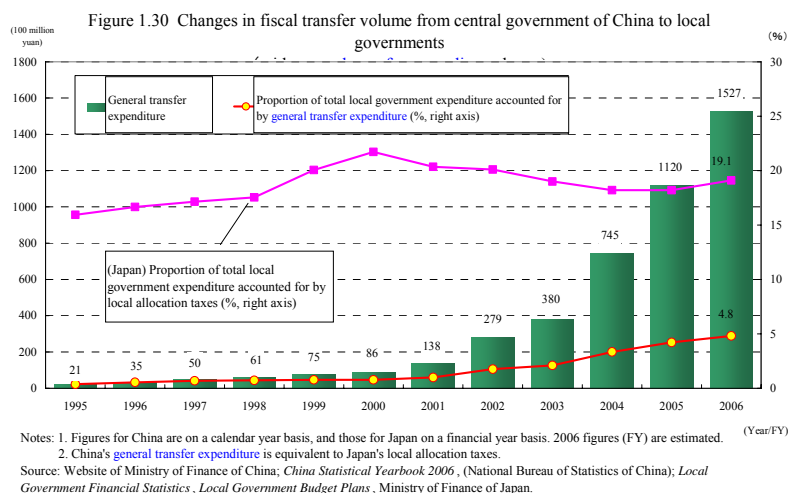
- In order for the Chinese economy, which currently depends on investment and exports, to achieve sustainable development it is important to make a transition to a consumption-led economy. However, currently there are no signs that consumption is growing. Although household income is increasing, consumption patterns are flat or on a downward trend and this situation will not lead to an expansion in consumption (Figures 1.24, 1.25, 1.26).



- In order to construct a base for consumption-led growth, an important key will be to correct disparities. Looking at regional disparities in China we see that in terms of per capita GDP, the difference between the City of Shanghai and Guizhou Province is approximately ten-fold (the largest ever difference among the prefectures of Japan in the post-war period was 2.9-fold (1961), with a difference now of 2.3-fold). In terms of per capita disposable income, the difference between the top 20% income earners and the bottom 20%, is approximate six-fold. In addition, income disparities in urban areas have also expanded significantly, from approximately two-fold to approximately six-fold over the course of ten years (Figures 1.27, 1.28, 1.29)



- In order to correct these disparities it is important to improve and enhance income redistribution functions. This requires improvements in financial transfers from central government to local governments, a response to agricultural industry, villages and people who are lagging behind in benefiting from economic growth (low agricultural productivity, deterioration of rural villages, and poverty of those engaged in agriculture), the creation of a tax structure that would contribute to income redistribution, and the development of social security, among other measures (Figures 1.30, 1.31, 1.32, 1.33, 1.34).



(Major Efforts in addressing China's three agricultural problems)

- Tax reforms for agricultural villages

- Agricultural villages tax reform (from 2003 – implemented nationwide) (Abolition of tax collection, etc., by local governments)
- Abolition of agricultural industry taxes (2006)

- Increase in fiscal expenditure

- Support for agricultural households (from 2004 – introduction of subsidy system for food production, purchase of good seeds, and agricultural equipment)
- Making compulsory education in agricultural areas totally free (implemented in western areas from 2006, expected to be expanded nationwide in 2010)
- New joint agricultural village medical care system (Gradual introduction from 2003, expected to be expanded nationwide in 2010)
- (Increase in subsidies provided by government)

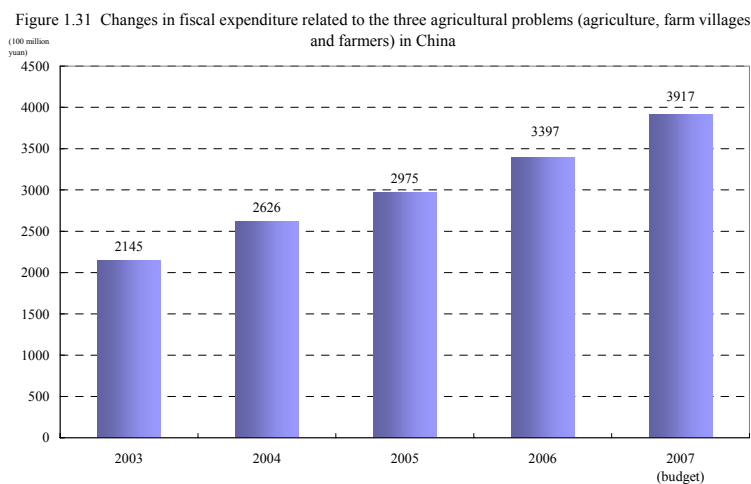
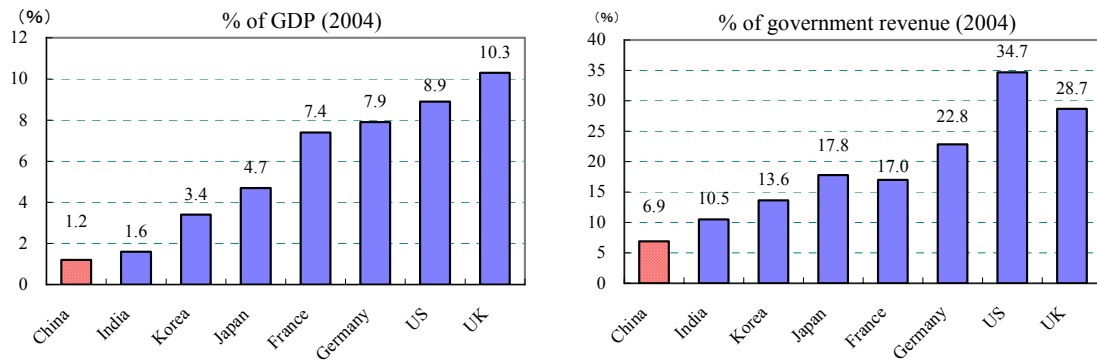


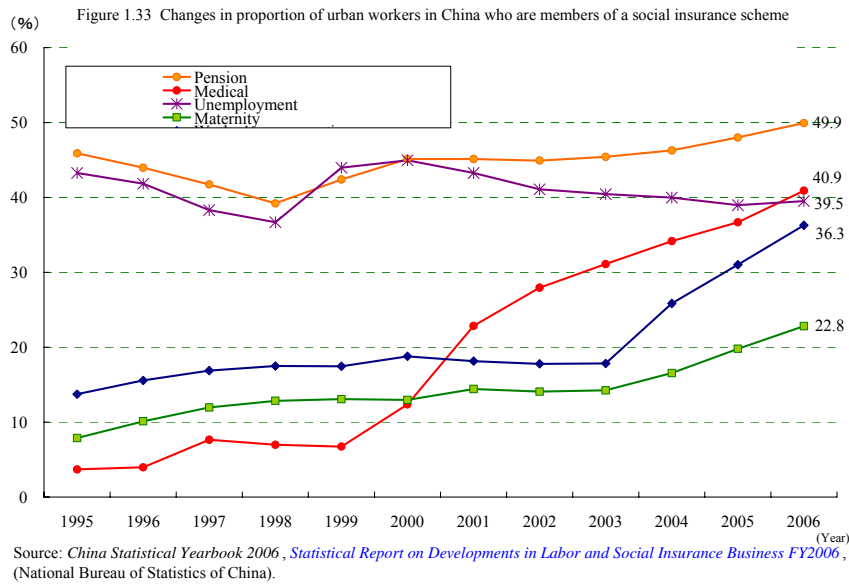
Figure 1.32 International comparisons of tax revenue from income taxes (2004)



Notes: 1. Data for China and India are for 2003.

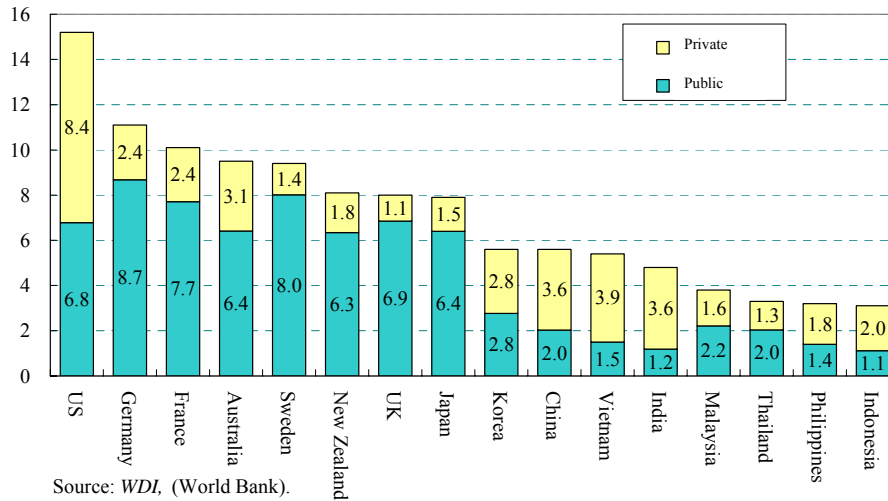
2. Social security burden is included in government revenue.

Source: *Revenue Statistics 2006, Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series (2006)*, (OECD).



Source: *China Statistical Yearbook 2006*, *Statistical Report on Developments in Labor and Social Insurance Business FY2006*, (National Bureau of Statistics of China).

Figure 1.34 Proportion of private and public sector expenditure on health and medical-related expenses as a proportion of GDP (2003)



Source: *WDI*, (World Bank).

- In addition, while it has been pointed out that in China there are hidden unemployed and university graduates find difficulty in gaining employment, it is also the case that in some regions and in some industries labor shortages are also very apparent. In order to correct disparities and expand consumption, it is necessary to take measures to overcome employment mismatches, and develop employment promotion policies through promotion of the services industry, etc., as well as to improve the income level of the lowest earners (Figures 1.35, 1.36).

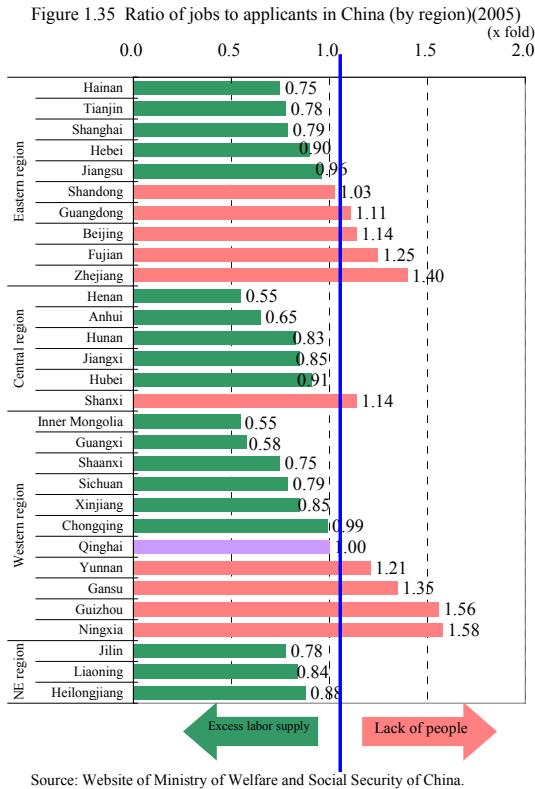
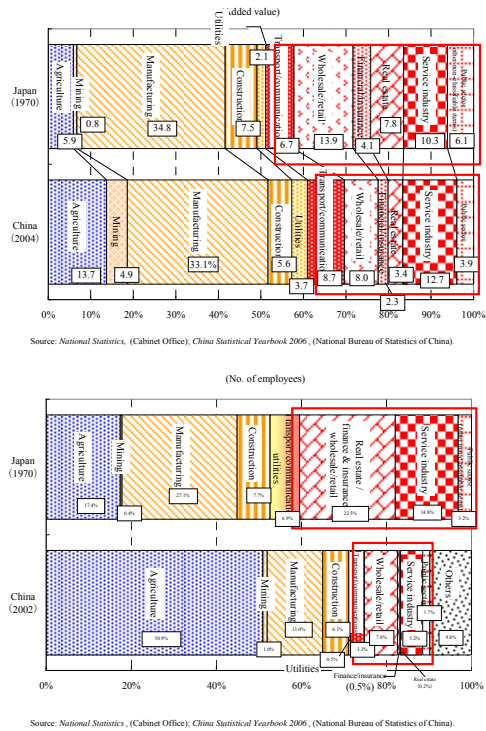


Figure 1.36 Weighting comparison of the service industry in China and Japan (during Japan's high growth era)



(3) Energy and environmental problems—Converting to an energy efficient, environment-protecting economy

- China's energy consumption is rapidly expanding, in line with the high growth rate of the economy and the advance of industrialization. Accordingly, serious environmental issues are arising, including risks from crunches in supply and demand of energy, and water and air pollution, etc. It is important to make the change from a resource-intensive model to an economy that is energy efficient and in tune with the environment, by improving energy consumption efficiency, etc. (Figures 1.37, 1.38, 1.39).

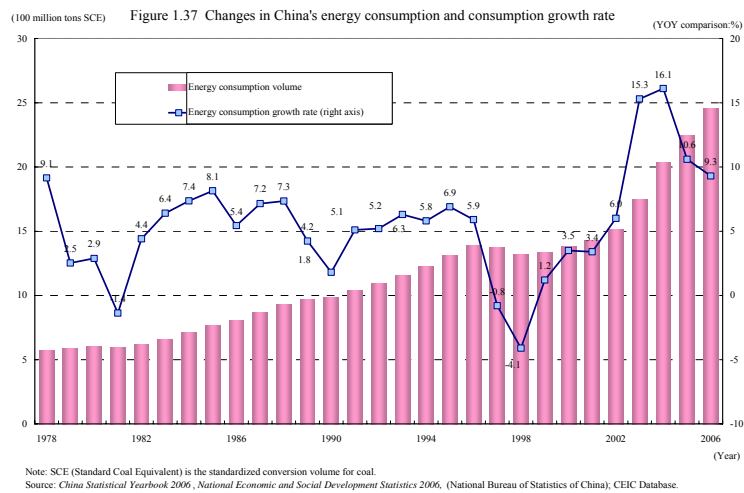


Figure 1.38 Share of global consumption of primary energy resources by country (2005)

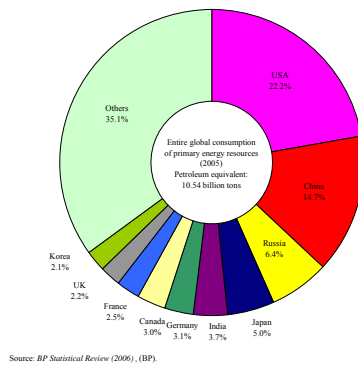
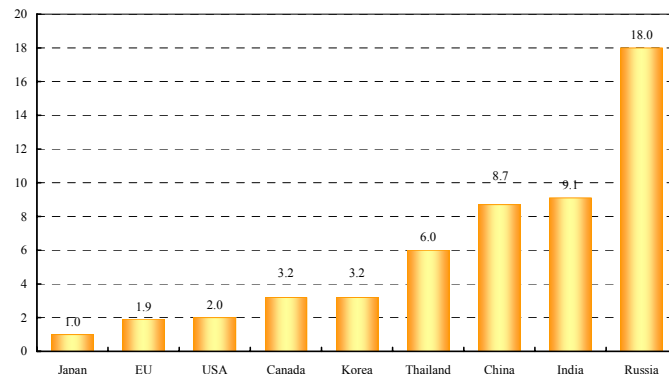


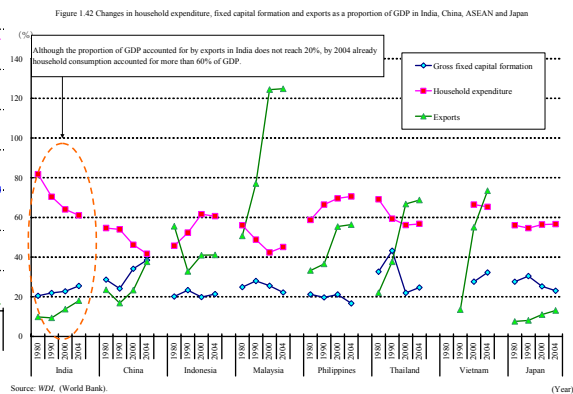
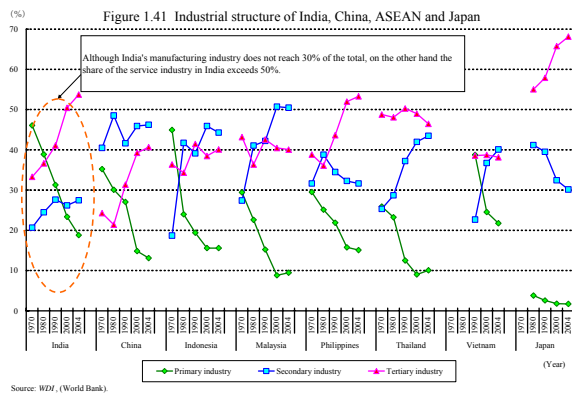
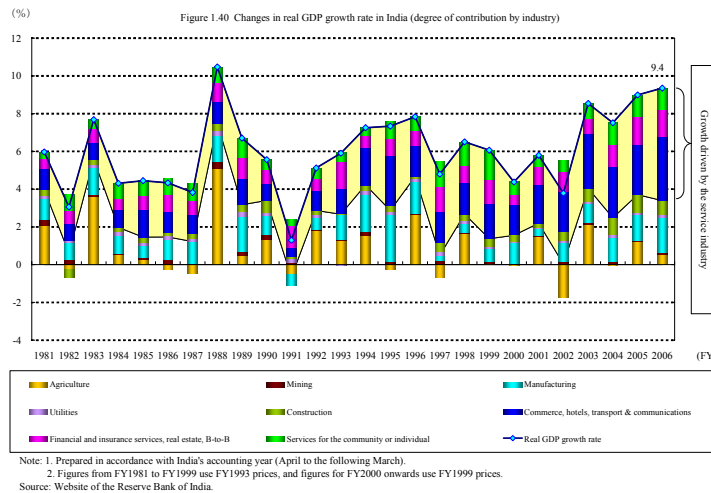
Figure 1.39 Consumption efficiency of primary energy for major countries and regions (2004)



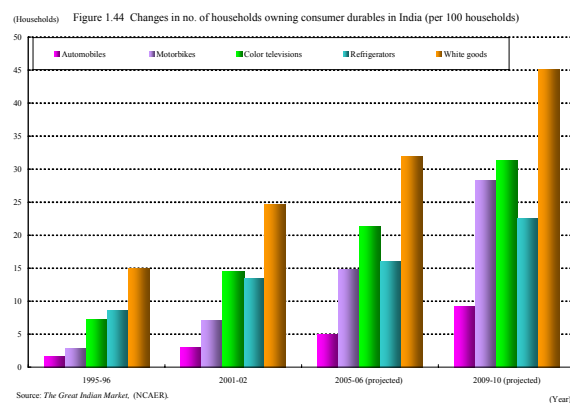
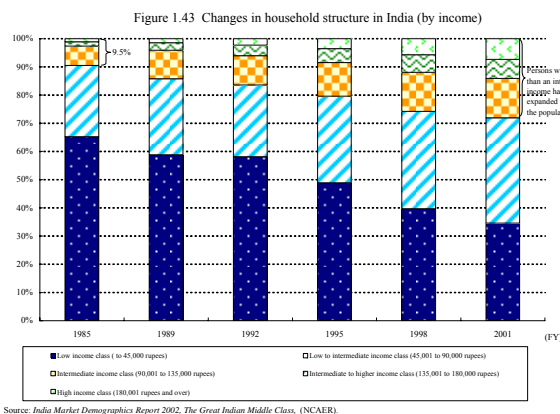
Note: Calculated as primary energy supply volume / real GDP (2000 values) for each country, with Japan set at 1.0.
Source: Key World Energy Statistics 2006, (IEA).

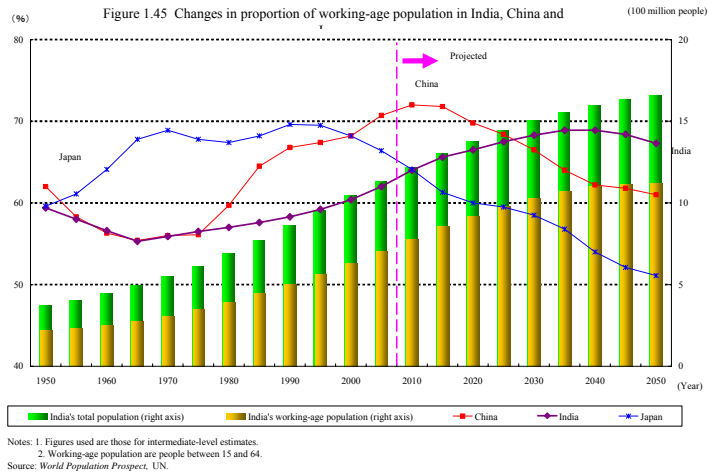
4. Characteristics of the high-growth Indian economy

- On the back of service industries and domestic demand, the Indian economy has realized a high average growth rate of 8.6% since 2003. India's growth has by and large been the mirror opposite of the countries of East Asia, which have pursued growth focused on manufacturing and external demand.



- Due to income increases, the number of consumer durables owned is also increasing and given the size of the Indian population, the appeal of the market is expanding. In addition, the aging society phenomenon is not as advanced in India as it is in China and for the foreseeable future it is expected to be able to provide a rich source of labor power, increasing its appeal also as a production base.





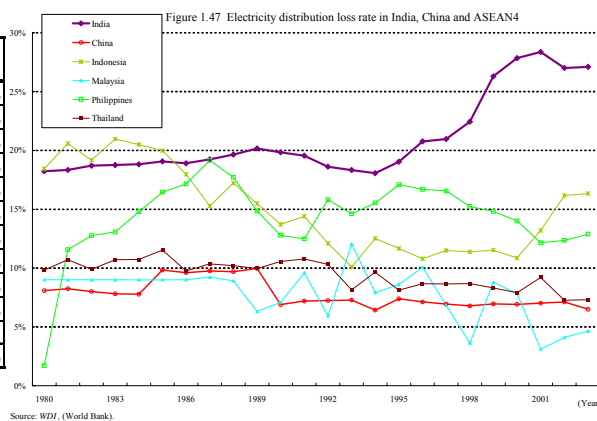
- On the other hand, of the challenges for the Indian business environment, those that are very often pointed out are the lack of infrastructure and lack of transparency in operation of legislation. In the future, in order to continue to attract foreign companies and continue to develop the economy, it will be important for India to improve the business environment.

Figure 1.46 Challenges for India's business environment

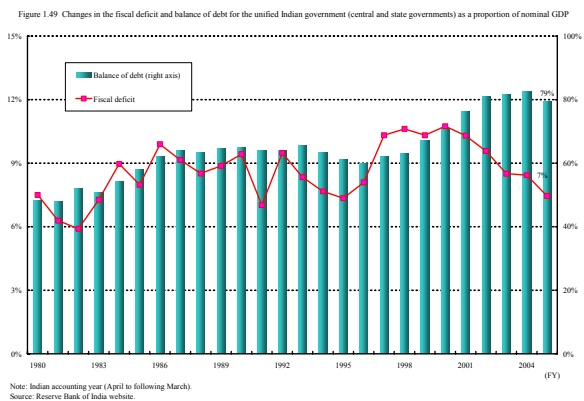
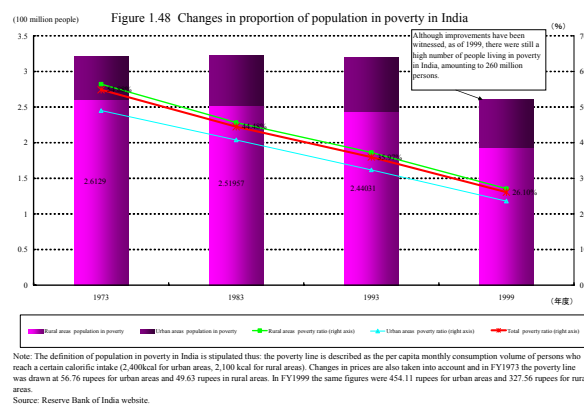
No.	Challenges	No. of companies	Share
1	Incomplete infrastructure	89	50.0%
2	Opaque application of legislation	55	30.9%
3	Lack of investment information	48	27.0%
4	Unease about law and order, public situation	46	25.8%
5	Severe competition with other companies	45	25.3%
6	Labor issues	43	24.2%
7	Opaque application of tax system	39	21.9%
8	Underdeveloped supporting industries	33	18.5%
9	Lack of legislation	27	15.2%
10	Complex tax system	26	14.6%
⋮			
18	Insufficient IP protection	16	9.0%

Note: n=178 companies, multiple responses.

Source: FY2006 Survey on Foreign Direct Investment (18th survey), (JBIC).

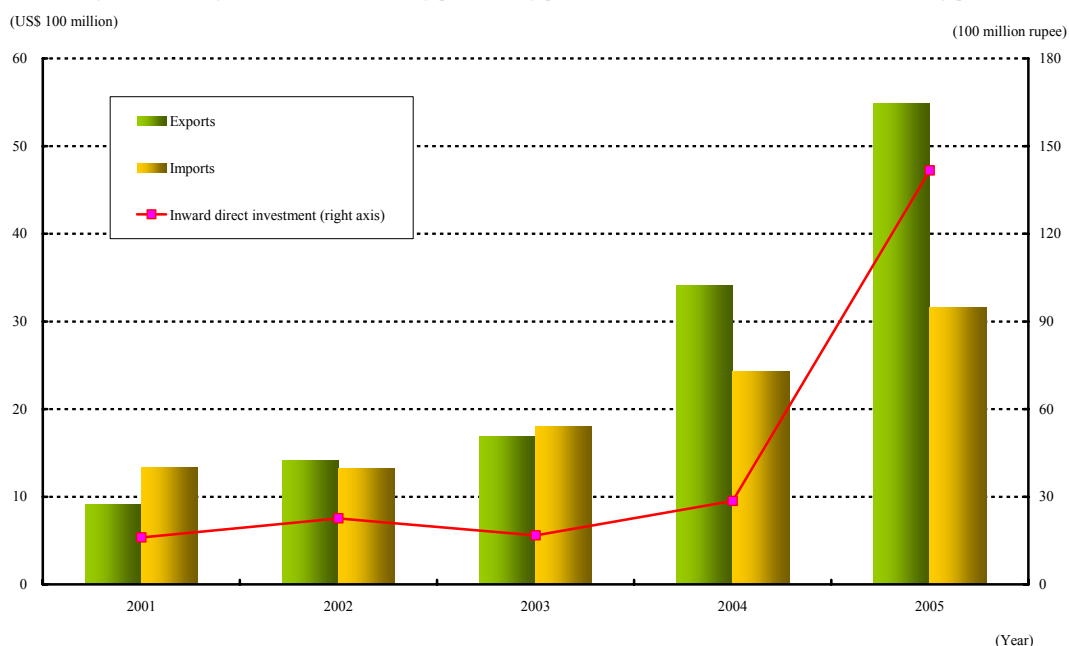


- In addition, in realizing sustainable growth it will be necessary to deal with issues of poverty in order to further expand domestic demand in a sustainable manner. Furthermore, it is necessary to eliminate the fiscal deficit in order to promote infrastructure development with an eye to achieving improvement of the business environment as abovementioned.



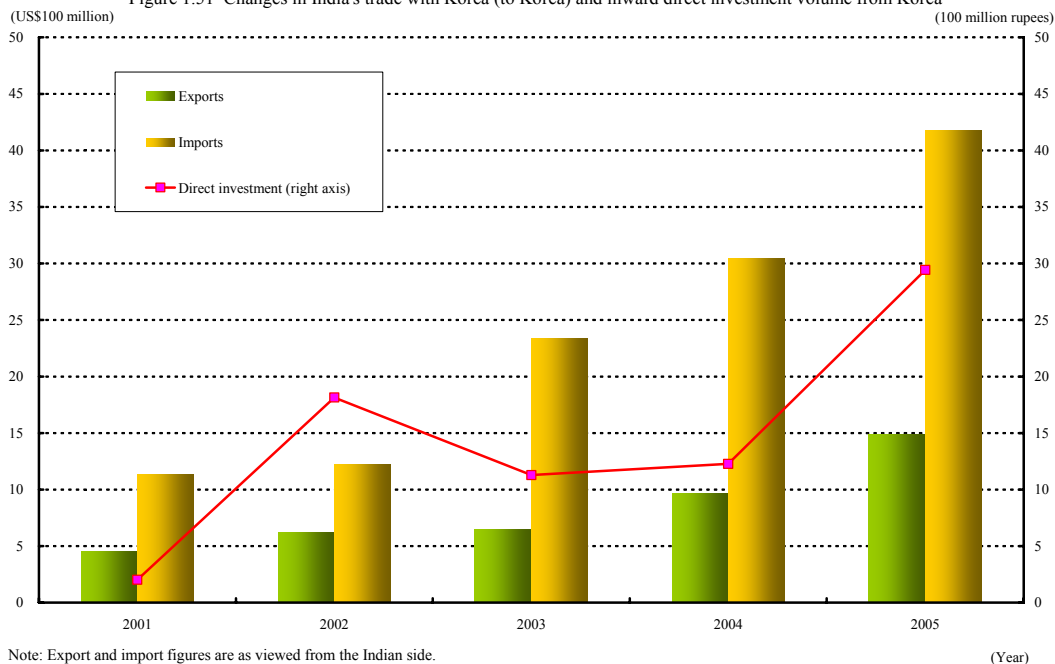
- India is advancing measures to open up its economy to the outside world, including liberalization of trade and inward investment. The countries of East Asia, including Korea and Singapore, are rapidly expanding their volume of trade and investment with India, as the expansion in consumption prompted by the economic growth of recent years has heightened India's appeal as a consumer market. Relations between the countries of East Asia and India are continuing to get closer.

Figure 1.50 Changes in India's trade with Singapore (to Singapore) and inward direct investment volume from Singapore



Note: Export and import figures are as viewed from the Indian side.
Source: CEIC Database, Global Trade Atlas.

Figure 1.51 Changes in India's trade with Korea (to Korea) and inward direct investment volume from Korea



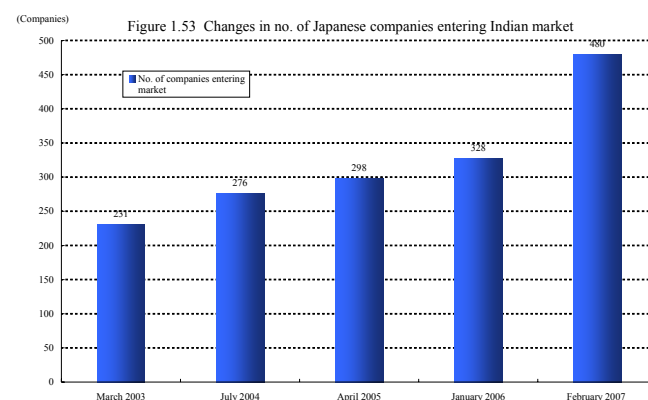
Note: Export and import figures are as viewed from the Indian side.
Source: CEIC Database, Global Trade Atlas.

- Given such circumstances, Japanese companies too are looking to India as a promising business location, and these companies are preparing market strategies for India using a variety of methods, including entering the Indian market itself, but also exporting to India from existing production bases in China and ASEAN, etc. In order to support such activities, various measures have been launched towards developing the business environment, including inter-governmental negotiations on Japan-India/India-East Asia EPA, and the Delhi-Mumbai Industrial Corridor Project.

Figure 1.52 Changes in promising markets and business locations in the mid- to long-term for Japanese companies

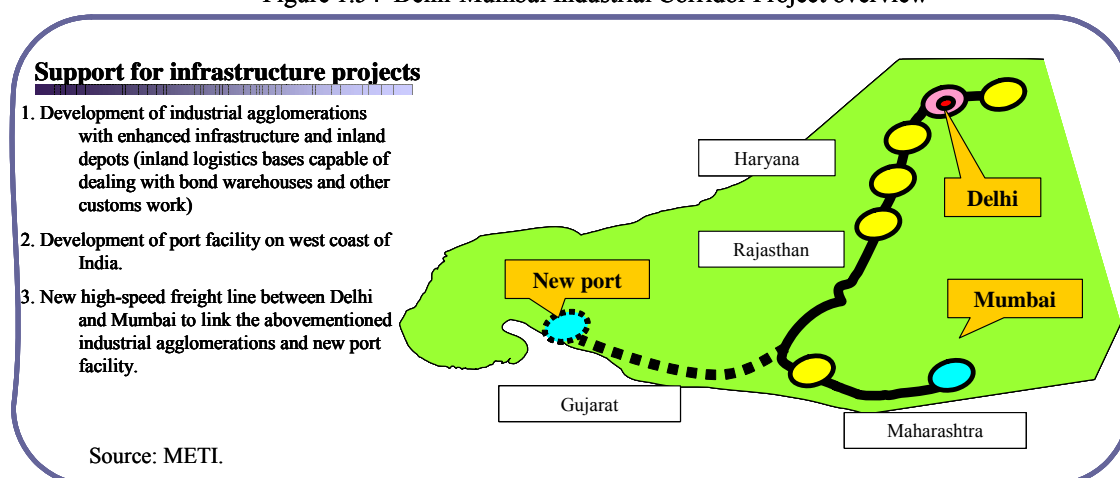
	FY2002	FY2003	FY2004	FY2005	FY2006
1st	China	China	China	China	China
2nd	Thailand	Thailand	Thailand	India	India
3rd	USA	USA	India	Thailand	Vietnam
4th	Indonesia	Vietnam	Vietnam	Vietnam	Thailand
5th	Vietnam	India	USA	USA	USA
6th	India	Indonesia	Russia	Russia	Russia
7th	Korea	Korea	Indonesia	Korea	Brazil
8th	Taiwan	Taiwan	Korea	Indonesia	Korea
9th	Malaysia	Malaysia	Taiwan	Brazil	Indonesia
10th	Brazil	Russia	Malaysia	Taiwan	Taiwan

Source: FY2006 Survey on Foreign Direct Investment (18th survey), (JBIC).



Note: Information provided by the three consulates in India (Mumbai, Chennai, Kolkata), Japanese Chambers of Trade and Commerce in each region, and other related organizations, and collated by the Embassy of Japan in India.
Source: Website of the Embassy of Japan in India.

Figure 1.54 Delhi-Mumbai Industrial Corridor Project overview



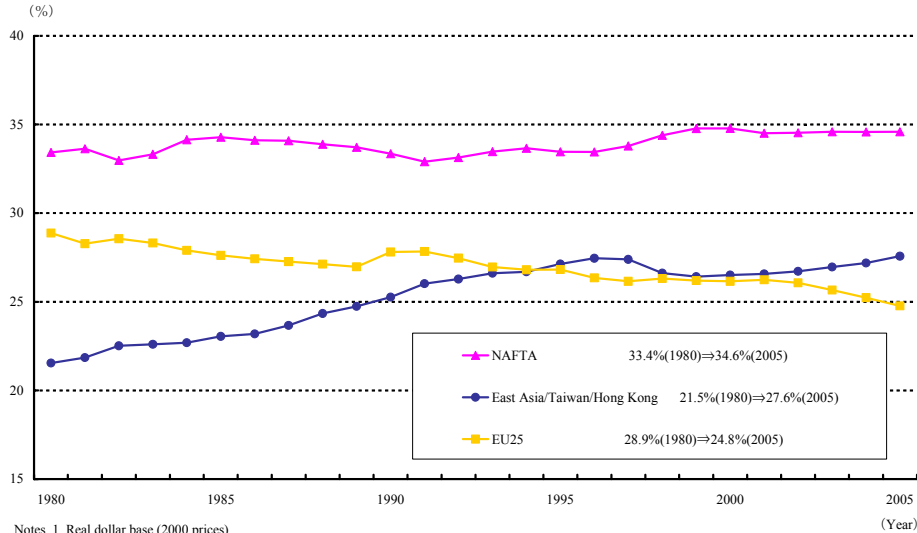
Chapter 2 Expansion and deepening of East Asian business networks

- East Asia is maintaining high economic growth and advances are being made towards integration within the region.
- In East Asia, due to the development of EPA/FTA networks and a multilateral division of labor structure, (i) triangular trade (whereby goods are assembled in China and ASEAN using major parts from Japan and the NIEs, for export to Japan, the US and Europe) and mutual supply of intermediate goods is expanding. In addition, (ii) Japanese companies are increasingly seeing East Asia as a unified market, and are promoting measures to concentrate intra-regional production and supply functions, and establish comprehensive intra-regional sales bases. Furthermore, (iii) with the increasing proportion of locally procured items, development functions are being seen to be expanding throughout East Asia.
- The expansion of business into East Asia brings about significant effects such as large increases in production volume for domestic industries, and improvements in profitability, through such means as opening up sales channels in East Asia and increasing the export of intermediate goods, as well as specializing in high value-added products domestically. In addition, the entry into East Asia, which boasts great diversity, also helps to realize innovation that is utilizable both in Japan and in developing countries also, as well as contributing to the securing of human resources who can work effectively on the global stage.
- In order to promote vigorous corporate activity in East Asia and realize further development of the regional economy, it is important to develop the business environment and create a seamless economic zone.

1. Promoting integration in the East Asian economy and enhancing its influence on the global economy

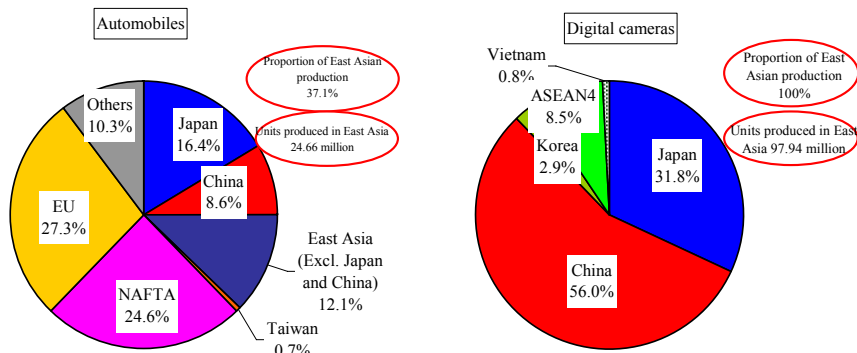
- East Asia among other regions is maintaining a high rate of economic growth and just as its global share of real GDP has grown from 21.5% in 1980 to 27.6% in 2005, accordingly its influence is expanding too. These is also an expression of how in terms of some items, East Asia is taking on a large part of the global production share. In addition, it is anticipated that the importance of East Asia will grow not merely in terms of production, but also as a consumer market.

Figure 2.1 Changes in share of global real GDP for East Asia (incl. Taiwan, Hong Kong), NAFTA and EU25



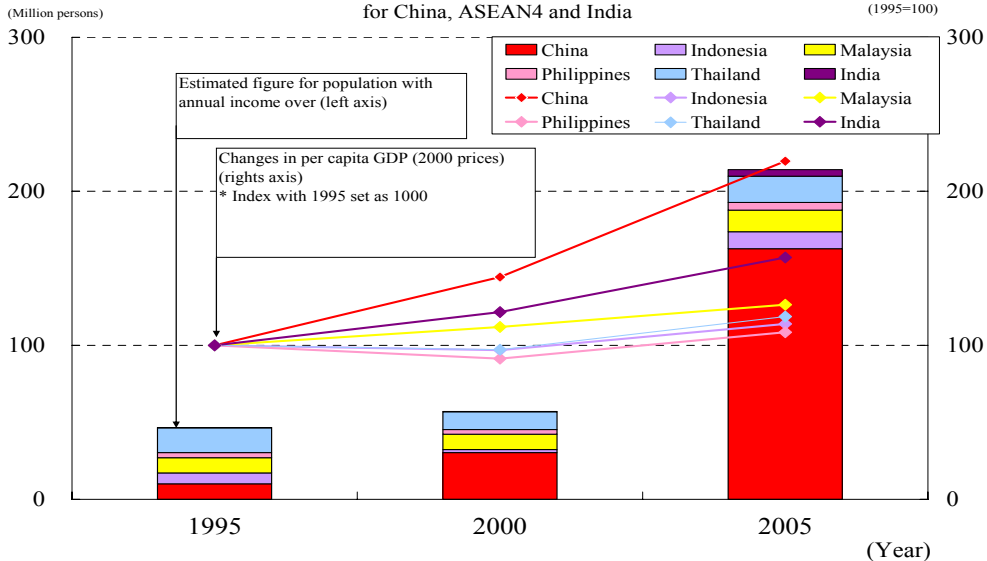
Notes: 1. Real dollar base (2000 prices).
 2. East Asia does not include Brunei Darussalam or Myanmar.
 3. "Global" in this sense uses the "World" as recorded in the WDI of the World Bank.
 4. Countries or years with incomplete data are not included.
 Source: WDI (World Bank), website of the Directorate General of Budget, Accounting and Statistics, Executive Yuan, Taiwan.

Figure 2.2 Share of global production in terms of units produced of automobiles and digital cameras in East Asia



Notes: 1. Figures are for 2005.
 2. Due to statistical differences overlapping figures for production are included for Japan and Malaysia.
 Source: World Motor Vehicle Statistics, (JAMA).
 Note: Figures are for 2006 (projected).
 Source: World-wide Production of Major Electronics from 2005 to 2007 (JEITA).

Figure 2.3 Estimate for population with annual income over US\$3,000 and changes in per capita GDP for China, ASEAN4 and India



- The intra-regional exchange of goods, money and persons is becoming more and more intertwined in East Asia, and the ratio of intra-regional trade stood at 55.8%, just one factor demonstrating how the degree of regional integration is deepening. In terms of intra-regional trade in East Asia, the proportion of trade accounted for by intermediate goods is large when compared to similar trade within the EU or NAFTA, and from this it can be understood that the cross-border division of labor is progressing.

- In addition, when analyzing data by product, we can see that the proportion of trade accounted for by electrical machinery is large and has grown to reach 27%, whereas the proportion of transportation equipment, which accounts for approximately 20% of trade in both the EU and NAFTA is small in East Asia.

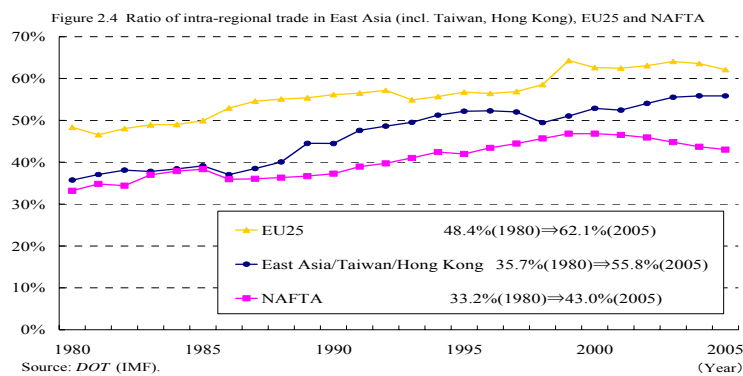


Figure 2.5 Breakdown by goods of intraregional trade in East Asia (incl. Taiwan, Hong Kong), EU25 and NAFTA

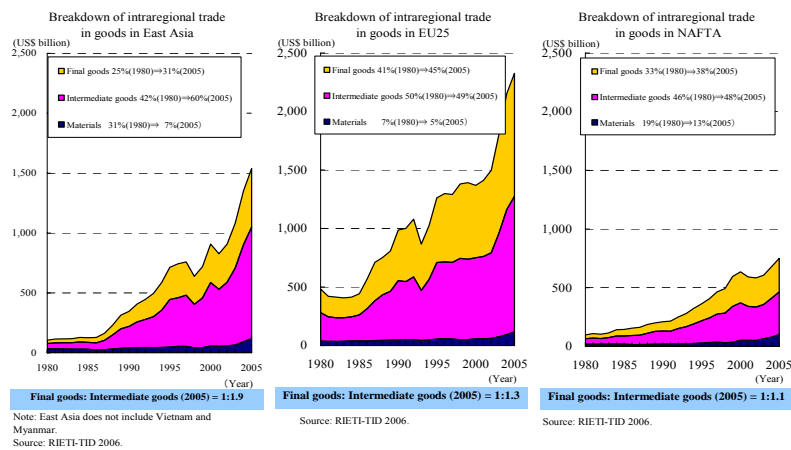
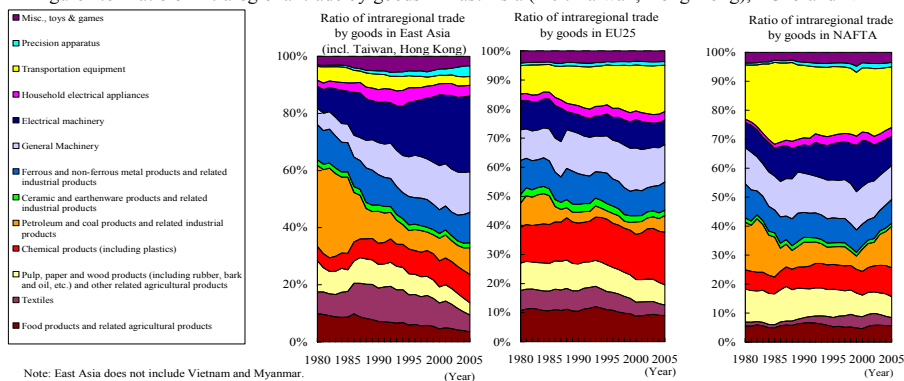
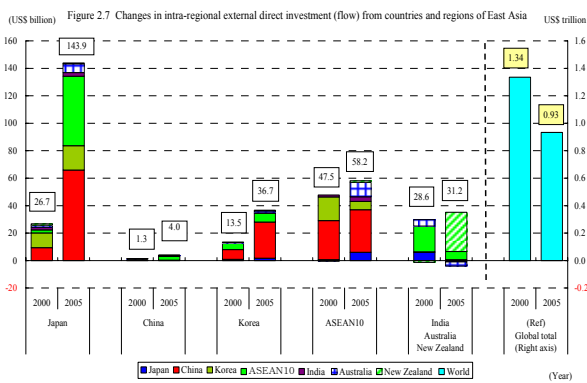


Figure 2.6 Ratio of intraregional trade by goods in East Asia (incl. Taiwan, Hong Kong), EU25 and NAFTA

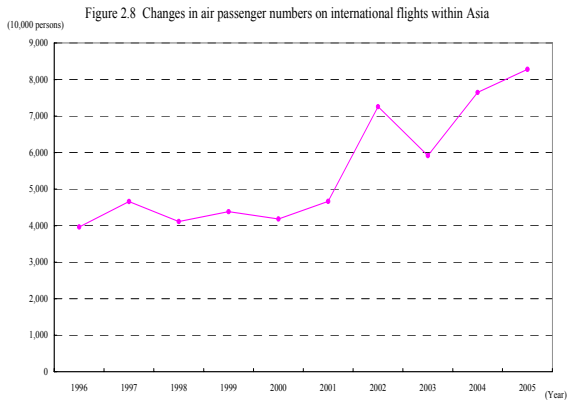


- The trends in foreign direct investment from the countries of East Asia to other destinations within the region show that while the figure for FDI is decreasing in the world as a whole, in each country and region in East Asia it is increasing and also in terms of the flow of money, transactions within the region are increasing, providing further evidence of the progress of integration.

- With regard to the movement of persons also, the number of international air passengers within the Asian region has doubled from 1996 to 2006 and the number of intra-regional exchange students has grown from 140,000 persons in 2000 to 268,000 persons in 2003. These facts demonstrate that the movement of people within the region is becoming more vigorous.

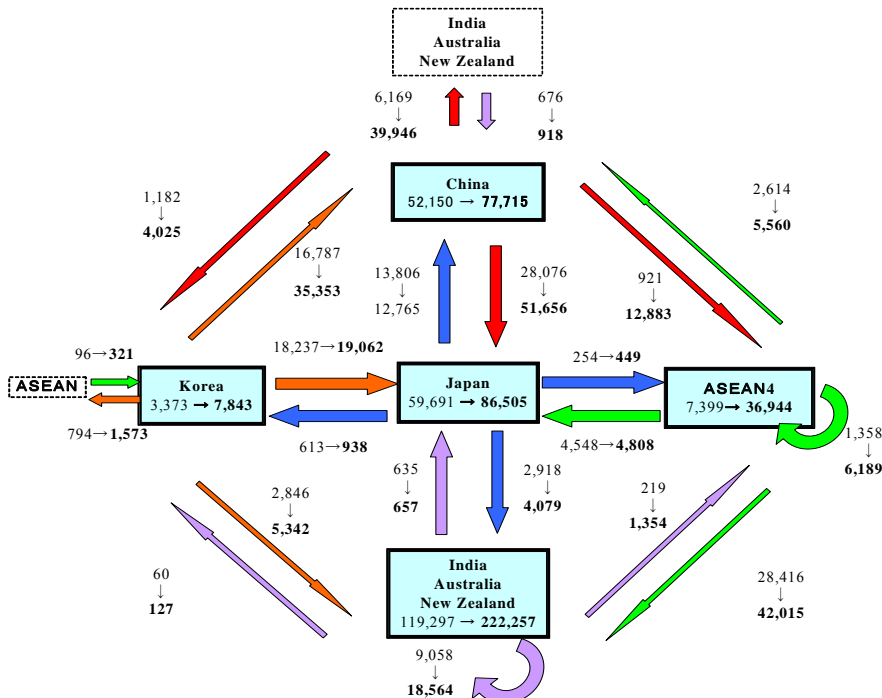


Notes: 1. Figures for global total, Japan, Korea, Australia and New Zealand are on an international payments base, and figures for China are on an approved amount base. With regard to the volume of external direct investment for ASEAN10 and India, due to data constraints figures have been reverse calculated from the volume of inward direct investment of counterpart countries. (Due to data constraints, inward direct investment data to ASEAN from Korea and India does not include investment to Brunei Darussalam, Lao PDR, Cambodia, Myanmar and Vietnam. Inward direct investment from ASEAN to India does not include that from Singapore, Brunei Darussalam, Lao PDR, and Cambodia. 2. Figures for 2000 for Australia and New Zealand, and figures for 2005 for New Zealand are on a fiscal year base. Source: SEKAU SHIYOU KOKUNO CHOKUSEI TOUSHI TOUKEI SHU (17).



Note: Shows transportation figures for flights originating and concluding in Asia of airlines that are affiliated to IATA. Source: Aviation Statistics Overview 2006, (Japan Aeronautic Association).

Figure 2.9 Changes in exchange student numbers within the East Asian region (2000 to 2003)



Notes: 1. Figures in boxes are the total figures for exchange students accepted from around the world in each of the countries/region. 2. As figures for exchange students to Thailand in 2000, exchange students from the Philippines and Malaysia to China in 2000, and exchange students from India and New Zealand to China in 2000 and 2003 could not be acquired, these figures were not included in the totals. 3. Increases in student numbers relative to 2000 are shown in bold type. Source: Education Database, (OECD), Educational Statistics Yearbook of China, People's Education Press.

- In addition to these advances in integration in terms of economic conditions, in recent years a network of EPA/FTA has been expanding around East Asia as part of a movement to integrate structural and systemic aspects also.

Figure 2.10 Status of efforts towards EPA/FTA in East Asian region in 1997 and 2007

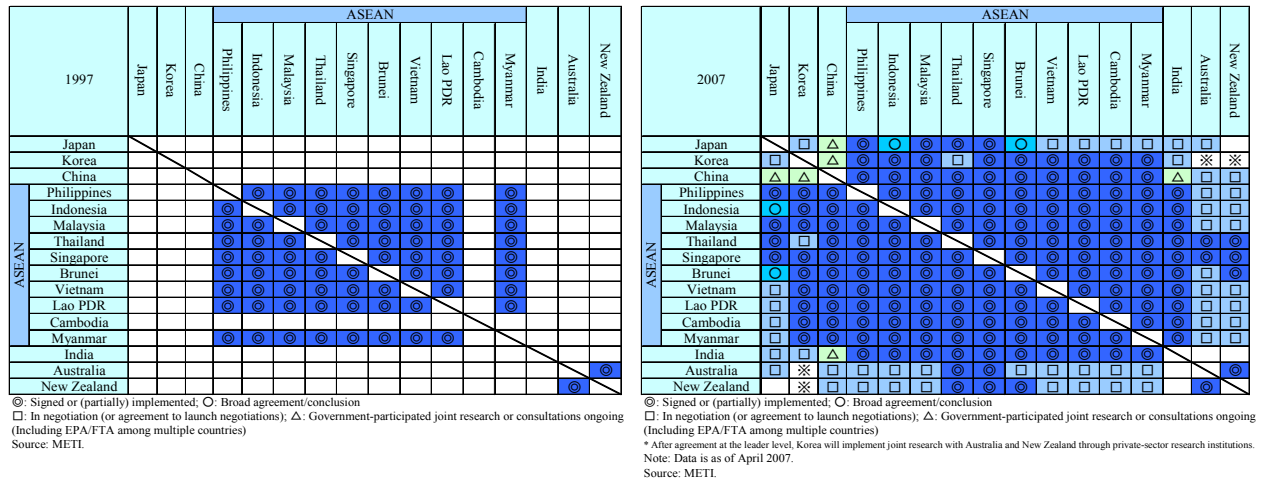
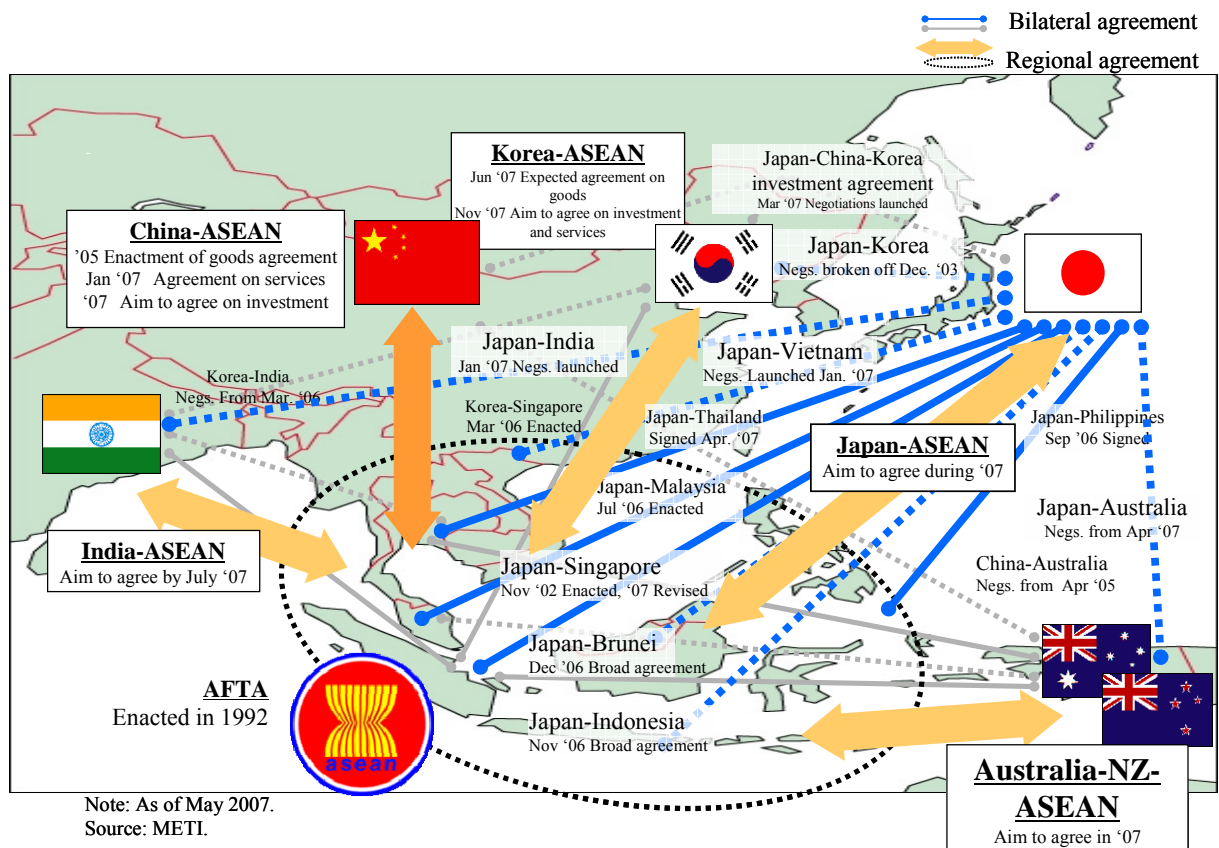


Figure 2.11 Trends in economic partnership in East Asia



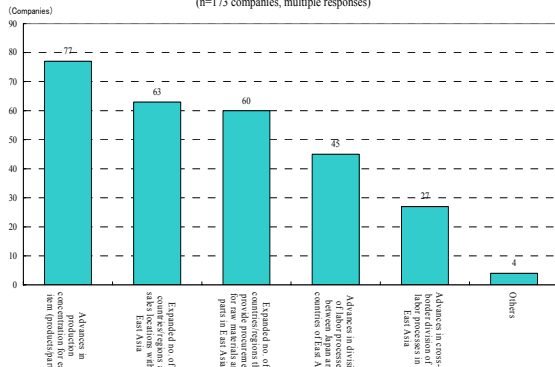
2. New expansion by Japanese companies in East Asia

(1) Expansion and deepening of Japanese companies' production and sales networks in East Asia

(i) Development of multilateral division of labor processes as part of a structure for “triangular trade and mutual supply of intermediate goods”

- As barriers to trade have come down due to the expansion of EPA/FTA in East Asia and technological improvements have been witnessed in the countries in the region, the Japanese companies that have entered East Asian markets have been promoting multilateral division of labor processes that aim to procure intermediate goods from the optimal region.

Figure 2.12 Changes in East Asian production and sales networks of Japanese manufacturers over the past three years (n=173 companies, multiple responses)



Note: Valid responses received from a total of 366 companies. Figures here are for 173, excluding those that responded that there were “no changes” over past three years.
Source: SEICHO WO TOGERU CHUGOKU-INDO KEIZAI NO GENJOBUNSEKI TO SERVICE SANGYO WO FUKUMU WAGAKUNI KIGYO NO KAIGAITENKAI NI KANSURU CHOSA KENKYU, (JIPPI)/2007.

Figure 2.13 Procurement trends for Japanese manufacturing industry in China and ASEAN4

(Proportion of companies procuring from places in China and ASEAN4 other than their production base)

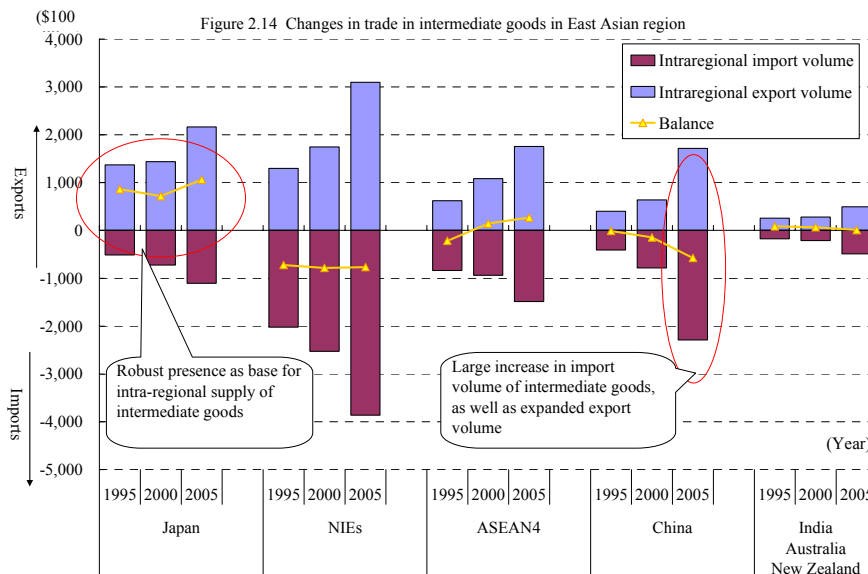
	No. of responses	Share (%)
No. of companies procuring from Chinese bases	298	(100.0)
Of which procurement is sourced in China	277	(93.0)
Of which procurement is sourced in ASEAN4	91	(30.5)
No. of companies procuring from ASEAN4 bases	190	(100.0)
Of which procurement is sourced from ASEAN4 (bases)	157	(82.6)
Of which procurement is sourced from ASEAN4 (non-bases)	76	(40.0)
Of which procurement is sourced from China	77	(40.5)

(Procurement trends in companies that responded procurement volume from Japan has reduced)

	No. of responses	Share (%)
No. of companies with Chinese bases with reduced procurement from Japan	81	(100.0)
Of which local procurement has increased	76	(93.8)
Of which procurement from ASEAN4 has increased	21	(25.9)
No. of companies with ASEAN4 bases with reduced procurement from Japan	39	(100.0)
Of which local procurement has increased	24	(61.5)
Of which procurement from ASEAN4 (non-bases) has increased	13	(33.3)
Of which procurement from China has increased	11	(28.2)

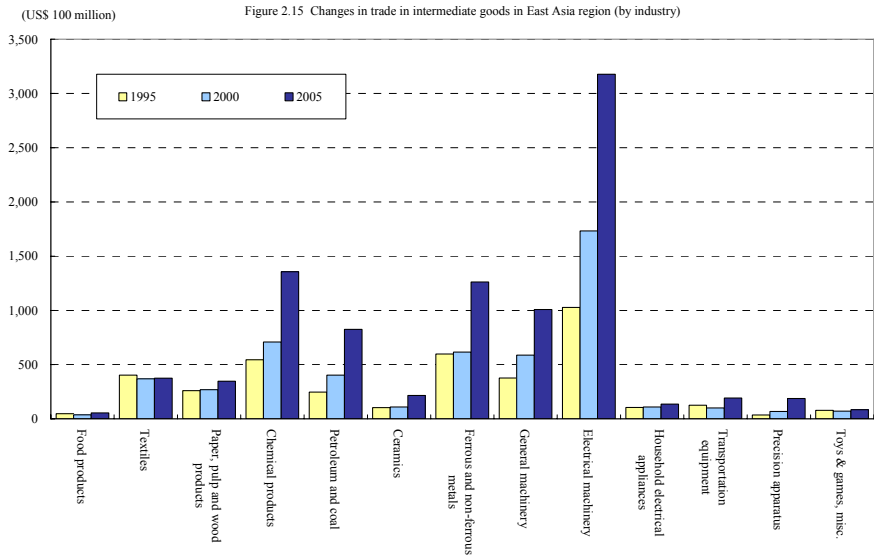
Source: SEICHO WO TOGERU CHUGOKU-INDO KEIZAI NO GENJOBUNSEKI TO SERVICE SANGYO WO FUKUMU WAGAKUNI KIGYO NO KAIGAITENKAI NI KANSURU CHOSA KENKYU, (JIPPI)/2007.

- Reflecting such activities by Japanese companies, the trade in intermediate goods in the region has been expanding rapidly. Japan's exports from the region significantly exceed imports and while this implies that there is still a healthy reliance on intermediate goods supply hubs in the region as from before, on the other hand, in the case of China and ASEAN too, the amount of intermediate goods exported is increasing rapidly and this would suggest that there is mutual supply of intermediate goods.



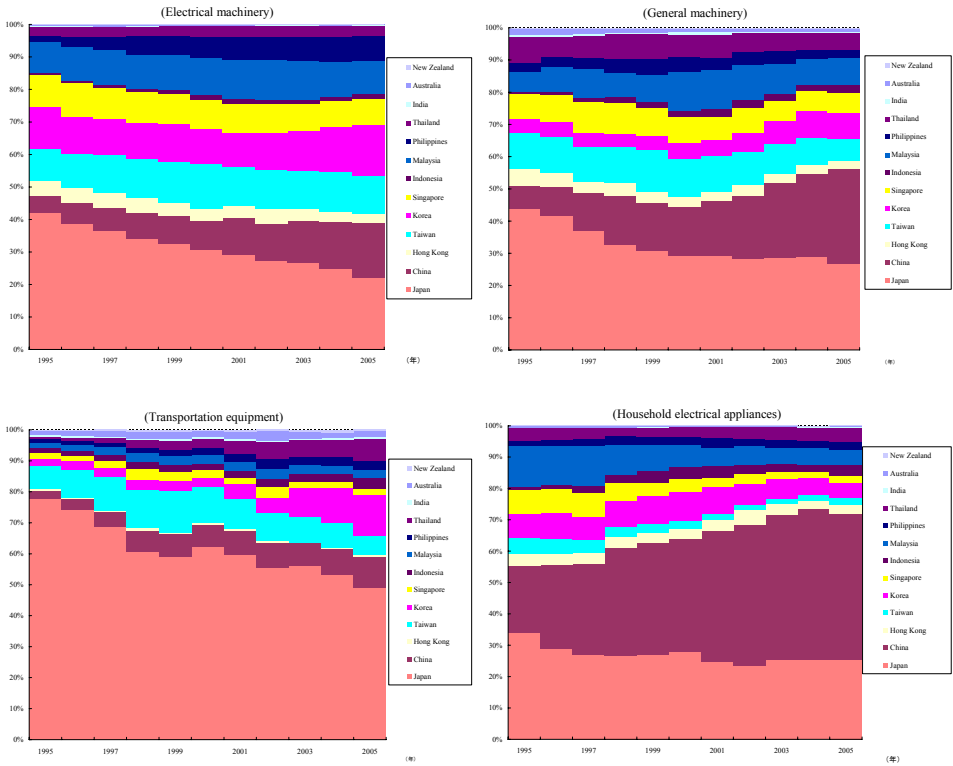
Source: RIETI-TID 2006.

- Looking at this intra-regional trade in intermediate goods, we can see that business is lively, with the trade in electrical machinery accounting for the largest share on a by industry base. In addition, looking at share of each exporting country by product shows that in the area of electrical machinery and general machinery, since the latter half of the 1990s for ASEAN, and since 2000 for China, both have been growing their roles as intra-regional supply hubs.



Source: RIETI-TID 2006.

Figure 2.16 Changes in trade in intermediate goods in East Asian region (by share of exporting



Source: RIETI-TID 2006.

- While Japan is expanding its supply of intermediate goods from the NIEs, China and ASEAN are rapidly expanding their exports focused on general-purpose components, and as a result a trade structure is being demonstrated whereby a mutual supply of intermediate goods is existing in the region, with final products being exported to Japan, the United States and Europe.

Figure 2.17 Trends in triangular trade involving East Asia

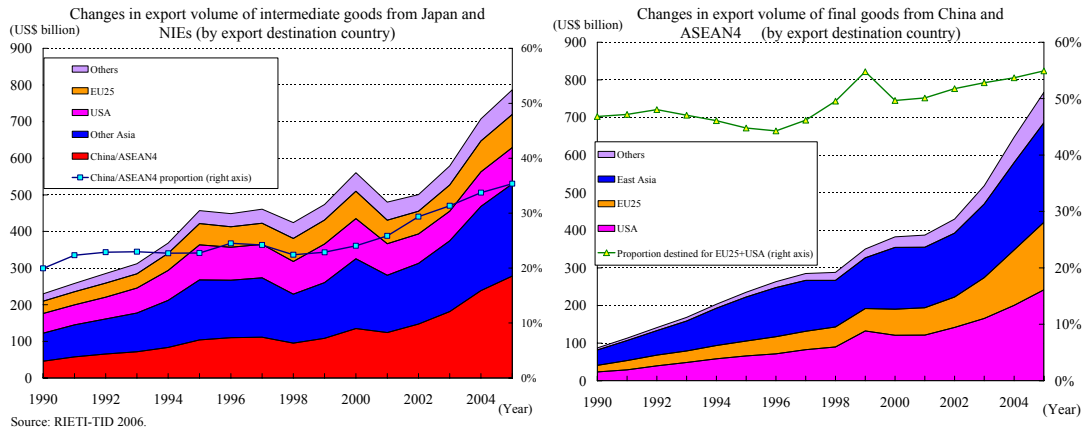
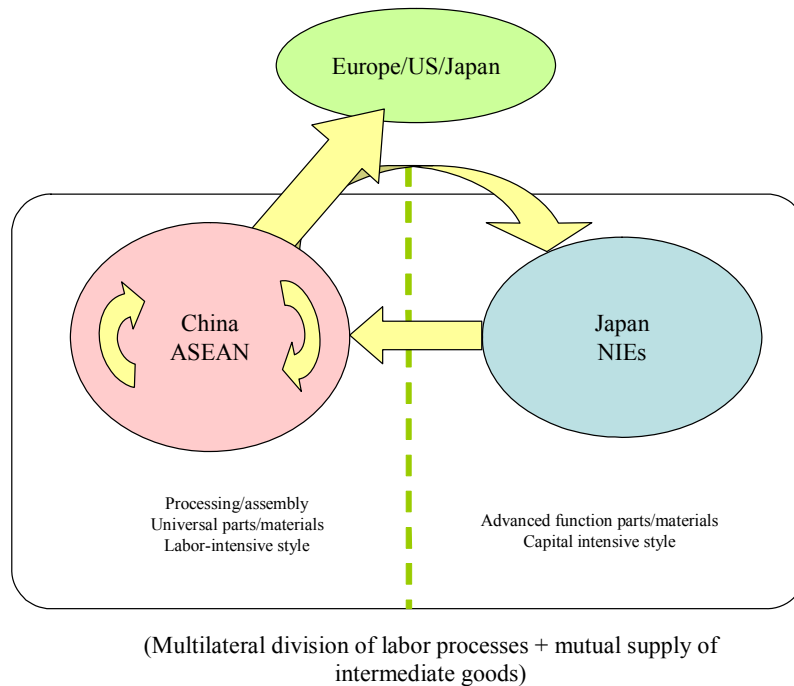


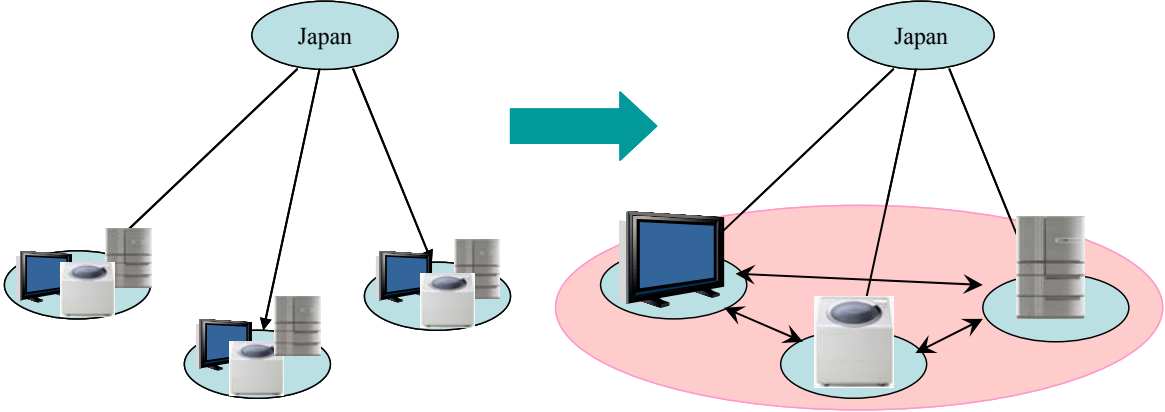
Figure 2.18 Development of division of labor structure in East Asia



(ii) Concentrations of intra-regional production and supply functions based on local market integration through EPA/FTA

- The expansion of EPA/FTA means that through the abolition of tariffs on final goods integration is promoted not merely in East Asia as a production region, but also in terms of East Asia as a market. In this situation Japanese companies are constructing optimized production and sales structures, and in order to bring down costs and realize economies of scale, they are engaging in the concentration of intra-regional supply functions. For each country in East Asia if the competitive edge of the region as a production base can be heightened, then the potential will expand for direct investment and production activities that would not be feasible using only individual domestic markets.

Figure 2.19 Concentration of intraregional supply functions through concentration of production items



Source: METI.

Figure 2.20 Examples of concentration of production functions by Japanese companies

Type of industry	Content of concentration of production function
Auto maker A	Established Thailand and Indonesia as passenger vehicle supply bases in ASEAN region
Auto makers B & C	Concentrated pickup truck production bases in Thailand
Electrical appliance maker D	Stopped producing televisions in Philippines, instead concentrating production in Malaysia and exporting from there
	Stopped producing refrigerators and washing machines in Malaysia in 2005, instead concentrating production in Thailand and exporting from there
Electrical appliance maker E	Stopped producing televisions in India in 2004, instead concentrating production in Thailand and exporting from there
Electrical appliance maker H	Stopped producing car stereos in Malaysia and Indonesia, instead concentrating production in Thailand and exporting from there
	Stopped producing DVD players in Thailand, instead concentrating production in Malaysia and exporting from there
Chemical manufacturer I	Stopped producing facial care products, etc., in Malaysia in 2002, instead concentrating production in Indonesia and Thailand, which are positioned as supply bases for the ASEAN region, and exporting from there

Source: Press releases of above companies and Umada & Ohki (2005), *SHINKOKOKU NO FTA TO NIHON KIGYO*, (JETRO).

- Looking by product, we see that exports within the ASEAN region are increasing rapidly. For example, refrigerators from Thailand, air conditioners from Thailand and Malaysia, and televisions from Malaysia and Indonesia, etc. Export volume to India is also increasing which with Thailand has concluded an FTA, and from these and other developments we can surmise that production functions are being concentrated and products are being supplied widely throughout the region.

Figure 2.21 Trade in refrigerators (HS8418) in ASEAN4

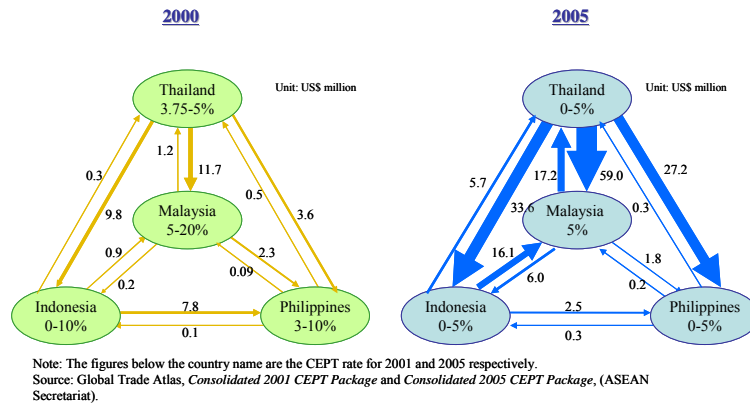


Figure 2.22 Trade in air-conditioners (HS8415) in ASEAN4

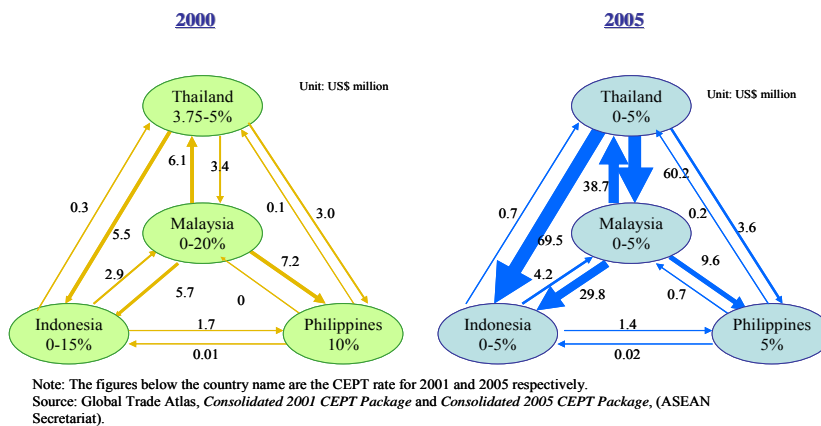
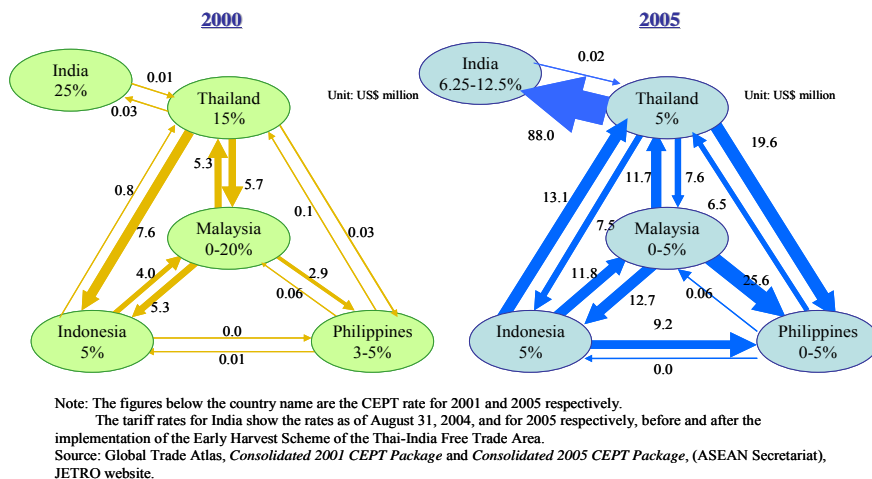


Figure 2.23 Trade in televisions (HS8528) in ASEAN4 and between Thailand and India

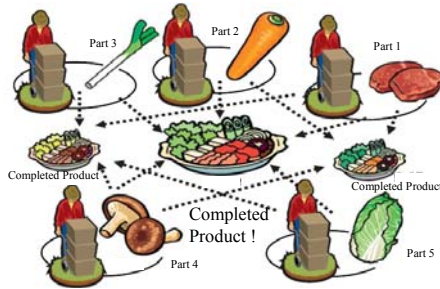


(Column: East Asian “cooking pot” economic zone characteristics brought about by mutual supply of intermediate goods by “mountain type” supporting industries

- Intra-regional trade in East Asia is characterized by the point that trade in intermediate goods is greater than that in final goods. This demonstrates that the countries in the region are specializing in parts and materials in which they possess particular strengths and also that cross-border division of labor is progressing. With each country exchanging the parts and materials that they each excel in, it is possible to describe the economic zone as having the strong characteristics of a production structure in which single ingredients are placed in a cooking pot to create a complete culinary dish.

- On the other hand in the EU and NAFTA the proportion of trade in final goods is greater than that in intermediate goods. These economic zones can be said to have the strong characteristics of a production structure in which each country divides roles up like those of a chef, patissier, baker, etc., a then creates their own particular culinary dish to bring to the table as part of a course.

Column Figure 1 Image of an economic zone with division of labor processes and mutual supply of intermediate goods



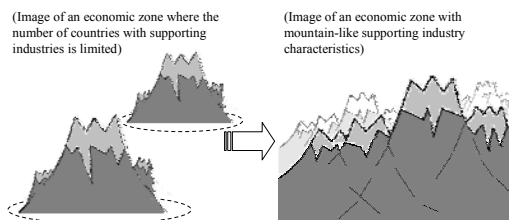
Column Figure 2 Image of an economic zone with division of manufacturing processes, with each country producing completed goods



- Taking a look at the development of supporting industries in East Asian countries that have achieved mutual supply of intermediate goods which is a characteristic of East Asian intra-regional trade, it can be said that the industrial structure of the region is one in which support for industry overlaps between countries, creating a mountain-like structure of supporting industries, which support the industries of each country in a flexible manner.

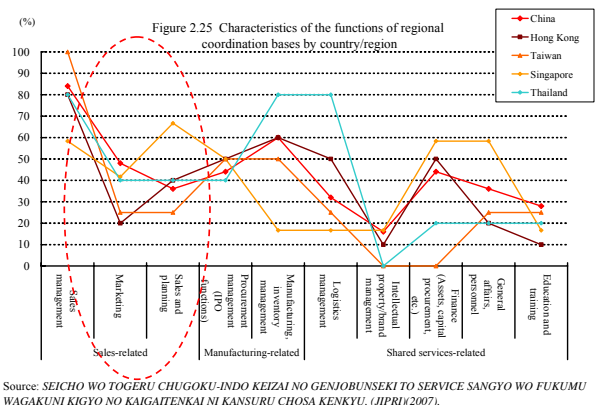
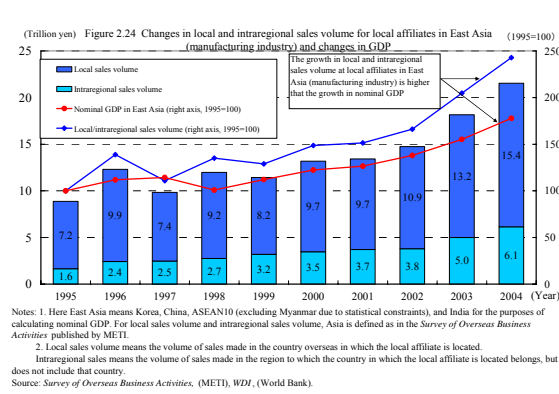
- On the other had, in NAFTA and the EU, relatively speaking it can be said that there are many industries for which the supporting industry structure is basically complete within the confines of a single country. The structure that East Asia has realized of an intra-regional inter-industry form of organic partnership can be seen to be different largely from the situation of NAFTA and the EU.

Column Figure 3 Image of an economic zone with mountain-like supporting industry characteristics



(iii) Full-fledged opening up of intra-regional markets

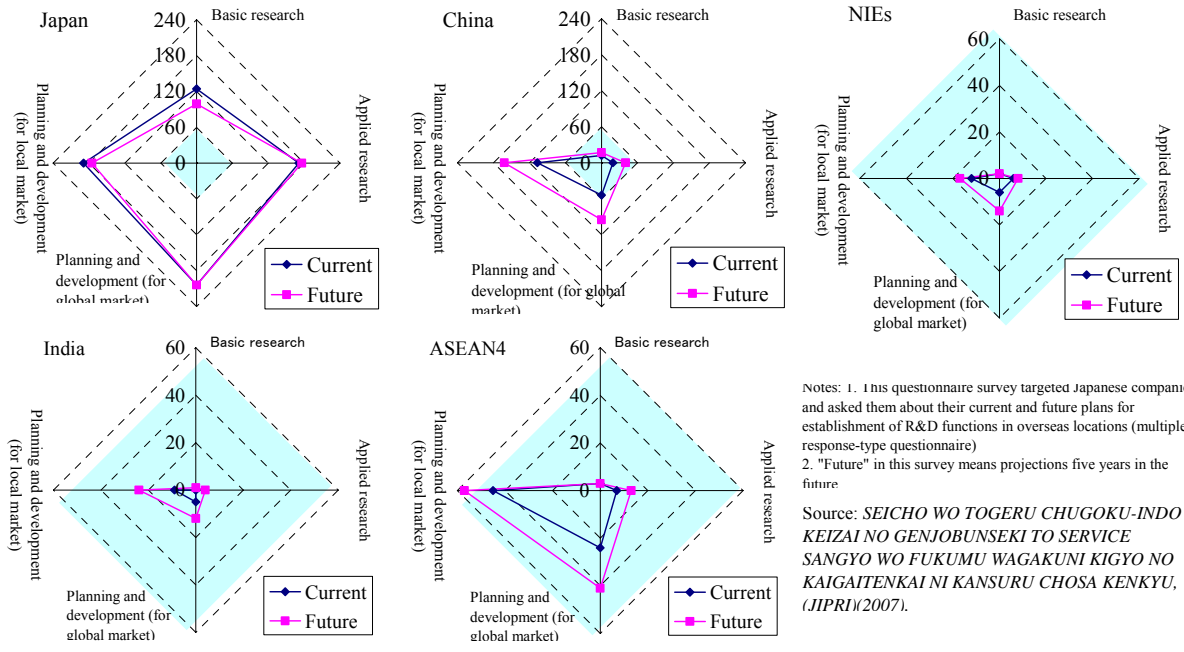
- Given the increasing importance of East Asia also as a market, Japanese companies are seeking to increase their sales volume and market share within the region, including in countries where they have a presence. In addition, efforts are being strengthened that treat East Asia as a unified market, such as establishing bases to comprehensively coordinate sales.



(iv) Development functions linking production and sales take root in East Asia

- Japanese companies are not only creating production and sales bases in East Asia, there are also actively promoting the development of product design and development functions. In particular, there are many companies that are seeking to locate in China.

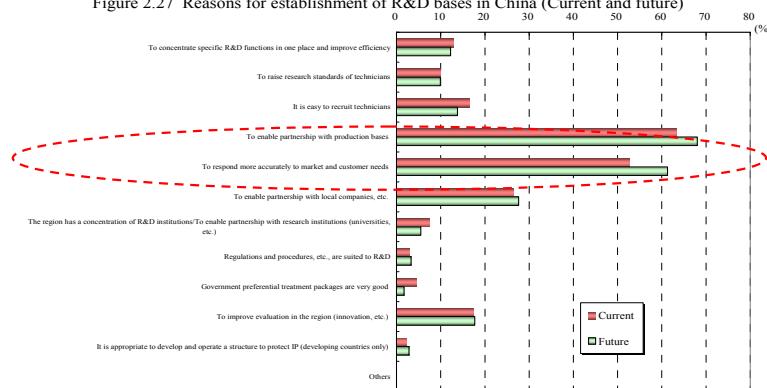
Figure 2.26 Status of the establishment of R&D functions by Japanese companies



Notes: 1. This questionnaire survey targeted Japanese companies and asked them about their current and future plans for establishment of R&D functions in overseas locations (multiple response-type questionnaire)
 2. "Future" in this survey means projections five years in the future
 Source: SEICHO WO TOGERU CHUGOKU-INDO KEIZAI NO GENJOBUNSEKI TO SERVICE SANGYO WO FUKUMU WAGAKUNI KIGYO NO KAIGAITENKAI NI KANSURU CHOSA KENKYU, (JIPRI)(2007).

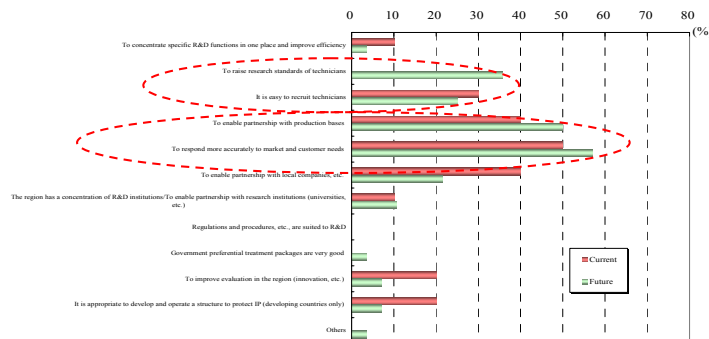
- Of the reason for the establishment R&D bases in East Asia, some of the most frequently heard are to create partnership with production bases, and respond accurately to market needs. It is thought that these reasons are foremost because in a market environment where product cycles are short, in order to introduce a new product that is ideally timed and suited to market needs, companies are seeking to keep production and development bases in close proximity to each other and through this reduce lead time, and resolve production site challenges through development and planning.
- In addition, with regard to India, in addition to the above two reasons, the market is characterized by the facts that it is easy to recruit able technicians, and research standards are also high.

Figure 2.27 Reasons for establishment of R&D bases in China (Current and future)



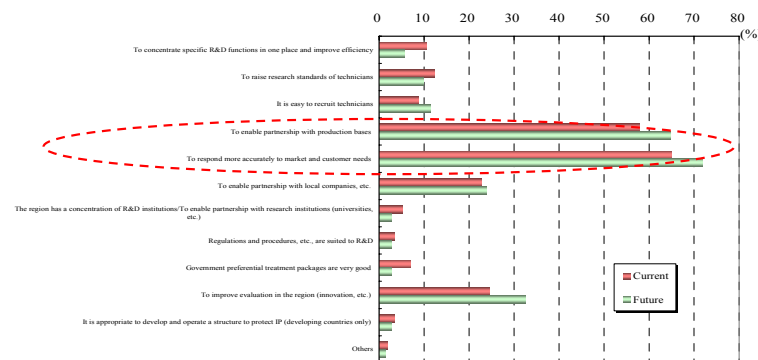
Notes: 1. Share of total responses by reason for establishment (multiple responses).
 2. Total number of responses: Current=133, Future=108.
 3. "Current" means the reason for establishing R&D functions already existing at the time of the questionnaire, and "future" means the R&D functions being considered to be created within five years from the time of the questionnaire.
 Source: SEIHO WO TOGERU CHUGOKU-INDO KEIZAI NO GENJOUBUNSEKI TO SERVICE SANGYO WO FUKUMU WAGAKUNI KIGYO NO KAIGAITENKAI NI KANSURU CHOSA KENKYU. (JIPRI/2007).

Figure 2.29 Reasons for establishment of R&D bases in India (Current and future)



Notes: 1. Share of total responses by reason for establishment (multiple responses).
 2. Total number of responses: Current=113, Future=108.
 3. "Current" means the reason for establishing R&D functions already existing at the time of the questionnaire, and "future" means the R&D functions being considered to be created within five years from the time of the questionnaire.
 Source: SEIHO WO TOGERU CHUGOKU-INDO KEIZAI NO GENJOUBUNSEKI TO SERVICE SANGYO WO FUKUMU WAGAKUNI KIGYO NO KAIGAITENKAI NI KANSURU CHOSA KENKYU. (JIPRI/2007).

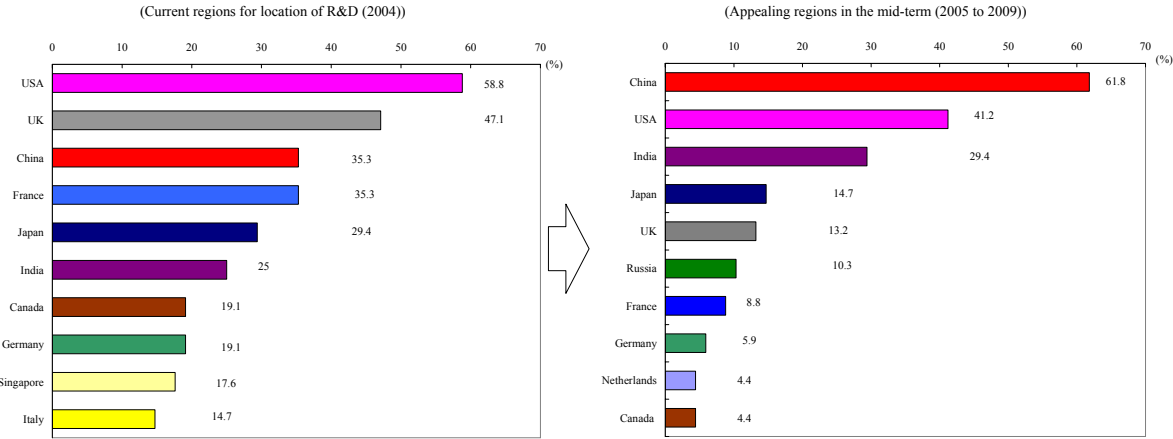
Figure 2.28 Reasons for establishment of R&D bases in ASEAN4 (Current and future)



Notes: 1. Share of total responses by reason for establishment (multiple responses).
 2. Total number of responses: Current=57, Future=71.
 3. "Current" means the reason for establishing R&D functions already existing at the time of the questionnaire, and "future" means the R&D functions being considered to be created within five years from the time of the questionnaire.
 Source: SEIHO WO TOGERU CHUGOKU-INDO KEIZAI NO GENJOUBUNSEKI TO SERVICE SANGYO WO FUKUMU WAGAKUNI KIGYO NO KAIGAITENKAI NI KANSURU CHOSA KENKYU. (JIPRI/2007).

- China is the country in East Asia in which Japanese companies have established the most R&D bases, and this movement is not limited to Japanese companies, as companies from around the world are also locating R&D to China, demonstrating the rapidly heightening of R&D location in China.

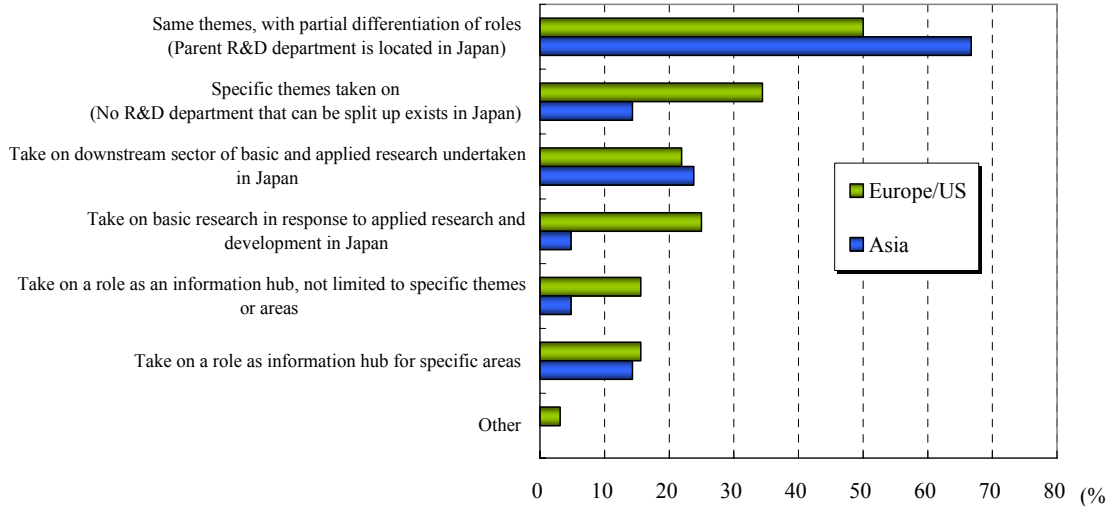
Figure 2.30 Location of R&D activities of global companies by country



Note: Survey implemented by UNCTAD targeting 316 companies selected on the basis of the size of their R&D expenditure (November 2004 to March 2005). Total number of responding companies: 68.
 Source: *World Investment Report 2005*, (UNCTAD).

- There are many cases in which a part of R&D that would have been undertaken at a Japanese R&D base is instead implemented at these East Asian bases. This demonstrates how important it is to decide what can be done overseas and what can be done in Japan, even in R&D aspects, and, after having taken the appropriate measures to protect intellectual property, etc., to promote the division of labor and functions.

Figure 2.31 Division of roles between overseas and domestic (Japan) R&D bases



Notes: 1. Answers received were in response to the question, "In what way are the functions that you possess split in terms of role division with R&D departments in Japan?" (multiple responses).
 2. Japanese companies where the parent organization has R&D functions located overseas. Total number of responses: Europe and US: n=32, Asia: n=21.
 Source: *KENKYU KAIHATSU KINOU NI OKERU KOKUSAI BUNGYO NO SHINTEN TO SANGYO GIJITSUSEISAKU NI KANSURU CHOSA*, (2005)(NRI).

Figure 2.32 Impact of overseas expansion of R&D functions on domestic R&D activities



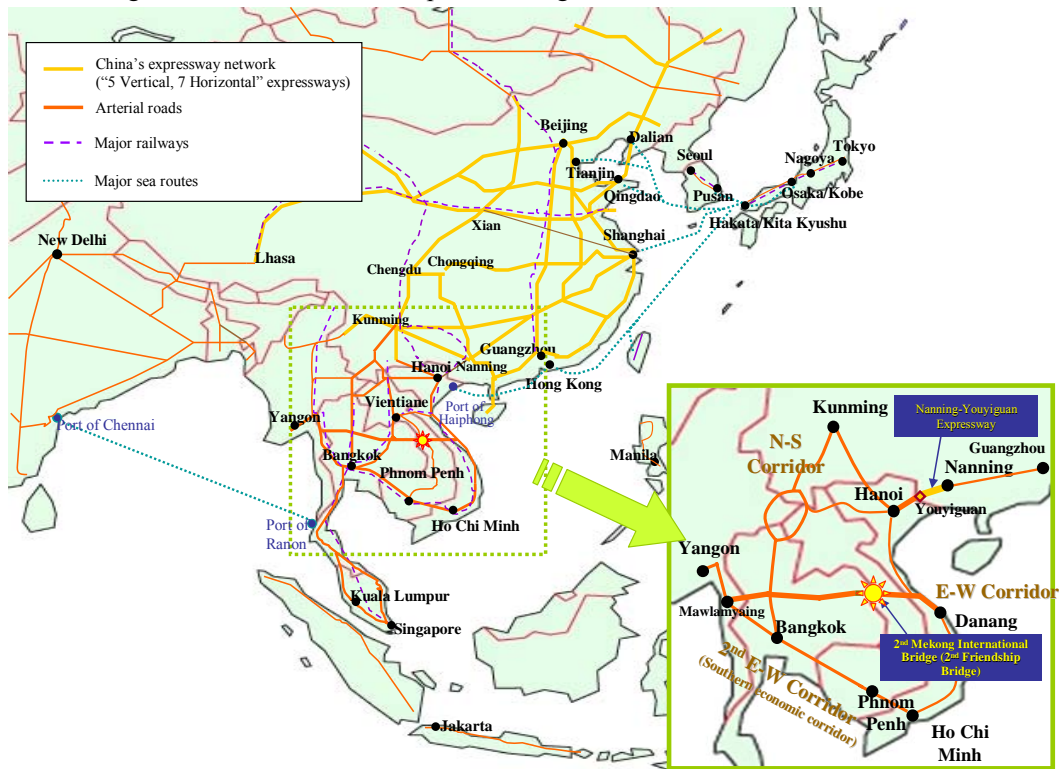
Note: "Materials" refers to chemicals, petroleum and coal, steel, and non-ferrous metals, "machinery" refers to general, electrical, transportation and precision machinery and equipment.

Source: KENKYU KAIHATSU KINOU NI OKERU KOKUSAI BUNGYO NO SHINTEN TO SANGYO GIJUTSUSEISAKU NI KANSURU CHOSA, (2005)(NRI).

(2) Advanced logistics functions to support business networks

- In addition to the expansion of EPA/FTA, the development of logistics infrastructure in China and ASEAN is another aspect that is supporting the construction of more efficient business networks for Japanese companies, and it is projected that even smoother logistics will be realized in the future.

Figure 2.33 Status of development of logistics infrastructure in East Asia



- Japan too is making efforts towards strengthening the competitiveness of Japanese companies that are expanding overseas and realizing East Asian economic integration. To this end it established the Committee on Partnership for International Logistics Competitiveness, which formulated an action plan towards the improvement of logistics infrastructure within the ASEAN region. It is important that specific measures be implemented in accordance with this plan.

Figure 2.34 Overview of the Action Plan to Strengthen Japan's Competitiveness in International Logistics by the Committee on Partnership for International Logistics Competitiveness

	Development of wide-area logistics network	HR development related to logistics and customs procedures	Utilization of logistics materials	Facilitation of customs procedures
Logistics challenges in ASEAN	<ul style="list-style-type: none"> Development of basic infrastructure and logistics management facilities, etc., is still insufficient 	<ul style="list-style-type: none"> Low awareness of logistics quality or local manufacturers Lack of logistics management specialists, etc. 	<ul style="list-style-type: none"> Lack of movement toward the utilization of RFID tags Insufficient use of logistics materials and equipment (pallets, fork lift trucks, etc.) 	<ul style="list-style-type: none"> Lack of customs capacity Opaque customs systems Lack of information sharing about customs and among related institutions, and delays in operational integration, etc.
Specific measures	<ul style="list-style-type: none"> Realize soft and hard infrastructure development on routes where Japanese company needs are high →FY2007: Implement land route tests in the Mekong region 	<ul style="list-style-type: none"> Export of the Japanese logistics qualification program, etc. →FY2007: Collection of basic data in order to enable selection of model region for program expansion 	<ul style="list-style-type: none"> Export of Japanese know-how, including introduction of RFID tags, etc. →FY2007: Implementation of trials utilizing RFID tags and logistics materials and equipment 	<ul style="list-style-type: none"> Computerization of customs procedures (Creation of single window for each country and support for mutual interconnectivity) →FY2007: Implementation of survey into system requirements, etc.
Expected effects	<ul style="list-style-type: none"> Eliminate infrastructure bottlenecks Comprehensive logistics management Facilitation of cross-border transportation links 	<ul style="list-style-type: none"> Halt downturn in and improve operations quality 	<ul style="list-style-type: none"> Cost reductions through operations efficiency Advanced logistics services through freight status management, etc. (location, status, etc.) 	<ul style="list-style-type: none"> Significant simplification and enhanced efficiency of operations through unified one-stop processing of customs procedures

Source: Action Plan to Strengthen Japan's Competitiveness in International Logistics, (December 22, 2006)(Committee on Partnership for International Logistics Competitiveness).

3. Merits for domestic business, etc., brought about by expansion into East Asia

- Through opening sales challenges and increases in the export of intermediate goods, and specializing in high value-added goods domestically, etc., expansion into East Asia is bringing about considerable benefits, including boosting production volume for domestic business and improving profitability.

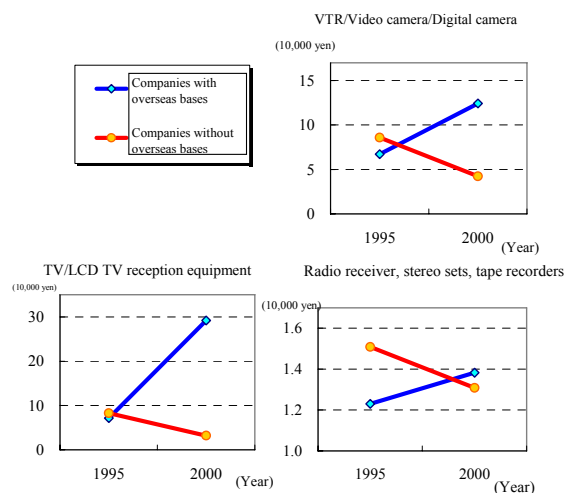
Figure 2.35 Impact of expansion into East Asia on domestic business



Notes: 1. This survey includes "no change" responses, and also non-responses (n=581).
 2. The industrial classifications are: materials (mining and textile industries (excluding textile products), chemicals, petroleum, coal products, plastic products, rubber products, ceramic and earthenware products, steel, non-ferrous metals, metal products); machinery (general machinery, electrical machinery, ICT machinery, electronic components and devices, transportation equipment, precision and medical equipment); lifestyle (food products, apparel and other textile products, wood and wood products, furniture and accessories, pulp, paper and processed paper products, printing, and leather goods)
 Source: SEICHO WO TOGERU CHUGOKU-INDO KEIZAI NO GENJOBUNSEKI TO SERVICE SANGYO WO FUKUMU WAGAKUNI KIGYO NO KAIGAITENKAI NI KANSURU CHOSA KENKYU. (JIPRI/2007).

- With regard to a number of product fields in the machine manufacturing industry, between companies that expanded their business overseas during the period 1995 to 2000 and those that did not, looking at the relationship to product unit price for domestically produced products, we see that for the companies that expanded overseas the same unit price has increased to a certain degree. From this we can understand that companies that expanded overseas are moving production of their relatively low priced products to overseas bases, while concentrating production of high value-added products domestically.

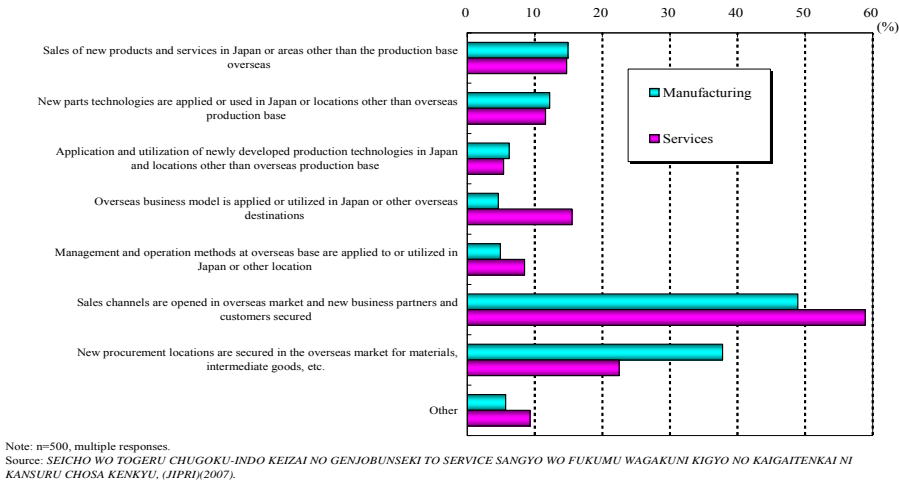
Figure 2.36 Comparison of changes in domestic product unit price for companies with or without overseas base



Source: Kwon, H. (forthcoming)(2007), *Realignment of "Industrial Statistics" and "Basic Survey of Japanese Business Structure and Activities" of METI*, (Research through cooperation between Kwon Hyeong Ug of College of Economics of Nihon University, and Trade Policy Bureau of METI).

- In addition, the entry into East Asia, which boasts great diversity, also helps to realize innovation that is utilizable both in Japan and in developing countries also, as well as contributing to the securing of human resources who can work effectively on the global stage.

Figure 2.37 Ripple effect of entry into East Asia



Examples of innovation/know-how acquired in East Asia

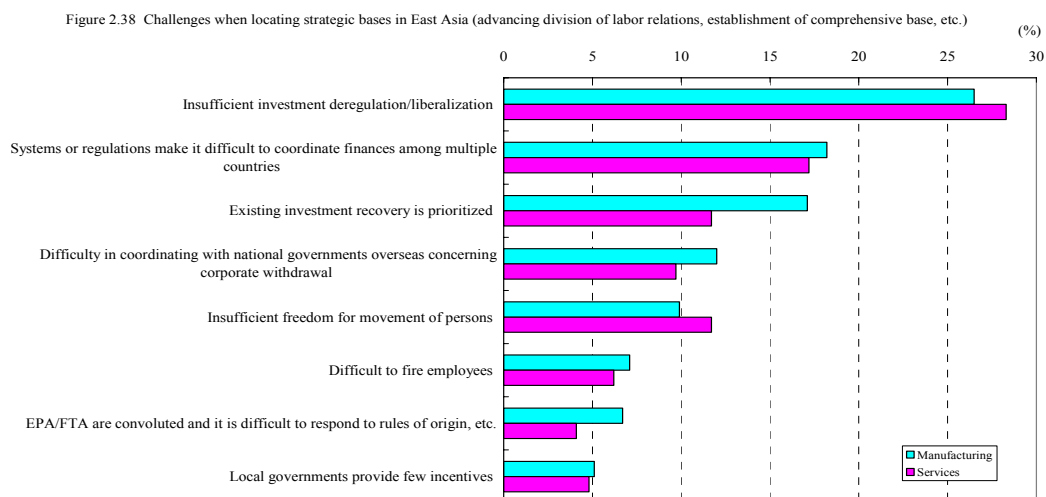
- Introduction of automated equipment and facilities in Japan to achieve a 3-person operated production line to respond to work tasks. This was converted to a 20-person line according to the skills and costs of local workers in Thailand, and a similar production line system has also been built and put into operation in China. (Vehicle component maker)
- Promoting mechanization and automation, methods used in a Vietnam factory for one-by-one production (production that uses an automated line, but produces one unit at a time due to diverse product requirements) were introduced into a Japanese domestic factory that engaged in lot production, producing a fixed volume of goods, and this introduction realized a considerable reduction in inventory of goods in progress and products. (Vehicle component maker)
- Development, production and sale of new products using local ingredients in China, and production and sale in Southeast Asia. (Cosmetics)

Examples of securing human resources in East Asia

- Appointing one of the managers of a Singaporean manufacturing and sales company the president of a Chinese manufacturing and sales company. (Non-ferrous metal products)
- Appointing a Chinese manager of a Chinese factory to launch a factory in Vietnam. (Garment production)
- Thai staff from a Thai factory are providing guidance on production management, etc., to staff at a Laos factory. (Vehicle component maker)

4. Aiming for further development through a seamless economic zone

- Many companies state that one of the challenges they face directly when establishing strategic bases from such considerations as multilateral division of labor and concentration of production functions, is the investment systems in each country.



Notes: 1. Multiple responses concerning challenges in establishing strategic bases (advancing division of labor relations, establishment of comprehensive base, etc.) in the East Asian region by companies already operating in the region, and those companies that indicated the intention to establish a strategic base. No. of responding companies: Manufacturing: 434 companies, Services: 145 companies.

2. The values represent the proportion of all responding companies for each challenge.

Source: *SEICHOU WO TOGERU CHUUGOKU-INDO KEIZAI NO GENJIBUNSEKI TO SAABISU SANGYOU WO FUKUMU WAGAKUNI KIGYOU NO KAIGAITENKAI NI KANSURU CHOU SA KENKYUU*, (JIPRI)(2007).

- In addition, various business risks in East Asia have been pointed out, including problems with the legal, tax and intellectual property protection systems in China, political and social unrest in the Philippines and Indonesia and lack of infrastructure in India and Vietnam.

- In East Asia, in order to promote vigorous business activities and realize further development of the regional economy, it is important to improve the business environment through EPA/FTA that cover the entire region, and thereby create a more seamless economic zone.

Figure 2.39 Business risks in each country

(Unit: %)

	China (n=596)	Thailand (n=353)	Indonesia (n=238)	Malaysia (n=245)	Philippines (n=177)	Singapore (n=244)	Vietnam (n=236)	India (n=201)
Political/social unrest	41.3	28.3	50.4	3.3	52.5	0.8	9.7	15.4
Incomplete legal system or problems with operation	59.9	5.9	28.2	6.5	13.0	0.0	32.2	35.3
Problems with protection of IPR	59.2	6.2	9.2	4.1	9.0	1.6	11.9	13.9
Risks and problems concerning taxes	33.2	7.6	15.5	6.5	7.3	2.0	10.2	17.9
High foreign exchange risk	20.5	9.1	23.5	5.3	7.9	3.3	8.5	6.5
Undeveloped infrastructure	21.6	7.4	29.8	7.8	32.2	0.0	47.9	57.2
High or rising personnel costs	28.4	20.4	5.5	13.9	4.0	39.3	5.1	3.5
Lack of concentration or development of related industries	4.7	6.2	15.1	12.7	20.9	3.7	31.4	18.4

Notes: 1. Population parameter (n) shows the number of companies with current business relations, or those seeking business relations.

2. Response rates are color coded - 40% and above are colored pink, between 20 and 40% are colored yellow, between 5 and 20% are white, and below 5%

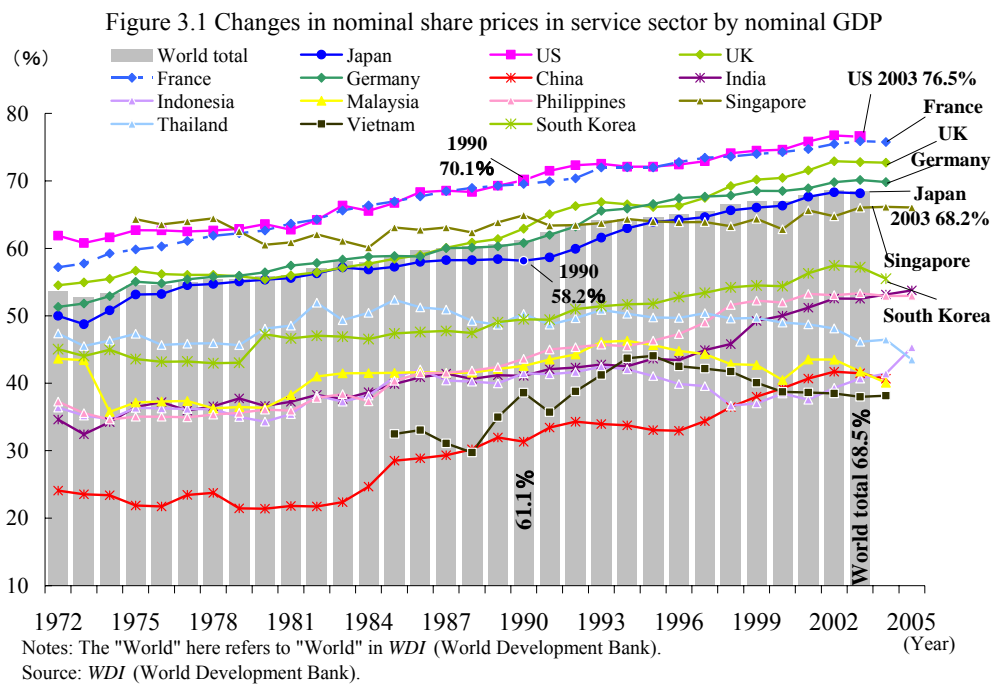
Source: *Questionnaire Survey on Foreign Business Activities by Japanese Companies FY2006*, (2007)(JETRO).

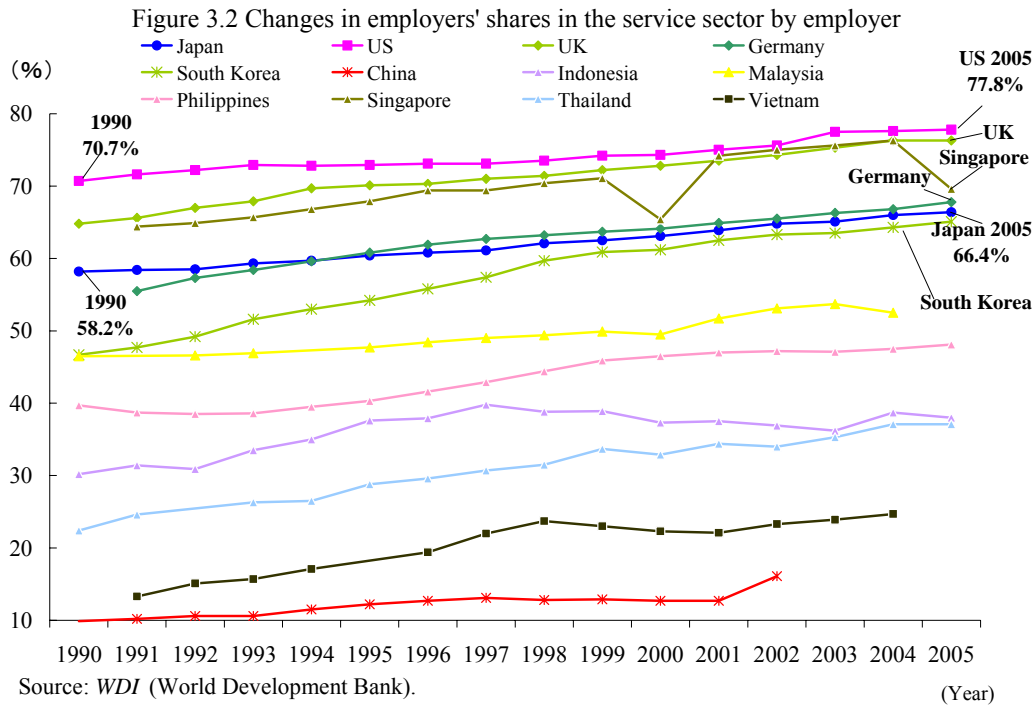
Chapter 3 Increasing Competitiveness of Japan's Industry and Expanding it Globally

- With the global economy continuing to develop into a more service-oriented structure, the service industries of the United States and European countries are making rapid moves to expand globally. On the other hand, the service industries of Japan are lagging significantly behind in their global development.
- As a backdrop to this global expansion are the following factors: (i) utilization of IT; (ii) creation of systems and deregulation in each country; (iii) internationalization of service transactions; and (iv) strengthened competitiveness through the realization of merits of scale thanks to global expansion.
- In order to develop Japan's economy, it is essential to achieve sustainable growth in the service industry, given that this sector accounts for 70% of GDP and employment. At the same time as achieving enhanced international competitiveness through the introduction of new business models including the promotion of IT investment and utilization that is lagging behind in Japan in international terms and the expansion of new business entrants, including foreign companies, it is important to realize active efforts to enter overseas markets.

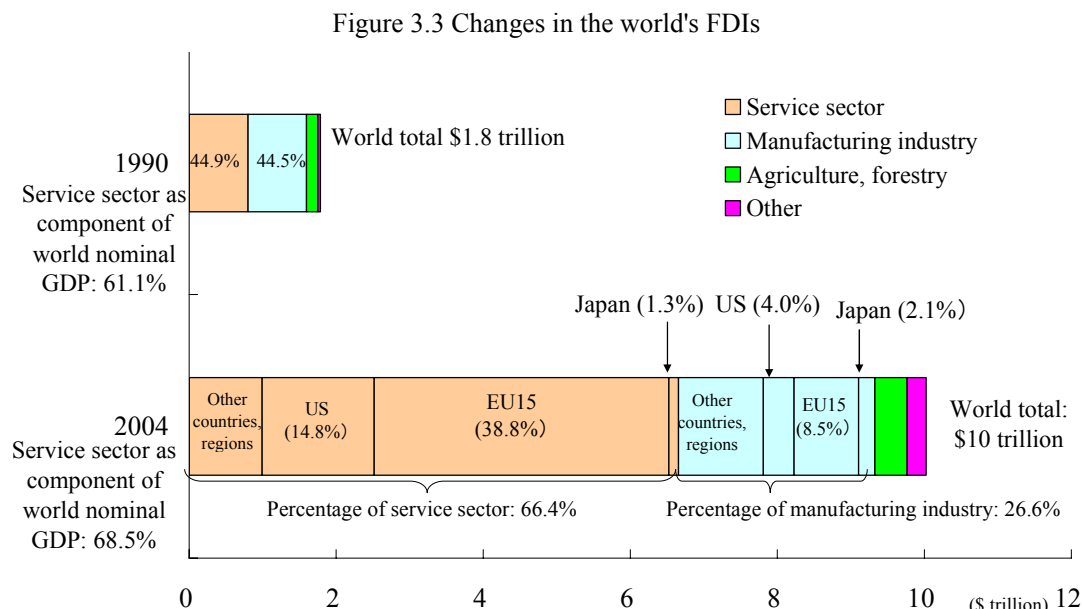
1. Global expansion of service industries—the era of global service industries

- The move towards a service-based economy is developing in each country, and the presence of service industries is advancing in terms of both GDP and employment. It is projected that the importance of service industries in the economies of each country will continue to heighten in the future.



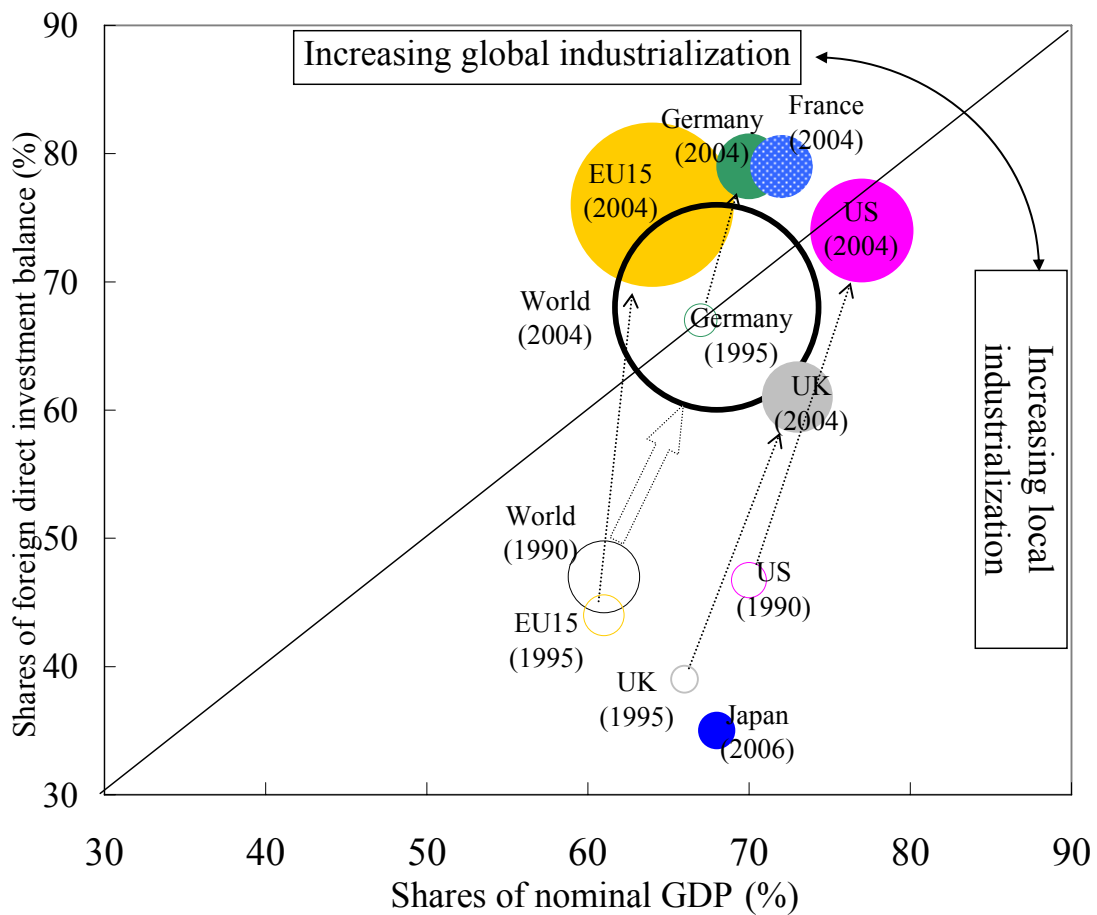


- The globalization of the service industry is rapidly expanding due to direct investment. The proportion of global foreign direct investment (FDI) accounted for by the service industry has rapidly expanded and likewise the proportion of nominal GDP taken up by the service industry is at an increasingly high level.



- There are some elements in the manufacturing industry of Japan that demonstrate its international competitiveness, however, in terms of the move to a service-based economy Japan is lagging behind other developed countries and is even more behind in terms of the global expansion of service industries.

Figure 3.4 Nations' service sectors as components of nominal GDP and of foreign direct investment positions



- Notes: 1. The size of the circle indicates the amount of direct investment.
 2. Due to data limitations, Japan and US service sectors as components of nominal GDP were calculated based on 2003 data.
 3. EU15 includes intra-regional investments.

Source: WDI (World Development Bank), *World Investment Report 2006* (UNCTAD), *IFS* (IMF), *Japan's Balance of Payments and International Investment Position* (Ministry of Finance, Bank of Japan), US BEA website, EUROSTAT.

- The globalization of the service industry is expanding throughout all industry types, including finance and services to businesses.
- The service industry of Japan has not made any advances towards globalization except in a limited number of fields, including the finance and insurance industry, and wholesale and retail industry.

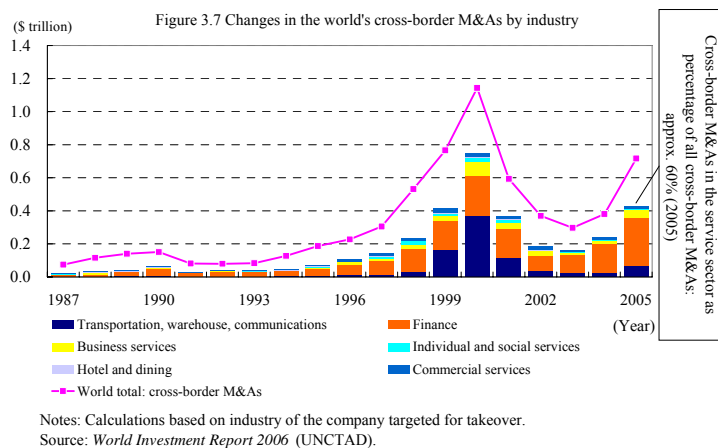
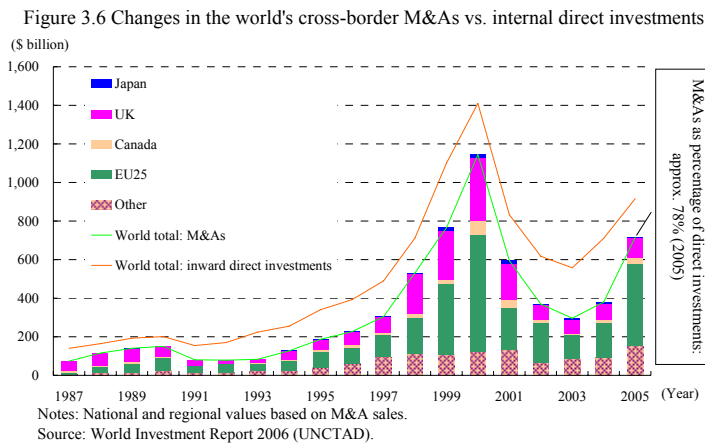
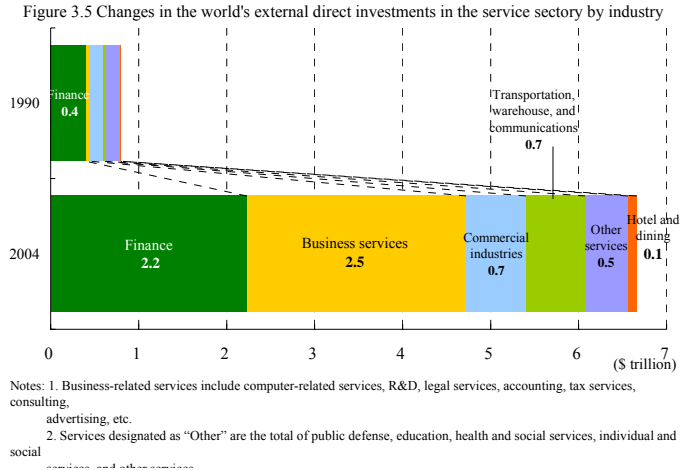


Table 3.8 Japan's external direct investment positions in the service sector by industry (end of 2006)

	Service sector	Finance, insurance	Wholesale, retail	Services	Communications	Real estate	Transportation
Direct investment Positions (100 million yen)	188,752	96,251	59,859	16,223	6,332	5,923	4,164
Composition of service sector (%)	100.0%	51.0%	31.7%	8.6%	3.4%	3.1%	2.2%

Source: Japan's Balance of Payments and International Investment Position (Ministry of Finance, Bank of Japan).

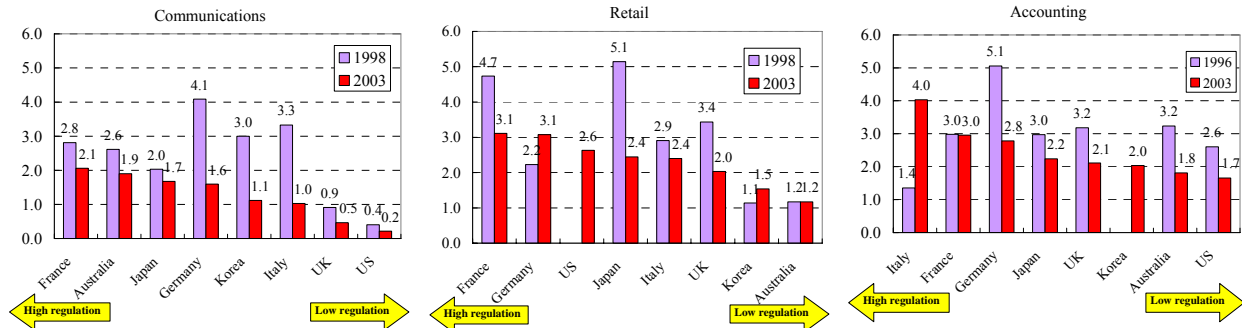
2. Major factors promoting global expansion of service industry

- In the past it used to be the case that an important source of competitiveness for the service industry was to maintain local links and contacts, and from the perspective of protecting and promoting domestic industries and securing employment the business environment was limited in terms of competition. It is such factors that have impeded global expansion.

- The permeation of advanced IT utilization not only enhances cost competitiveness through improving operational efficiency, etc., through speedily and accurately grasping customer needs, etc., it is possible to develop business based on the characteristics of the local market and to improve customer service, contributing to the acquisition of a type of competitiveness that does not rely on the maintenance of local links, etc.

- In the service industry too, in recent years a variety of regulatory moves and system development have been achieved. In addition, in the countries of East Asia and others there are various efforts being witnessed, including active attempts to attract foreign service providers as a means of promoting economic development in each country, and therefore the business environment surrounding the service industry is undergoing significant changes.

Figure 3.8 Major countries' market regulation of products by industry



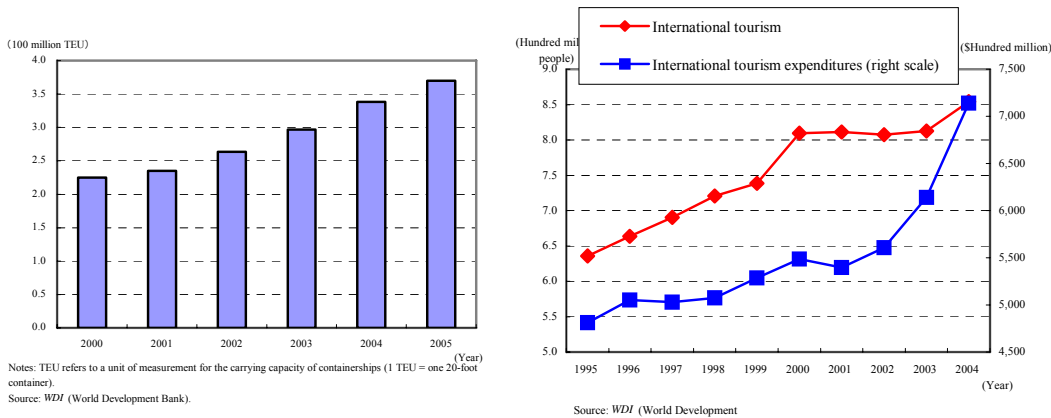
Notes: 1. A market regulation of products close to 0 indicates low degree of regulation and 6 indicates high degree of regulation.

2. Data not displayed in graphs are data that have not been announced.

Source: OECD (2006), "Product market regulation in the non-manufacturing sectors of OECD Countries: measurement and highlights," *OECD Economics Department Working Papers, No.530*

- In recent years as a backdrop to corporate globalization, the cross-border movement of assets, funds, information and people has been increasingly vigorous. This signifies the globalization of customer bases for the service industry. Through the increased use of international service transactions such as off-shoring, etc., the globalization of the service industry is being driven by demand.

Figure 3.10 Changes in international transaction of service



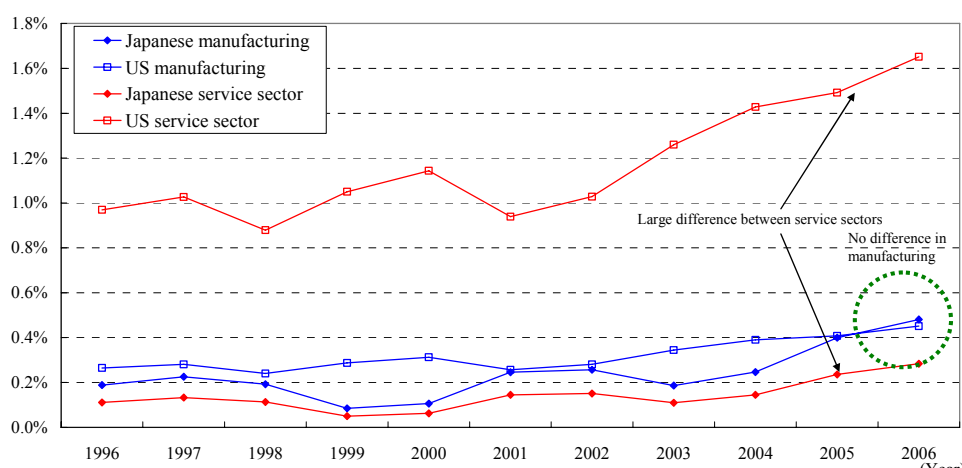
- In the past, given that within the service industry local links were a significant source of competitiveness, this limited business scale, and as a result there was a limit to the degree to which companies could enjoy merits of scale. However, as a backdrop to the enormous amount of investment being channeled in to IT in recent years, global service companies have emerged that are aiming to strengthen their corporate competitiveness by expanding business scale to realize scale merits. In this way the global development of the service industry is accelerating.

Examples of global service industries																																					
<Distribution industry>	<Transportation industry>																																				
<table border="1"> <thead> <tr> <th></th> <th>Profits on sales (US\$)</th> </tr> </thead> <tbody> <tr> <td>Wal-Mart (US)</td> <td>345 billion</td> </tr> <tr> <td>Carrefour (France)</td> <td>109 billion</td> </tr> <tr> <td>Metro (Germany)</td> <td>75 billion</td> </tr> <tr> <td>Aeon (Japan)</td> <td>41 billion</td> </tr> </tbody> </table> <p>Notes: Profits on sales for Carrefour, Metro, and IKEA calculated based on US\$ conversions of the IFS FY2006 average rates. Source: The respective company's materials and IFS (IMF).</p>		Profits on sales (US\$)	Wal-Mart (US)	345 billion	Carrefour (France)	109 billion	Metro (Germany)	75 billion	Aeon (Japan)	41 billion	<table border="1"> <thead> <tr> <th></th> <th>Profits on sales (US\$)</th> </tr> </thead> <tbody> <tr> <td>Deutsche Post (Germany)</td> <td>76 billion</td> </tr> <tr> <td>UPS (US)</td> <td>47.5 billion</td> </tr> <tr> <td>Fedex (US)</td> <td>21.4 billion</td> </tr> <tr> <td>Nippon Express (Japan)</td> <td>15.3 billion</td> </tr> </tbody> </table> <p>Notes: Profits on sales for Deutsche Post based on US\$ conversions of the IFS FY2006 average rates. Source: The respective company's materials and IFS (IMF).</p>		Profits on sales (US\$)	Deutsche Post (Germany)	76 billion	UPS (US)	47.5 billion	Fedex (US)	21.4 billion	Nippon Express (Japan)	15.3 billion																
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3. Current status of Japan's service industry viewed from an international perspective and challenges

- Japan's income (receipt) from direct investment remains at a low level when compared to the United States, despite the upward tendency of direct investment due to globalization. For Japan it is important to achieve an expansion in wealth, through expanding the receipt of FDI income. This would be achieved by the domestic service industry, which has not received a great deal of FDI to date, advancing global expansion.

Figure 3.11 Changes in direct investment income vs. nominal GDP ratio, by industry



Notes: Direct investment income for each industry was estimated by multiplying the share of FDIs for each industry (Japan: 2005, US: 2004) comprising total direct investment income.
Source: Balance of Payment Statistics, Japan's Balance of Payments and International Investment Position (Ministry of Finance, Bank of Japan), US BEA website.

- If we contrast the characteristics of the service industries of Japan that have entered foreign markets with those of the manufacturing industry, we see a trend in the service industry whereby regardless of corporate size, the higher the total factor productivity (TFP), then that company is likely to enter overseas markets.

Table 3.12 The relationship between moves to overseas markets and enterprise characteristics

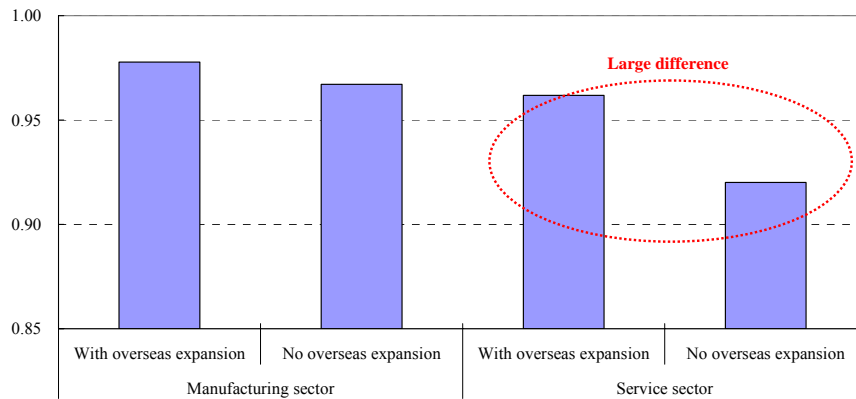
	Manufacturing		Service sector	
	Coefficient	z-value	Coefficient	z-value
Total Factor Productivity (TFP)	0.99	1.10	1.47	2.89***
Scale of employment	0.42	8.67***	0.04	0.72
Profit-to-sale ratio	2.25	2.95***	-1.18	-1.15

Notes:

1. The period for estimation is 1980 to 2005.
2. * indicates 10% significance, ** indicates 5% significance, and *** indicates 1% significance. The z-value tests whether the null hypothesis is true, i.e., whether the regression coefficient of an explanatory variable is 0 (the explanatory variable has no explanatory value). In this case, the null hypothesis that an absolute value of z greater than 1.96 indicates a 5% significance level, and greater than 1.64 indicates a 10% significance level, and greater than 2.57 indicates 1% significance level and an explanatory variable is 0, is rejected. It can be concluded that the explanatory variable has explanatory value.
3. "Coefficient" indicates the degree to which the probability of overseas market expansion changes given a 1-point change in enterprise characteristics.
4. The R&D/profit ratios for manufacturing and the service sector were not significant and are not given here.
5. Please see Note 3-1 for details on these estimations.

Source: KAIGAITENKAI NO SENTAKU TO SONOGO NO SEISANSEIHENKA (forthcoming, Ito 2007).

Figure 3.13 Comparison of productivity for companies with overseas expansion and those without



Notes: 1. Samples are limited to the period from 1980 to 2005.
 2. Values are based on the average rates of return of sample companies that have expanded overseas and sample companies that have not.
 Source: SERVICE SANGYO NI OKERU KAIGAI SINSHUTSU TO KIGYOU TOKUSEI NO KANKEI (tentative title, forthcoming; Ito 2007).

- In order to globalize Japan's service industry it is important to achieve high productivity that is on a par with that of the United States and Europe.
- The cause behind the relatively low added value margin of gain for Japan's service industry is due to the low labor productivity margin of gain.

Contributors to real value added growth in service sector

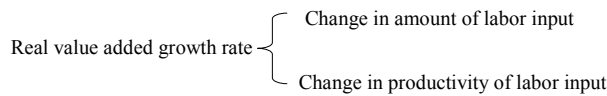
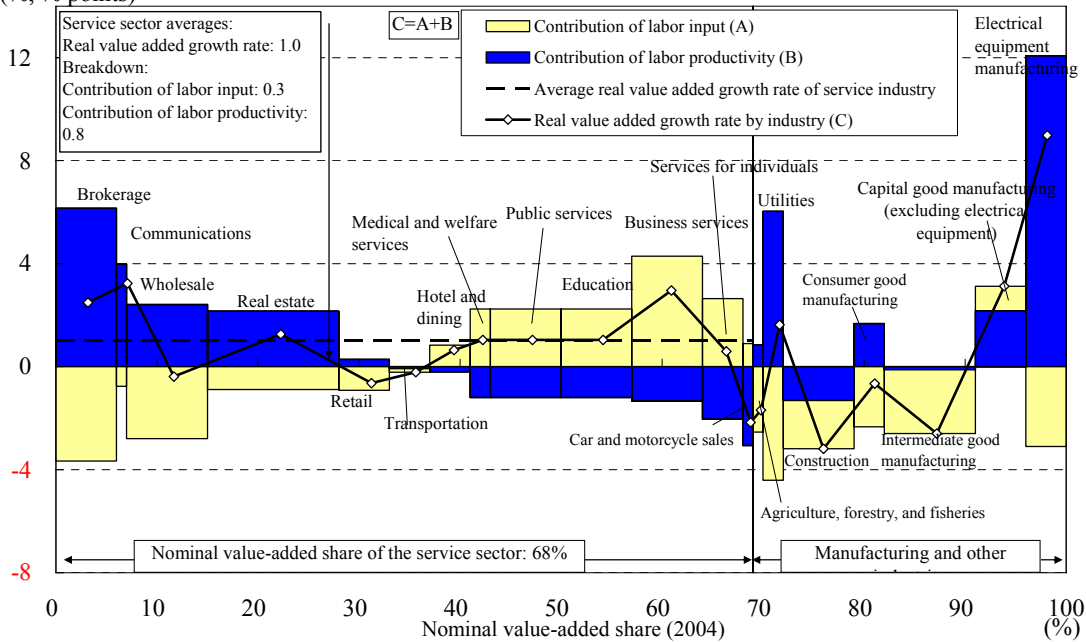
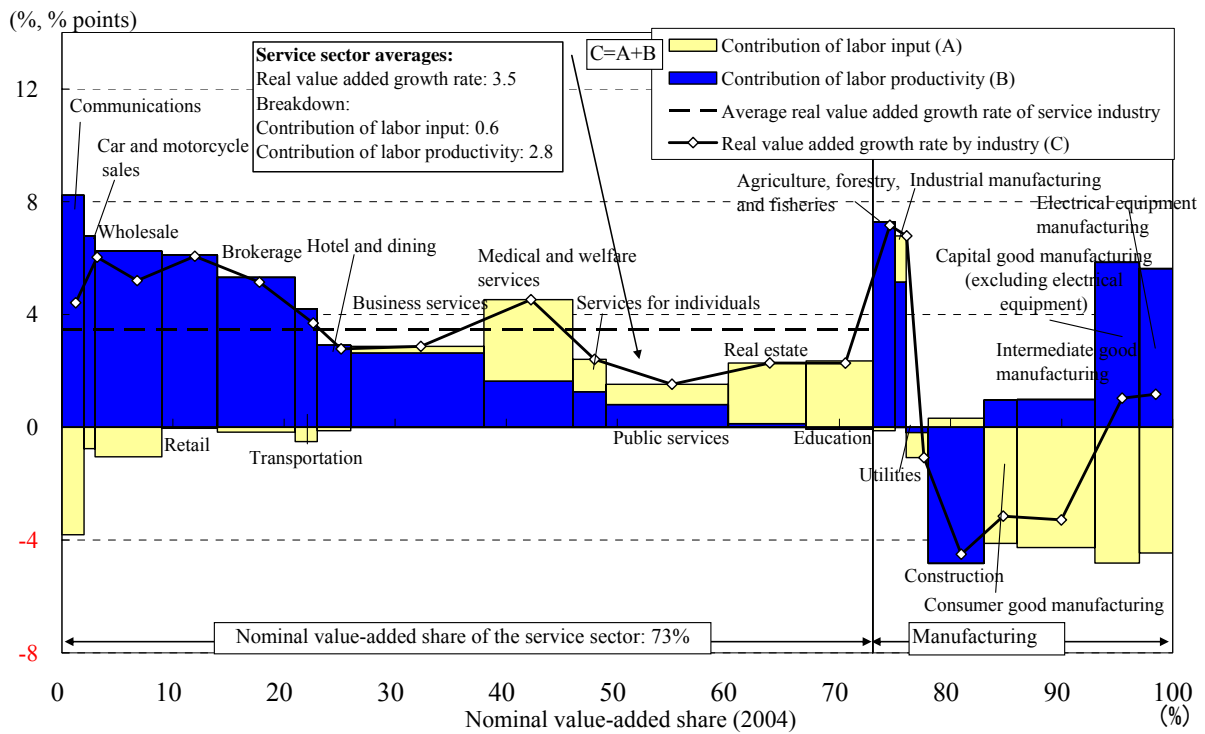


Figure 3.14 Factor breakdown of real value added growth rate in Japan's service sector (2001-2004 averages) (% , % points)



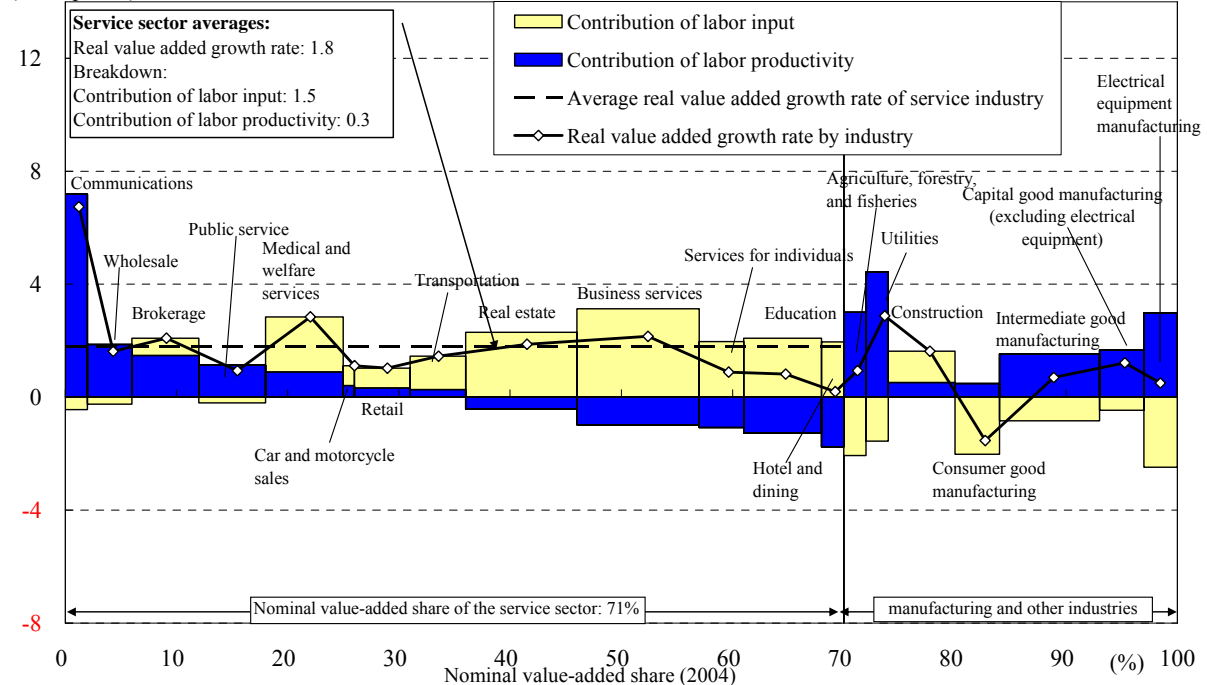
Notes: Service industry averages were calculated by using the weighted averages of nominal value-added 2004 shares for each industry.
 Source: EU KLEMS Database, March 2007, <http://www.euklems.net>.

Figure 3.15 Factor breakdown of real value added growth rate in US service sector (2001-2004 averages)



Notes: Service industry averages were calculated by using the weighted averages of nominal value-added 2004 shares for each industry.
Source: EU KLEMS Database, March 2007, <http://www.euklems.net>.

Figure 3.16 Factor breakdown of real value added growth rate in EU service sector (2001 to 2004 averages)



Notes: 1. Service industry averages were calculated by using the weighted averages of nominal value-added 2004 shares for each industry.
2. Totals for Austria, Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Spain, and the UK.
Source: EU KLEMS Database, March 2007, <http://www.euklems.net>.

- The cause behind the stagnant labor productivity margin of gain in Japan's service industry is due to the lack of IT capital contributions, and a low TFP margin of gain.

Contributors to labor productivity growth rate in service sector

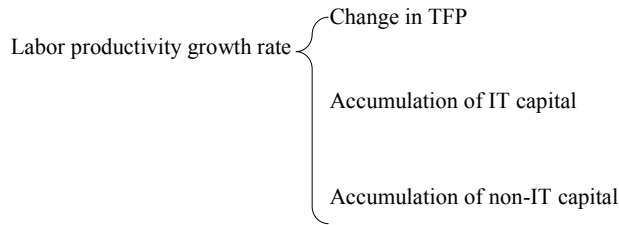
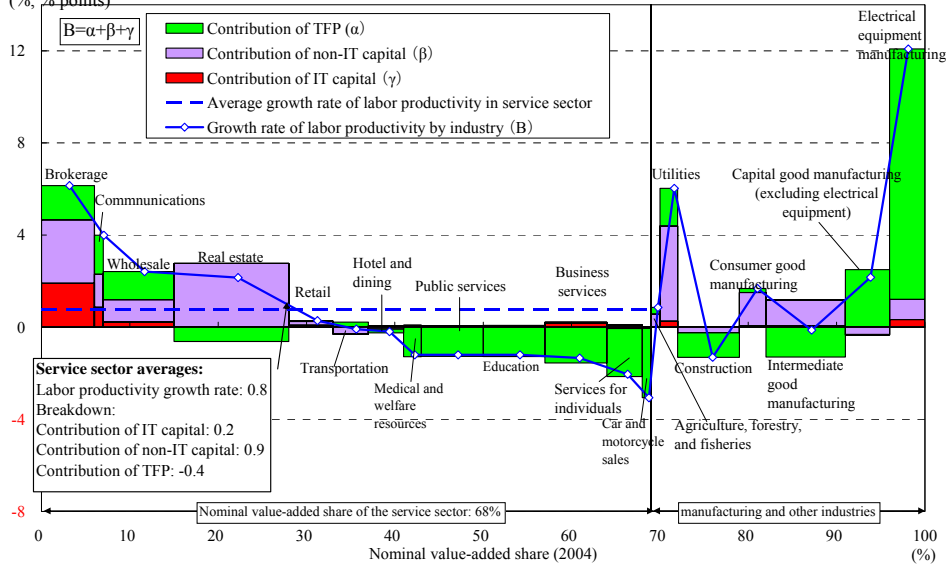
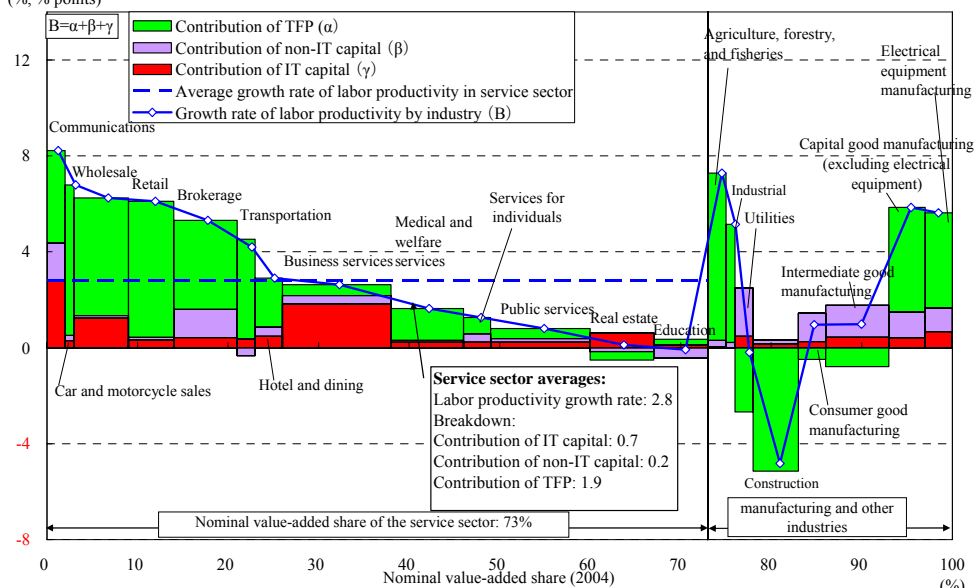


Figure 3.17 Factor breakdown of growth rate of labor productivity in Japan's service sector (2001-2004 avg) (% , % points)

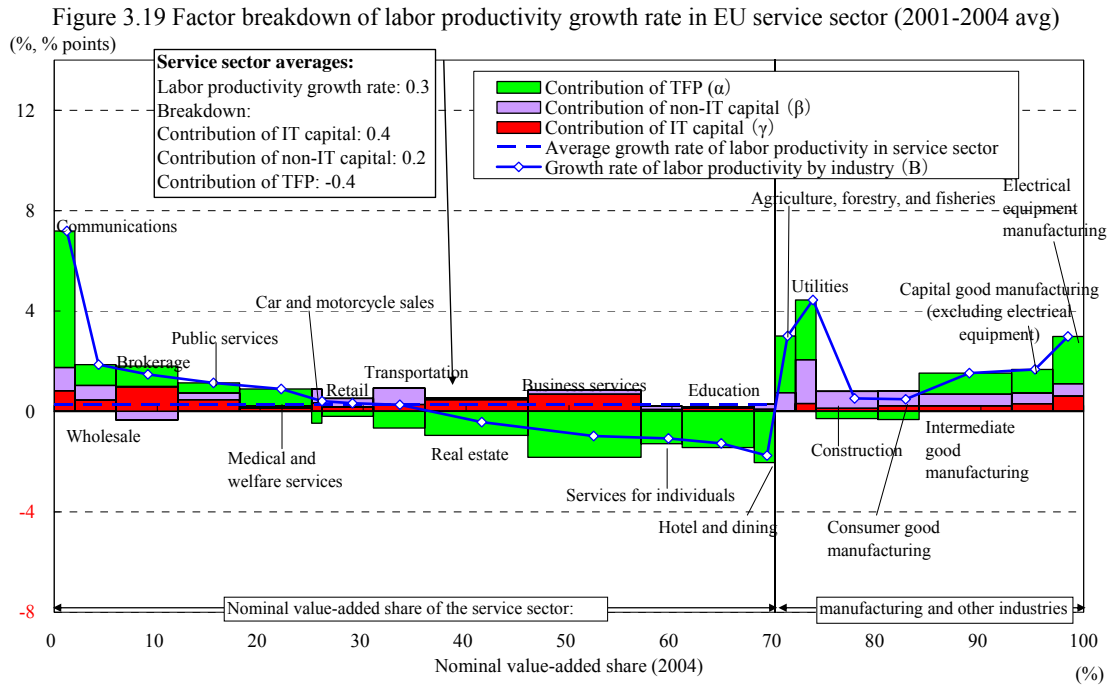


Notes: Service industry averages were calculated by using the weighted averages of nominal value-added 2004 shares for each industry. Source: EU KLEMS Database, March 2007, <http://www.euklems.net>.

Figure 3.18 Factor breakdown of labor productivity growth rate in US service sector (2001-2004 avg) (% , % points)

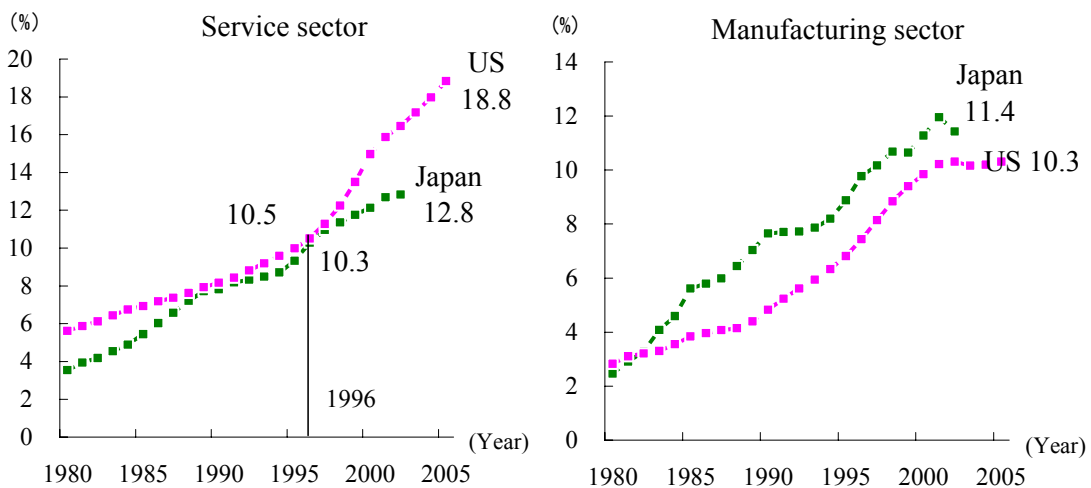


Notes: Service industry averages were calculated by using the weighted averages of nominal value-added 2004 shares for each industry. Source: EU KLEMS Database, March 2007, <http://www.euklems.net>.



- The United States' service industry has been accelerating the accumulation of IT capital stock since 1996 and the difference with Japan's service industry is expanding.

Figure 3.20 Percentage of IT capital stock in total capital stock in Japan and US



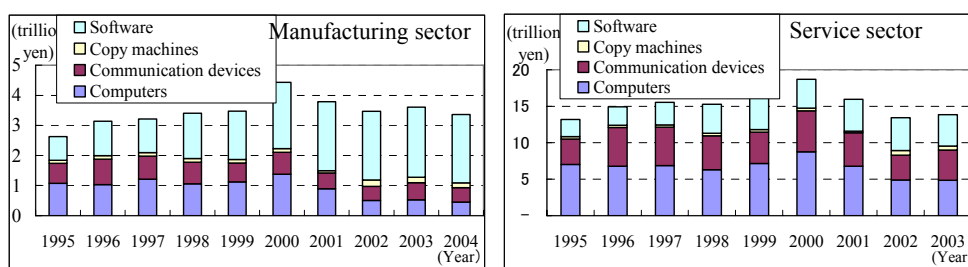
- When advancing IT capital accumulation, it is important to simultaneously improve TFP, by implementing flexible and strategic reviews of production methods that would maximize accumulated IT capital.

Example of the realization of TFP increase through fusion of IT utilization and business models

- A large US distributor implemented the comprehensive computerization of all office processing with regard to sales, inventory, demand outlook and delivery, and by sharing this system in real time with suppliers overall optimization was achieved in connection with deliveries and production plans. Not only were office-related costs reduced, the review also led to a reduction in faulty products, optimization of inventory, and reduction in procurement costs. (This contrasts with the case in Japan, where it has been pointed out that IT is only used for existing operations and efforts to optimize are in many cases made only at a departmental level, or within a part of a company.)

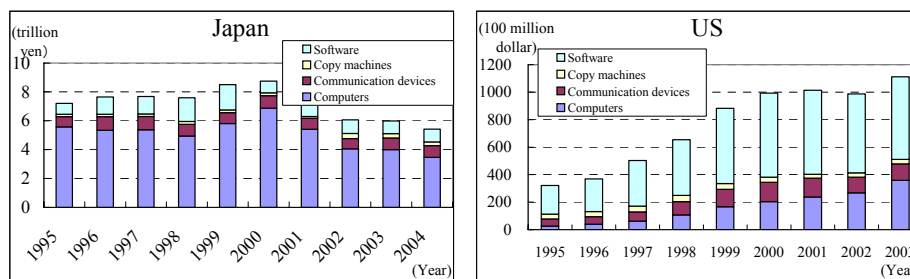
- 70% of IT investment by Japan's service industry is accounted for by investment in hardware, with focus on software investment lagging behind that of the manufacturing industry in Japan.
- In addition, IT investment in Japan's service industry even when defined in a narrow sense is still failing to show any increase in software investment. This is in contrast to the United States, where the proportion of software investment is extremely large and continues to increase annually.
- Within Japan's service industry there is a need to engage in efforts to simultaneously achieve an accumulation of IT capital and increase in TFP, by promoting strategic IT investment that actively utilizes software.

Figure 3.21 Changes in IT investment breakdown in Japan's manufacturing and service sectors



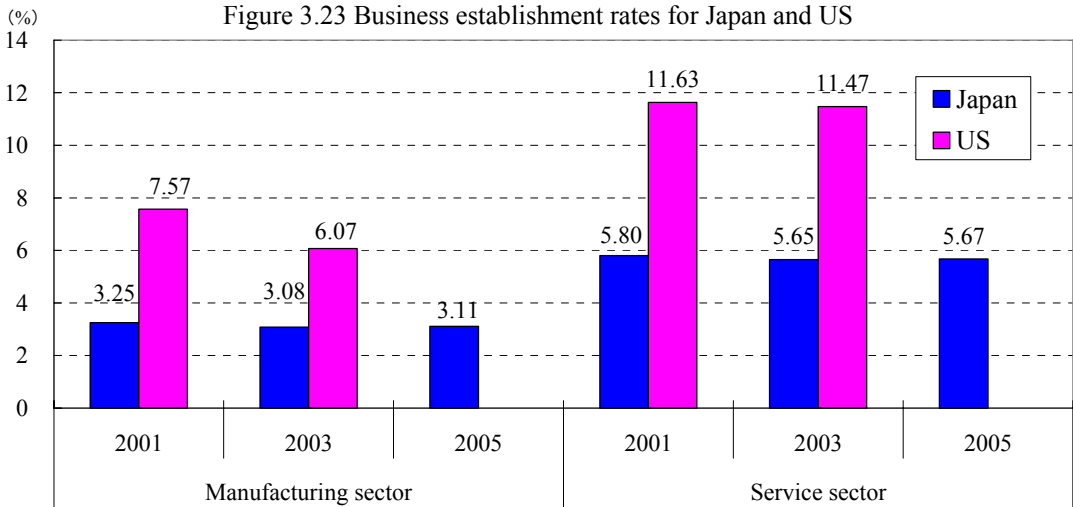
Source: CIO IKUSEI KATSUYO NO TAME NO IT TOUSHI NO GENJOU KADAI BUNSEKI CHOUZA JIGYOU HOUKOKUSHO (METI 2006).

Figure 3.22 Changes in IT investment breakdown of Japanese and US (narrowly defined) service sectors



Source: CIO IKUSEI KATSUYO NO TAME NO IT TOUSHI NO GENJOU KADAI BUNSEKI CHOUZA JIGYOU HOUKOKUSHO (METI 2006).

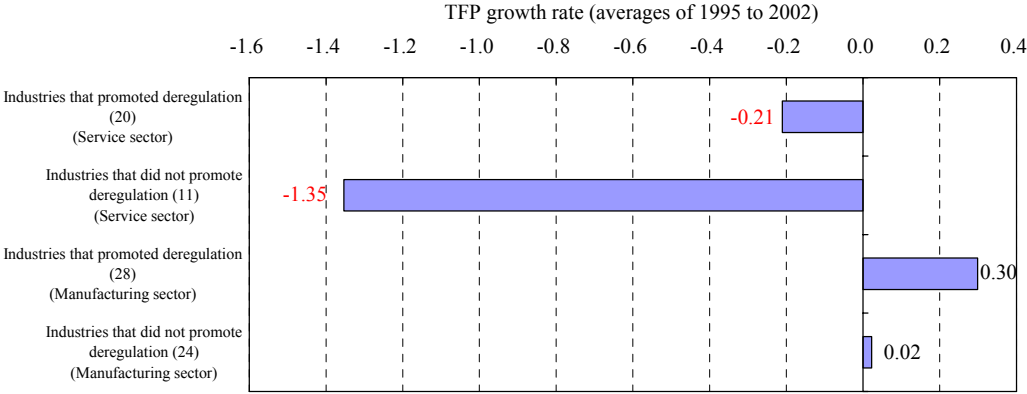
- The rate of opening of new businesses in the service industry in Japan is considerably lower than that of the United States. The low rate of newly participating companies which are generally viewed to have relative high productivity, helps us understand that the mechanisms that exist in Japan to improve productivity are insufficient.



Notes:
 1. Business establishment rates for Japan are based on calculating simple averages of business establishment rates in the manufacturing and service sectors as given in the *2007 White Paper on Small and Medium Enterprises in Japan*.
 2. Business establishment rates were calculated from the *NTT Townpage Database*. The manufacturing sector is considered to include four types of manufacturing: food, clothing, and personal items; construction and construction materials; industrial materials; and machines and appliances. The service sector is considered to include seven types of services: communications and information services; hotel and dining; public services and standards of living; business services; transportation; finance, education, medicine, and welfare; and other services. The eleven types of manufacturing and services are as given in the *2007 White Paper on Small and Medium Enterprises in Japan*.
 3. Data for Japan as shown are based on fiscal year data. Due to limited data, for 2001 as shown are for the second semester of FY2001.
 Source: *2007 White Paper on Small and Medium Enterprises in Japan*, US Census Bureau website.

- One of the factors hindering the entry of new businesses is given as the existence of regulations. Judging from the effect deregulation has in improving TFP, it can be surmised that regulations that have an inhibitive effect on new entrants in the service market should be either eased or abolished entirely based on consideration of their necessity and rationality.

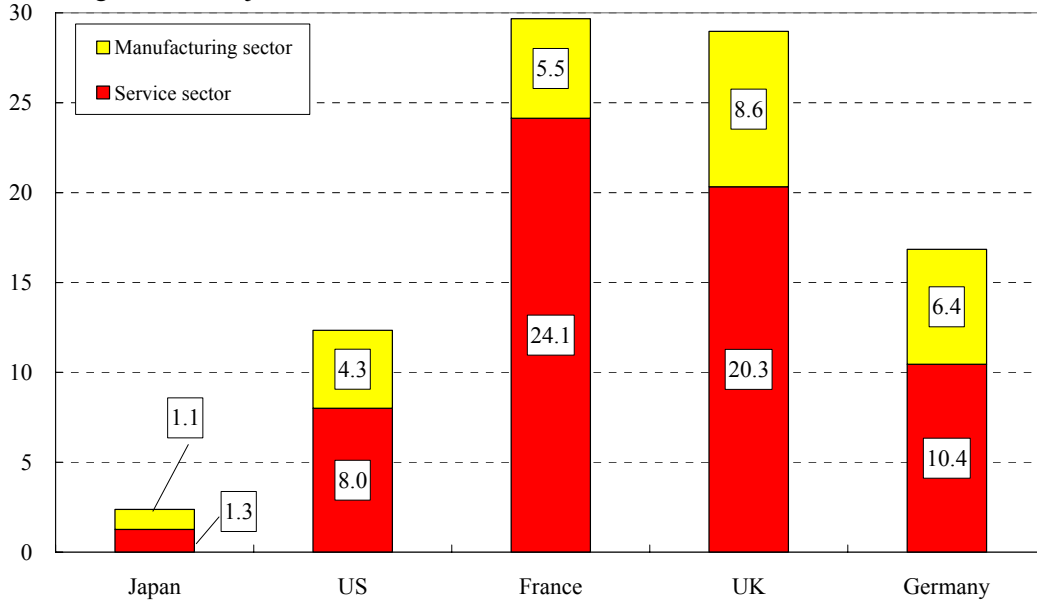
Figure 3.24 Promotion of deregulation and TFP growth rates



Notes:
 TFP growth rates are average growth rates from 1995 to 2002.
 Promotion of deregulation is based on comparing 1995 and 2002 figures in the *KOUZOU KAIKAKU HYOKA HOUKOKUSHO 6* (Cabinet Office) table presenting data on indications of regulation in 97 industries. Industries for which degree of regulation decreased even slightly since 1995 were designated as industries that promoted deregulation; industries for which degree of regulation were the same as or greater than in 1995 were designated as industries that did not promote deregulation. Please see below for details on the breakdown of industries. Figures inside parentheses are the number of industries in that category.
 Source: *JIP DATABASE 2006* (Research Institute of Economy, Trade and Industry (RIETI)), *KOUZOU KAIKAKU HYOKA HOUKOKUSHO 6* (Cabinet Office).

- The entry into Japan of foreign service companies that have high productivity and are expanding globally is very important as a means of developing Japan's service industry and expanding consumer merits through the introduction of new business models. However, the entry of such companies is very low compared to the situation in the United States and Europe.
- By achieving further reductions in business costs, etc., it is important that the appeal of doing business in Japan is enhanced and that an expansion in inward direct investment is achieved.

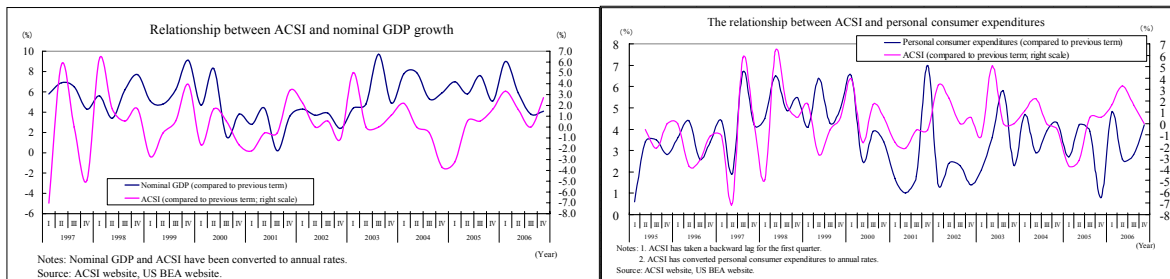
(%) Figure 3.25 Major countries' ratios of inward direct investment to nominal GDP



Notes: Data are from 2006 for Japan, 2005 for US and UK, and 2004 for France and Germany.
 Source: SEKAISHUYOUKOKU NO CHOKUSETSU TOUSHI TOUKEISHUU (2007) (Institute for International Trade and Investment), WDI (World Development Bank), Japan's Balance of Payments and International Investment Position (Ministry of Finance, Bank of Japan), System of National Accounts (Cabinet Office).

- Due to the asymmetry in information shared between supplier and consumer, the service industry has the potential to suffer from a lack of incentive to enhance the quality of service provision, nor to seek to heighten productivity. By utilizing a customer satisfaction index (CSI) and IT, efforts are required to eliminate asymmetry in information.

Figure 3.26 American Customer Satisfaction Index (ACSI) as an economic indicator



Example of a company engaged in efforts to eliminate information asymmetry

- There are information provision sites on the internet that enables consumers to look at reviews of the products and services of a number of restaurants and other hospitality establishments, including evaluations by other consumers on quality and price. The number of restaurants and stores affiliated with these sites and the number of users is on an upward trend.

- In many service industries, as services are produced or provided through people, it is important to engage in efforts to enhance human resources quality, thereby improving product quality, CSI, and efficiency and boosting productivity.

- From this perspective, in May this year, the Service Industry Productivity Council (headed by Jiro Ushio) was established to take on a role as a common platform for cooperation and partnership among industry, academia and government.

Example of cultivation of human resources for service industry

- Within the Service Industry Productivity Council, a HR committee has been established, and is engaging in the deliberations on: (i) the clarification of an HR image and HR needs; (ii) the establishment of a forum for deliberations on an educational structure; and (iii) the compilation of skill standards, and an HR cultivation program/qualification system.

- In Japan too, there are service companies that have outstanding business models and have an excellent degree of IT utilization, which they are using to expand overseas.

Examples of service companies expanding overseas due to excellent business models and IT utilization

- The business model of a barber shop business that has developed a unified price and service nationwide for a hair cut package service has been highly evaluated from different perspectives in the Japanese domestic market and overseas, and the business has realized an overseas expansion to the East Asian region.

- An educational service business that was thought would have difficulty in expanding overseas due to barriers arising from differences in the educational environment through cultural or systemic aspects, provided an educational service that enabled individual students to study for themselves, and this business has now developed globally to 47 countries and regions, by engaging in efforts to optimize business to local conditions.

- A manufacturing business of small-size boilers that provides maintenance services through remote management of product sales was able to develop the same kind of business model for overseas markets, and drawing on the strengths of the model has succeeded in advancing into overseas markets (China, South Korea, Taiwan, United States, Canada, etc.).

- A security business that has a business model that dispatches its own staff to the scene if a security sensor detects an anomaly, has developed its business in the United States, where almost all similar services contact the local police if an anomaly is detected.

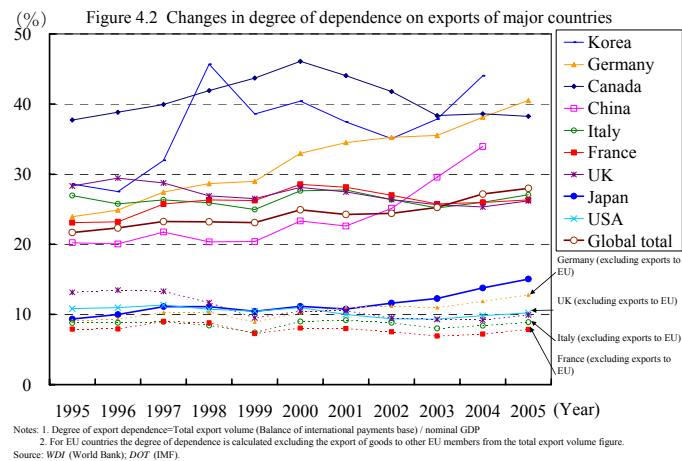
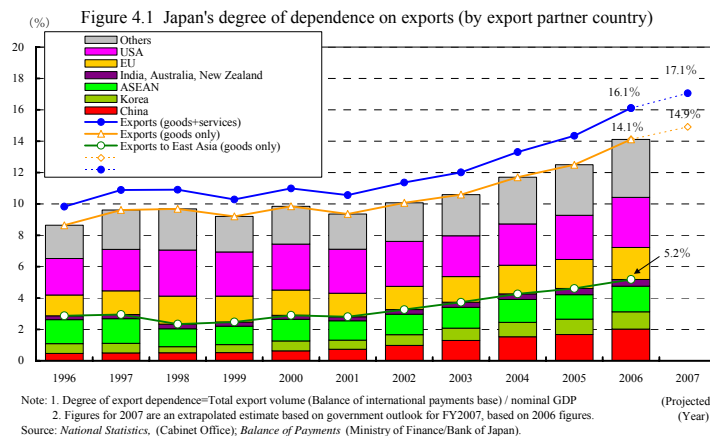
- In order to develop the Japanese economy, it is important to strengthen international competitiveness by improving productivity in the service industry that has just begun to create such unique business models as described above, as well as working to realize active global expansion.

Chapter 4 Towards the Creation of an Open and Seamless Economic System

- External economic activities such as trade and direct investment must be further expanded in order to improve productivity and achieve growth in the domestic economy.
- For Japan, which is creating a business network focusing on East Asia, in addition to promoting and developing a multifaceted trading structure, it is also important to develop a seamless international business environment, through the promotion of East Asian economic integration initiatives such as the Comprehensive Economic Partnership in East Asia (CEPEA) and the Economic Research Institute for ASEAN and East Asia (ERIA).
- In order to further invigorate the Japanese economy, it is important to create Japan as an open and appealing country, and actively acquire management resources and know-how that transcend national borders.

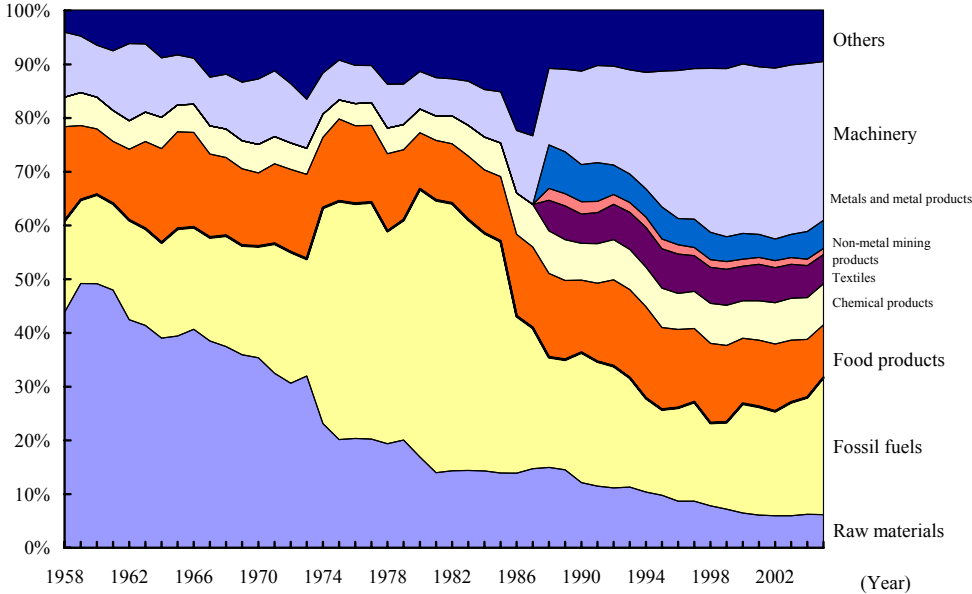
1. Increasing weight of Japan's external economic activities (a country built on new trade and investment)

- The import and export of Japanese goods and services is at its highest post-war level (looking at exports, these have been expanding, focused on East Asia, and in 2006 reached 16.1% of nominal GDP). This is at a higher level than the US but still at a low level when compared with the results of European countries (Figure 4.1, 4.2).



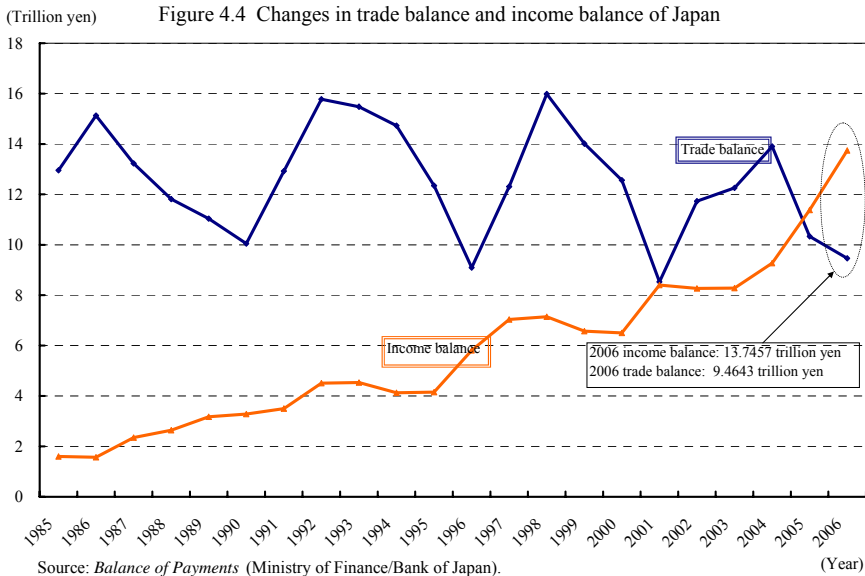
- Until the mid-1980s the proportion of total imports accounted for by energy resources stood at approximately 60% of all imports, but in recent years this proportion has decreased to approximately 30%. In the future, as the aging population and falling birthrate phenomena continue to advance, it will be important to expand import and export of goods and services, focusing on the East Asian region, as there will be a need to secure overseas markets, improve productivity through use of outstanding overseas products, and expand merits for consumers, etc. (Figure 4.3).

Figure 4.3 Changes in proportion of product imports to Japan (by type of product)



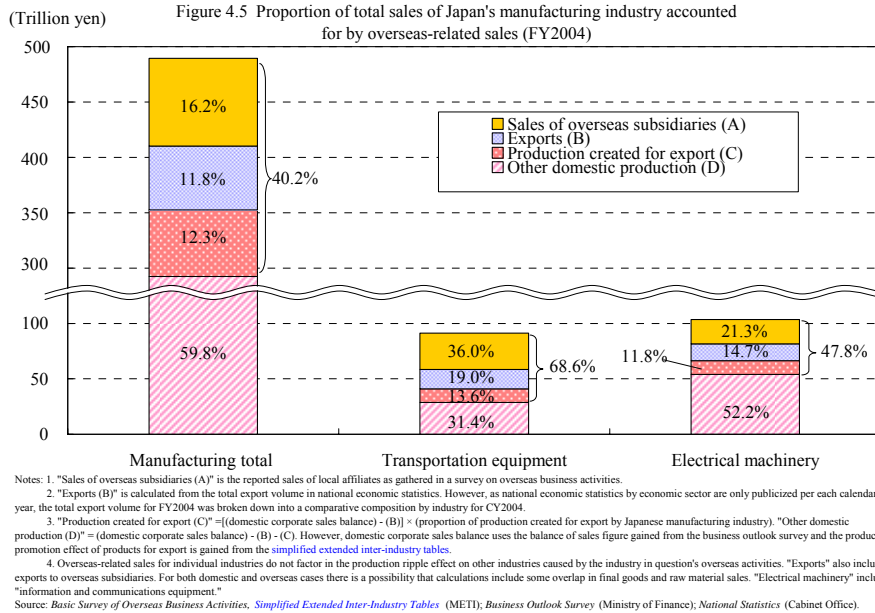
Source: JETRO website.

- In 2006 the income balance surplus reached new record levels. Increases in the net external asset balance through trade and external direct investment will bring about further increases to the income balance surplus (Figure 4.4).

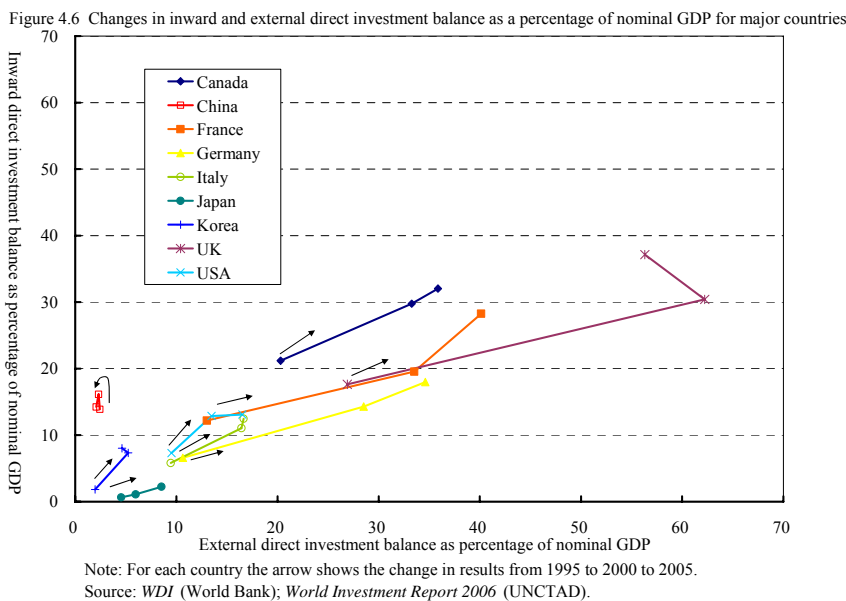


Source: Balance of Payments (Ministry of Finance/Bank of Japan).

- Approximately 40% of total sales of Japanese manufacturing industry are dependent on overseas demand, and the development of a business environment that enables smooth trade and direct investment will be important for improving growth and productivity of the Japanese economy (Figure 4.5).



- When compared with Europe and North America, Japan's balance of external and inward direct investment as a percentage of GDP are small and in recent years the disparity has been expanding. It is important to make active efforts towards the expansion of external and inward direct investment as they would lead to the introduction of new technologies and management know-how, and contribute to the enhanced efficiency and vitalization of the economy through competition among domestic and overseas companies (Figure 4.6).



2. Developing the international business environment through promotion of WTO, EPA/FTA, etc.

(1) Promotion of WTO

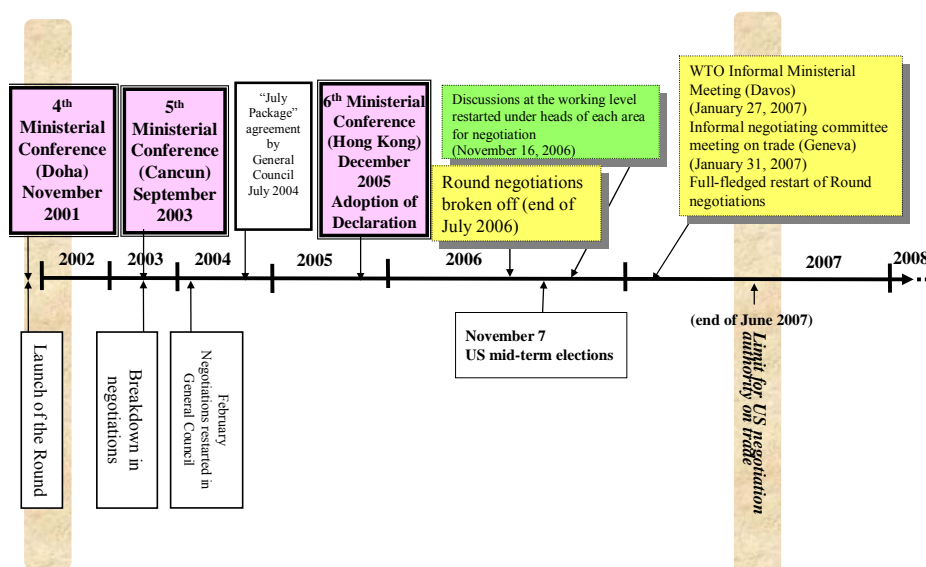
- The Doha Round of negotiations in the World Trade Organization (WTO) serve a very important role as their scope is very broad, including agriculture, non-agricultural market access, services, rules, trade facilitation and intellectual property rights, etc. (Figure 4.7). In January 2007 negotiations were resumed in full, and a successful conclusion to the negotiations will be of tremendous significance for the global economy (Figure 4.8).

Figure 4.7 Negotiation areas on the Doha Development Agenda

Agriculture	Negotiations on domestic support for agriculture, export competition, and market access.
NAMA <small>(Non-agricultural market access)</small>	Negotiations on abolition and reduction of tariffs and non-tariff barriers for all other products except agricultural products (industrial products, etc.)
Services	Negotiations on regulations for foreign companies, movement of persons and liberalization of cross-border transactions, etc.
Development	Special and differential treatment (S&D) that allows developing countries exemption from WTO agreement obligations and execution is under review, as is preferential treatment for least developed countries and a response to issues faced by small-scale economies.
Rules	Negotiations on anti-dumping (AD), subsidies, and regional trade agreements (RTA).
Trade facilitation	Negotiations on improving transparency, predictability and fairness of trade procedures, and aim to simplify and accelerate such procedures.

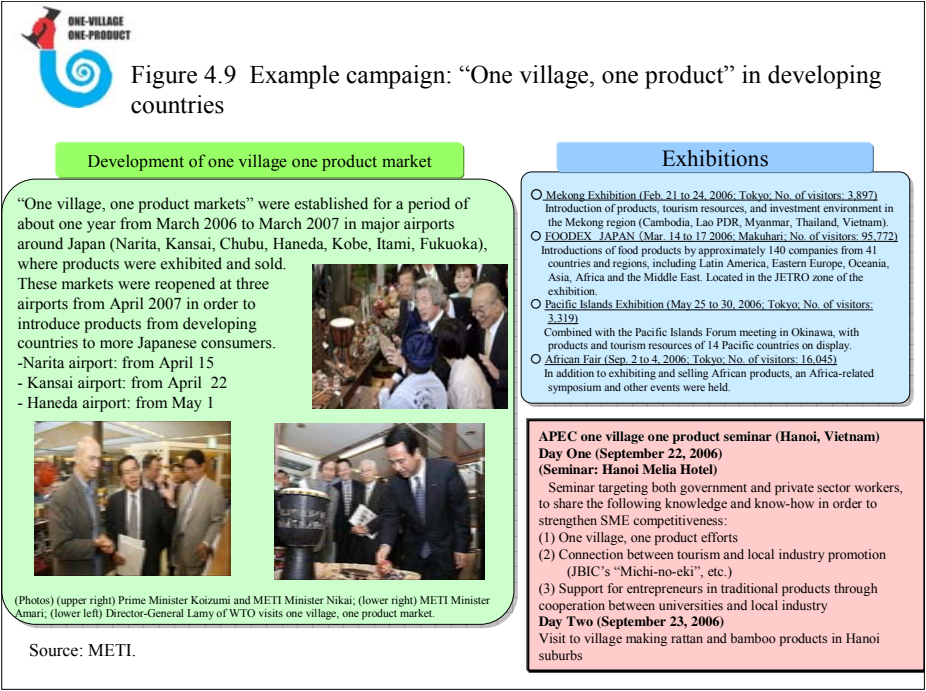
In addition to the above negotiations are also being conducted on the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) (creation of a multilateral register of Geographical Indications (GI) as part of IP-related rights) and the issue of trade and the environment.

Figure 4.8 Negotiation schedule of the Doha Round



Source: METI.

- As part of the Doha Round Japan proposed a “development initiative” that sets out a policy to contribute to the development of developing countries. Through the “one village, one product” campaign in developing countries, local residents identify special local products that they can boast about and take pride in, and active support is provided to ensure that competitive products are produced that can be sold not only in domestic markets, but also around the world (Figure 4.9).



- In addition to an enormous amount of EPA/FTA being required in order to cover all combinations of bilateral trade patterns with an EPA or FTA, it would also have the potential to make it almost impossible to maintain a uniform trade order (Figure 4.10). Accordingly, the WTO is essential in order to reduce global barriers to trade that EPA/FTA are not capable of covering.

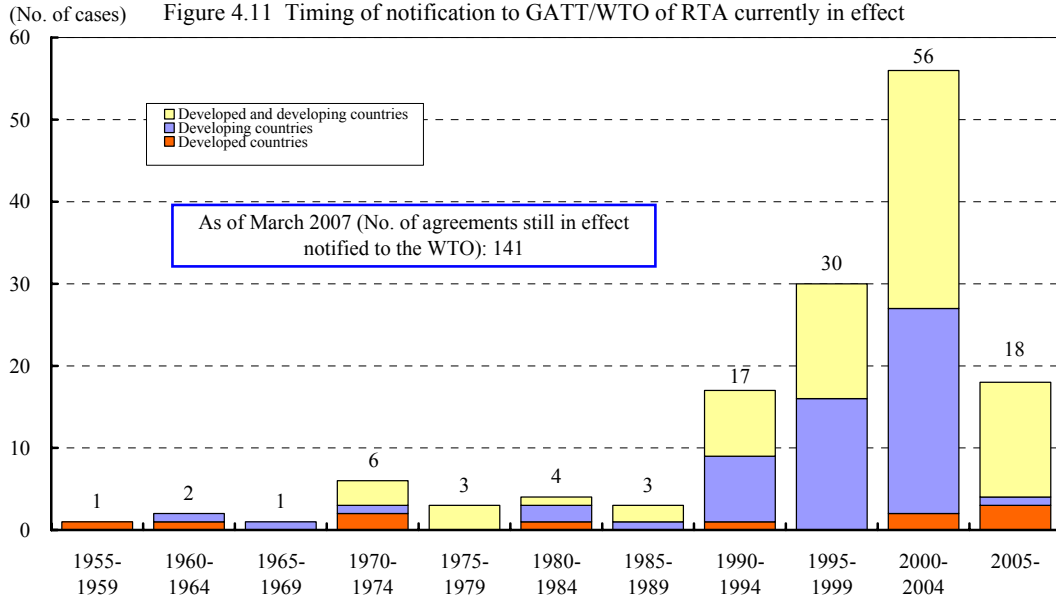
Figure 4.10 No. of bilateral trade relations that have concluded a regional trade agreement (RTA)

	No. of combinations	Proportion
No. of trade relations among all countries (n countries)	$n \times (n-1) / 2$	-
192 UN member countries	$192 \times 191 / 2 = 18,336$	100.0%
150 WTO member countries	$150 \times 149 / 2 = 11,175$	60.9%
Current no. of bilateral trade relations covered by an RTA	<u>2,686</u>	14.6%

Notes: 1. From the 141 RTA notified to the WTO, excluding those that overlap with reporting to GATT and GATS, and excluding those that overlap with new additional members joining existing agreements, the no. of bilateral trade relations covered by RTA was calculated.
 2. Combinations including non-UN members are excluded.
 3. The no. of WTO and UN members are both as of January 2007.
 4. The proportions are calculated as a percentage of the total no. of trade relations among all UN members.

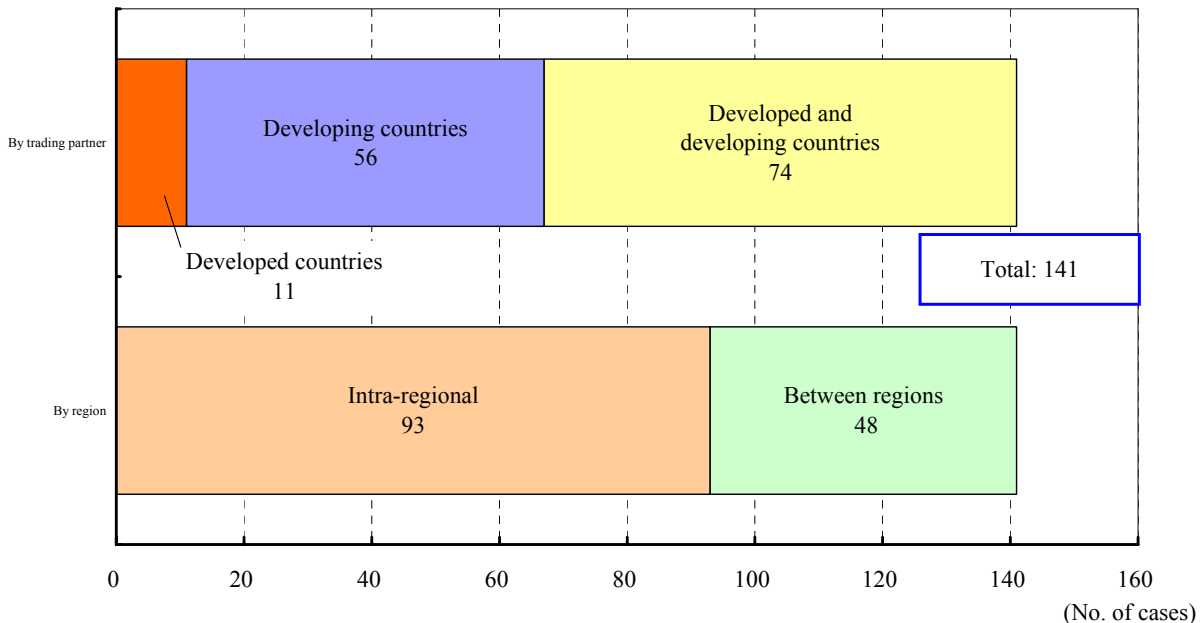
(2) Advance of EPA/FTA and increase in investment agreements, etc.

- Since the 1990s the number of EPA/FTA concluded around the world has been rapidly increasing. Of these agreements, EPA/FTA involving developing countries and cross-cutting regional EPA/FTA are currently being vigorously pursued (Figures 4.11, 4.12).



Notes: 1. Classified into 141 RTA notified to the WTO, excluding those that overlap with reporting to GATT and GATS, and excluding those that overlap with new additional members joining existing agreements.
 2. OECD and EU members are classed as developed countries and all other countries are classed as developing.
 Source: WTO Website.

Figure 4.12 Breakdown by trading partner and by region (as of March 2007) of RTA

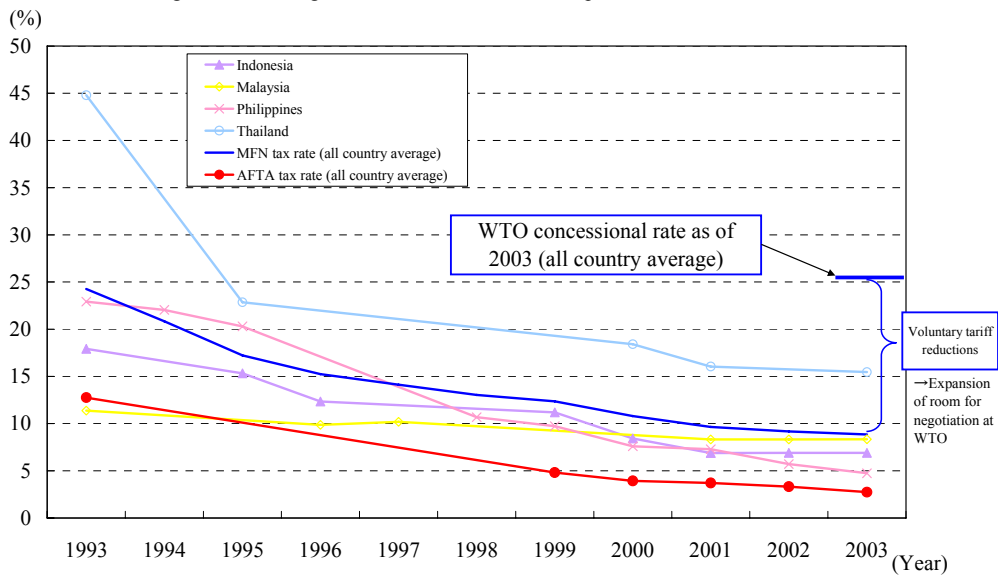


Notes: 1. Classified into 141 RTA notified to the WTO, excluding those that overlap with reporting to GATT and GATS, and excluding those that overlap with new additional members joining existing agreements.
 2. OECD and EU members are classed as developed countries and all other countries are classed as developing.
 3. The world is classified into six regions: Europe, Middle East, Africa, North America, Latin America, and Oceania. If countries with agreements conclude EPA/FTA purely within one of these regions they are classified as intra-regional, all others are classified as between regions.
 Source: WTO Website.

- After EPA/FTA have been concluded there is a tendency for tariff rates imposed on an implementation basis on imports from outside the region (MFN rates) to decrease. In ASEAN, in line with the reduction in intraregional tariff rates in the ASEAN Free Trade Area (AFTA), MFN rates on an implementation basis have decreased (Figure 4.13).

From this it is evident that the conclusion of EPA/FTA not only brings about economic merits through liberalization, but additionally also brings about tariff reductions for imported goods in an attempt to further pursue merits of liberalization, and also has an effect in addressing positively the advance of multilateral trade liberalization through the WTO.

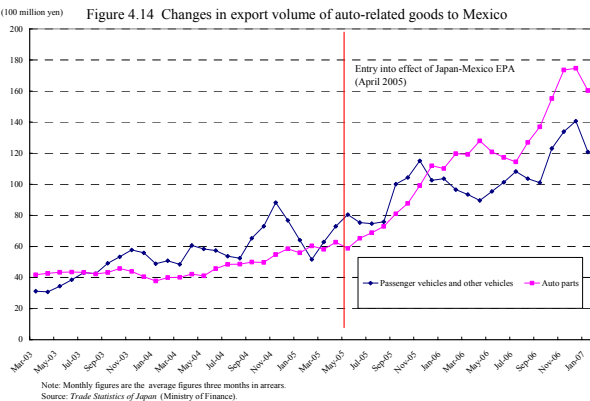
Figure 4.13 Changes in MFN tax rate and AFTA preferential tax rate for ASEAN4



Notes: 1. The tax rate for each country is the simple average of the product tariff rate to which ad valorem duties are applied.
 2. The all country average for MFN and WTO concessional rates, and the all country average for ASEAN4 and AFTA are the simple average of the preferential tax rates of the ASEAN10.
 3. For years where data was lacking the trends were interpolated to gain a figure.
 Source: TRAINS (UNCTAD), report of ASEAN Secretariat.

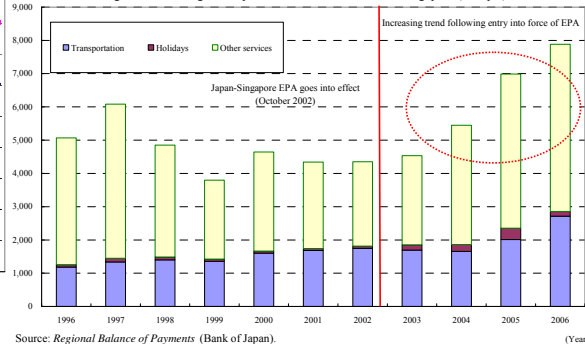
- Japan has concluded EPA with Singapore, Mexico and Malaysia, some in a steady manner and others in a more accelerated process. These EPA have realized advances in liberalization of trade and investment, including expansion of the volume of trade in goods and services.

Figure 4.14 Changes in export volume of auto-related goods to Mexico



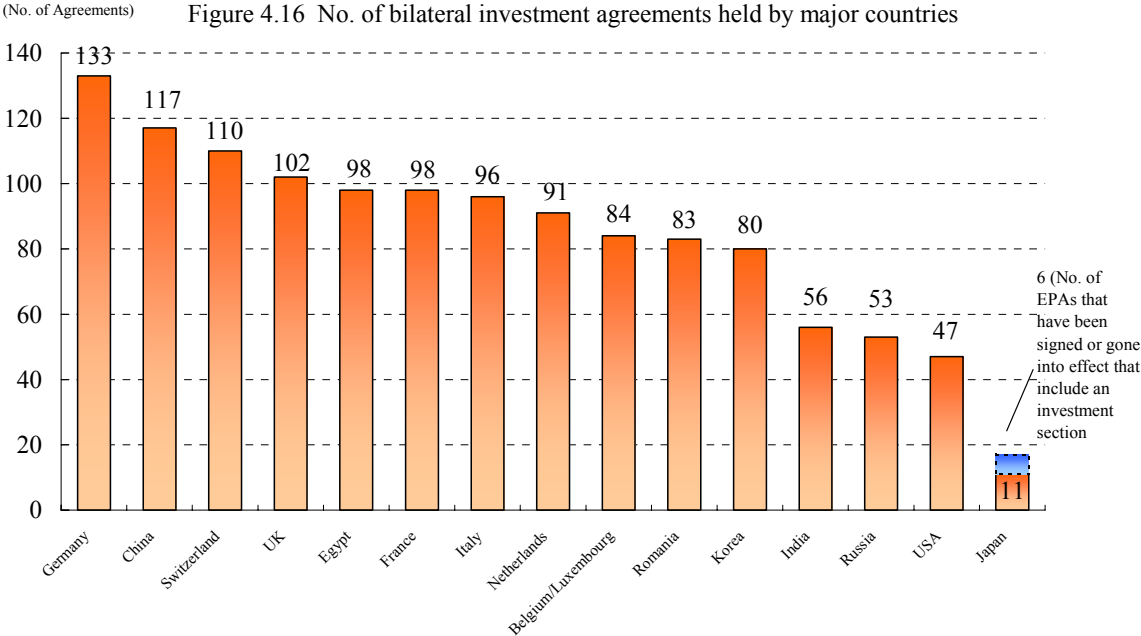
Note: Monthly figures are the average figures three months in arrears.
 Source: Trade Statistics of Japan (Ministry of Finance).

Figure 4.15 Changes in Japan's balance of services with Singapore (receipts)

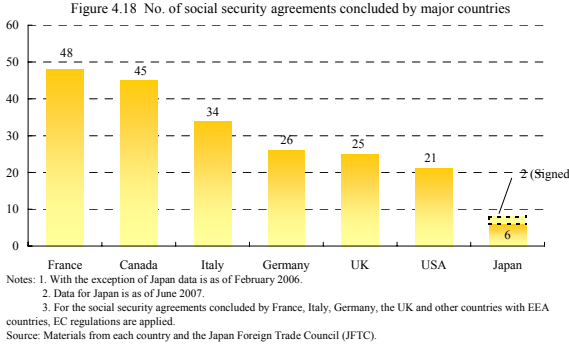
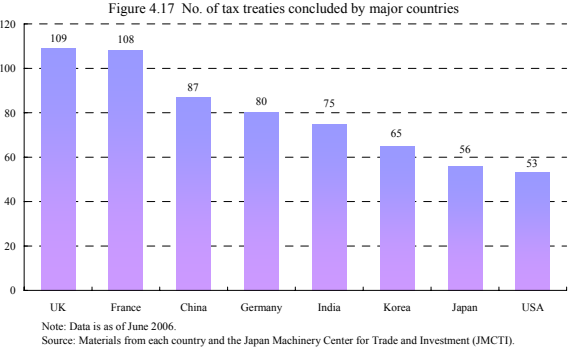


Source: Regional Balance of Payments (Bank of Japan).

- For Japan it continues to be important to strengthen efforts for East Asia-wide economic partnership, and to make active efforts in negotiations with resource producing countries. Internationally, although FTA negotiations are progressing vigorously among all countries, including large-scale economic zones, with regard to EPA/FTA with countries with large markets or investment destinations, such as the US, or the EU, while bearing in mind the various trends in each country and the economic relations that each country has maintained with Japan to date, as well as its economic scale, etc., efforts will be made to consider future challenges. Preparations for EPA/FTA are being advanced with those countries or regions it is possible to do so. Based on the specific needs of each country, in order to promote investment and invigorate the exchange of persons, not only EPA/FTA, but also social security agreements and investment agreements may be required, and the aim is to increase the number of such agreements in the near-term.



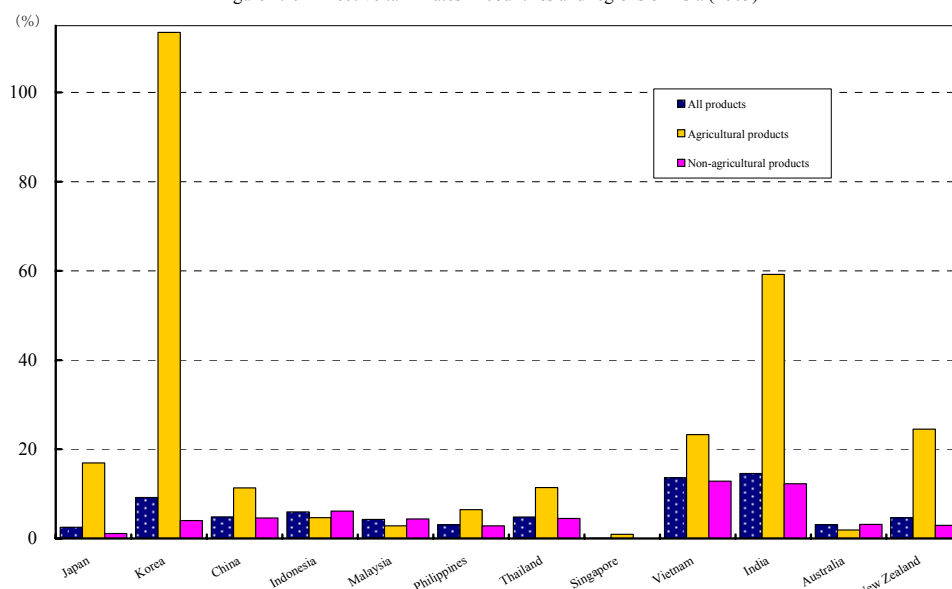
Note: Data is as of end of 2005 (data for Japan is as of May 2007). Except for Japan, EPA/FTA including an investment section are not included in the figures. Source: *World Investment Report 2006* (UNCTAD).



3. Efforts to strengthen partnership towards large-scale economic integration in East Asia

- In order to achieve further growth in East Asia, it would be to the region's advantage to enable the non-tariff trade of products and components. It is important therefore to realize reduction or abolition of tariff and non-tariff barriers helped by accumulated rules of origin, and to reduce procedural costs pertaining to trade and investment including liberalization of investment, as well as the creation of systems (Figure 4.19).

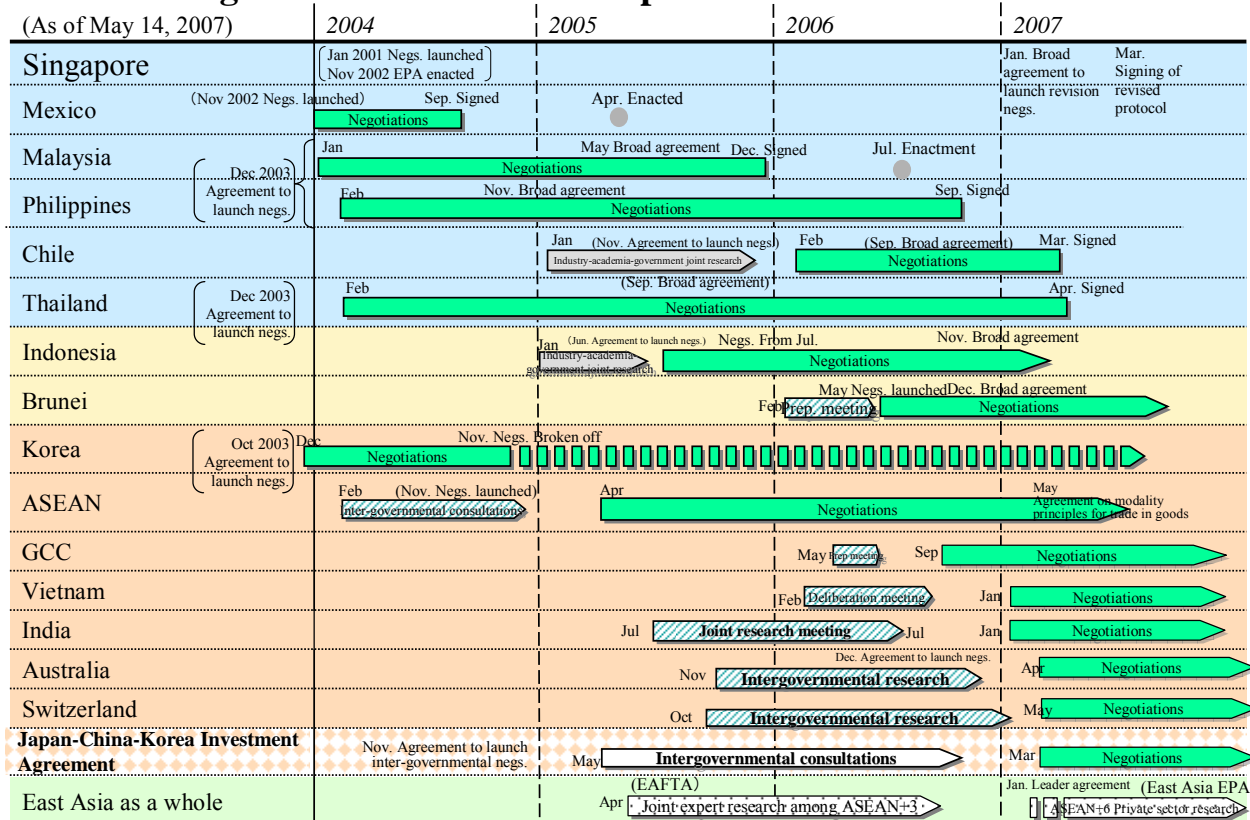
Figure 4.19 Effective tariff rates in countries and regions of Asia (2005)



Note: The effective tariff rate is calculated through a weighted average of the trade volume of each product. Figures for Korea are for 2004.
Source: TRAINS Database (UNCTAD).

- For this purpose Japan is working to promote and develop a multilateral trading structure, as well as promoting negotiations for a Japan-ASEAN EPA. This is because concluding a comprehensive EPA with ASEAN would not only bring about the abolition or reduction of tariffs, it would also result in the facilitation of trade, investment promotion, the creation of systems to protect intellectual property, etc., and the further development of the business environment. A broad framework was agreed on in May 2007, with the target of November 2007 for conclusion of an agreement. In addition, with regard to private sector expert research into an "East Asia EPA" as proposed by Japan at the East Asia Summit in January 2007, efforts are being made to launch such an endeavor in the near-term and to accelerate such research. In the mid- to long-term the aim is the construction of an open East Asian economic zone, and efforts are being advanced towards economic partnership (Figure 4.20).

Figure 4.20 Schedule for Japan's efforts towards EPA



Source: METI.

- However, in contrast to NAFTA and the EU, there are large disparities in the stages of economic development among the countries of East Asia (Figure 4.21).

Figure 4.21 Comparison of intra-regional economic conditions (2005)

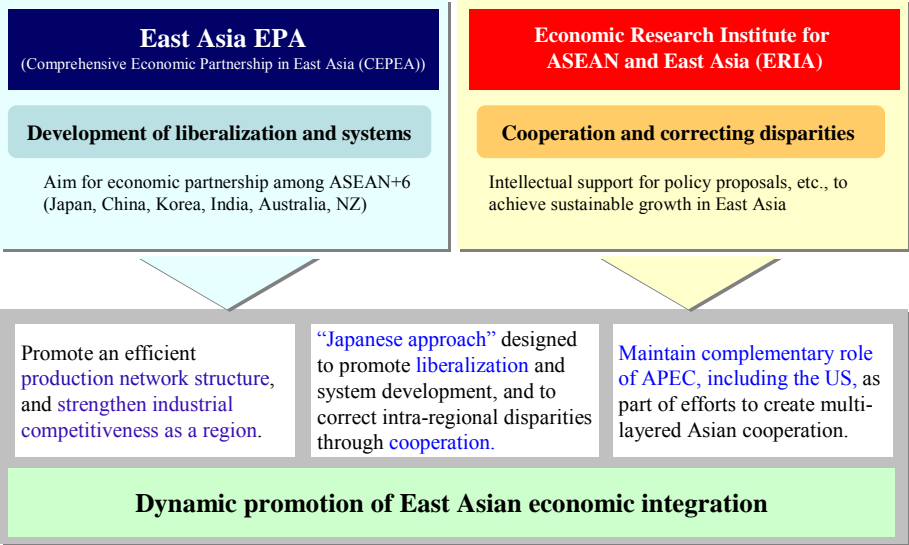
	Nominal GDP	Per capita nominal GDP	Greatest difference in per capital nominal GDP	Variance coefficient for per capita nominal GDP	Population
ASEAN	US\$881.5 billion	US\$1,599	252.1 fold (Singapore/Myanmar)	1.58	.55 billion
East Asia	US\$9.999 trillion	US\$3,173	330.8 fold (Japan/Myanmar)	2.36	.15 billion
NAFTA	US\$14.3387 trillion	US\$33,202	5.63 fold (USA/Mexico)	0.44	0.43 billion
EU27	US\$13.4257 trillion	US\$27,469	21.48 fold (Luxembourg/Bulgaria)	0.42	.48 billion

Note: The variance coefficient is the standard deviation divided by the average value, and the larger the value, this indicates a larger spread.

Source: WDI (World Bank).

- As a mechanism for the development of East Asia as a whole, it is necessary for Japan to promote liberalization of trade in goods and services, etc., and the creation of economic rules, as well as providing vigorous support for East Asian economic integration as one of the key pillars in correcting intraregional disparities. As means of contributing to such a goal, Japan should work to accelerate the private sector expert research into the Comprehensive Economic Partnership in East Asia (CEPEA), and promote the establishment of the Economic Research Institute for ASEAN and East Asia (ERIA) (Figures 4.22, 4.23).

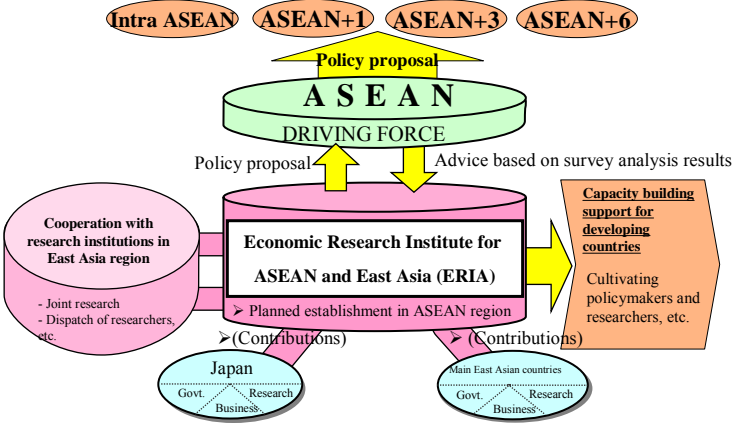
Figure 4.22 Goals for East Asia EPA (CEPEA), and Economic Research Institute for ASEAN and East Asia (ERIA)



Source: METI.

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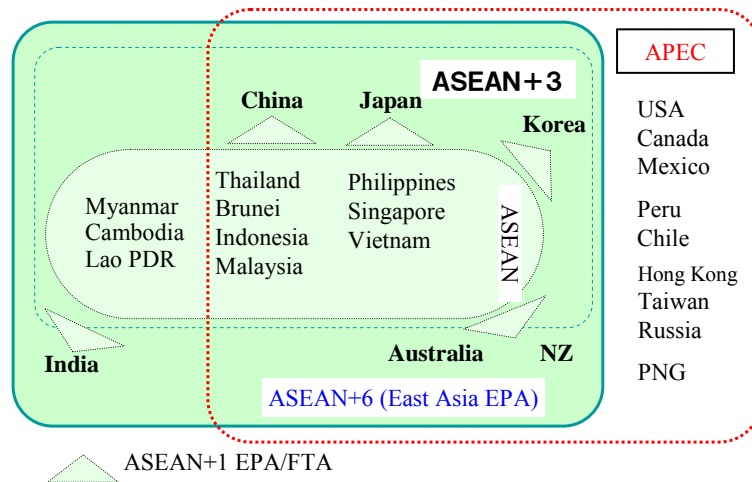
Figure 4.23 Framework for an Economic Research Institute for ASEAN and East Asia (ERIA)



Source: METI.

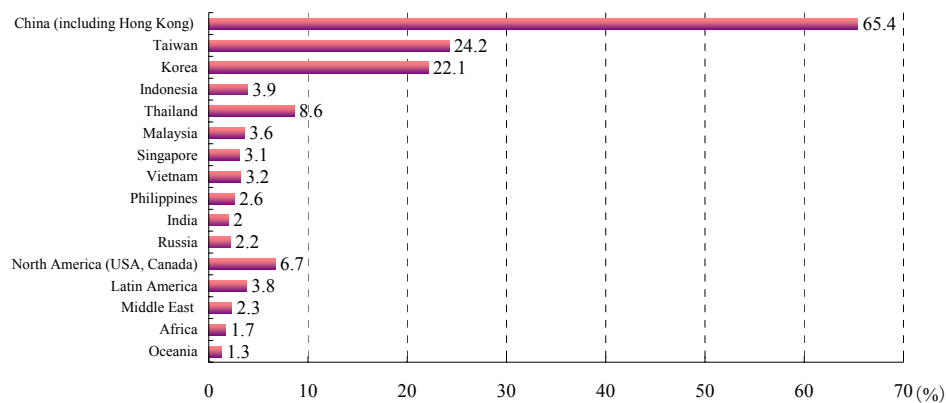
- In addition, consideration is also being advanced towards the long-term goal of an APEC-wide FTA (FTAAP), as proposed by the United States.

Figure 4.24 Movements towards economic integration in the Asia-Pacific region



- In East Asia the vast amount of counterfeit goods and pirated copies is becoming increasingly serious. In the East Asian region, concerted efforts to create an intellectual property protection system that would serve as a driving force for value creation are important as they would further vitalize trade and investment in the region, leading to strengthened economic links, and it would also further heighten the appeal of East Asia as a base for production activities and as a market.

Figure 4.25 Countries and regions that manufacture counterfeit goods (FY2005)



Note: Excluding Japan. Figures are the proportion of all answers from 687 responding companies that said they had suffered damage from counterfeiting.

Source: FY2006 Survey Report on Counterfeit Damage (Japan Patent Office).

4. Promoting the creation of an open and appealing country through the promotion of inward direct investment and the establishment of a “Japan Brand”

- Inward direct investment could be expected to have a number of effects, including the creation of new products and services, technologies and business models, as well as the creation of employment opportunities. Investment in the service sector in Japan is small, and in order to promote inward direct investment, including in the service industry, it is important to engage in further deregulation, business cost reduction efforts, simplification of various procedures, and facilitation of M&A, etc. (Figures 4.26, 4.27).

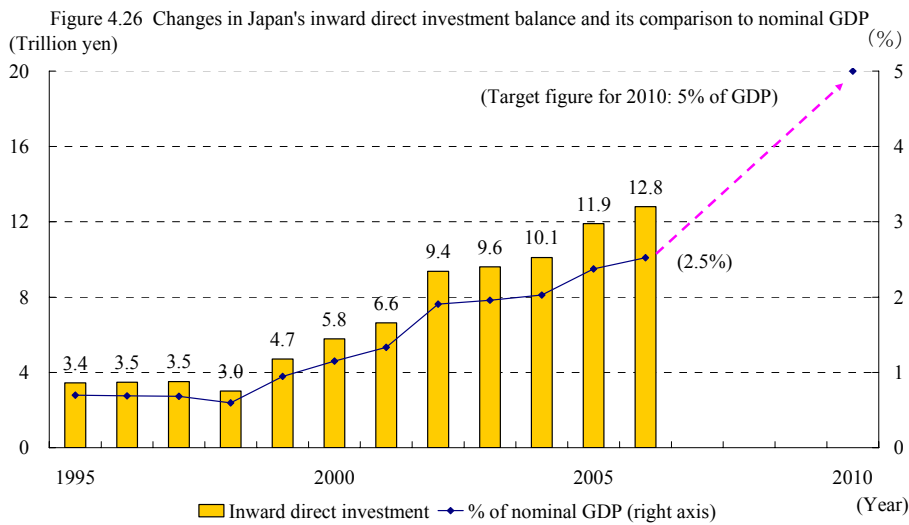
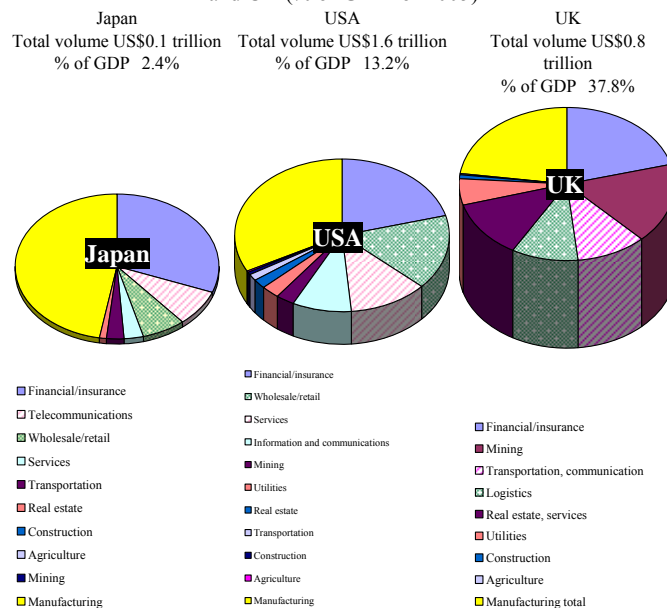
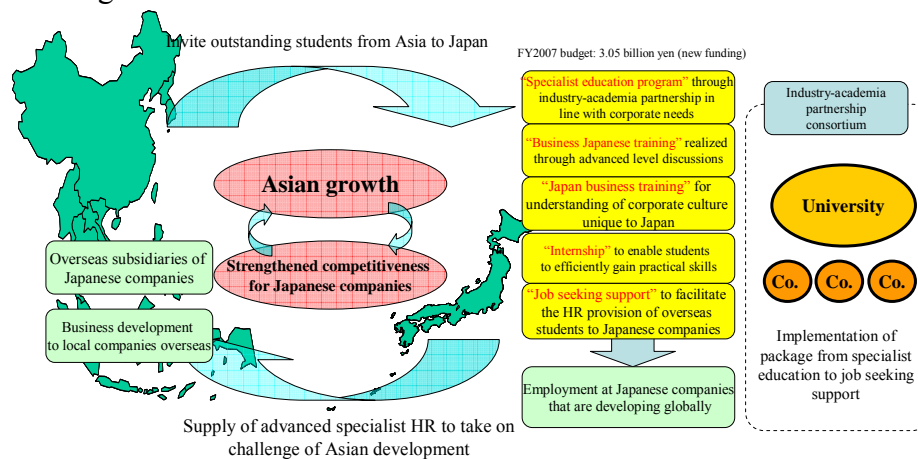


Figure 4.27 Inward direct investment balance by industry for Japan, US and UK (% of GDP for 2005)



- In a global environment in which competition to secure outstanding human resources is intensifying, it is important that Japan promotes the “Asia Human Resource Fund” initiative that links higher education with employment assistance in domestic companies, and that through expansion and increased closeness among human networks of outstanding human resources in Japan and Asia, growth for East Asia as a whole can be achieved (Figure 4.28).

Figure 4.28 Overview of Asian Human Resource Fund Initiative



Source: METI.

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- In order to make Japan a country that is open and appealing to the world, it is important to: (i) promote the image of Japan abroad through a Japanese-style top sales approach that links the securing of resources and markets with industrial cooperation; and (ii) the promotion of the “Japan Brand” overseas. Towards the establishment of a “Japan Brand” overseas active support will be provided for the international development of the contents and fashion industries in Japan, as well as efforts to disseminate the concept of “Japanesque Modern” (Figures 4.29, 4.30).

Figure 4.29 Examples of top sales efforts in Japan

Visit by Prime Minister Abe to Vietnam (November 2006)	<ul style="list-style-type: none"> ○ Opening of economic mission meeting attended by two leaders and 130 representatives of Japanese business. ○ Prime Minister attends "Japan-Vietnam Economic Seminar"
Visit by Prime Minister Abe to five Middle East countries (Saudi Arabia, UAE, Kuwait, Qatar, Egypt) (April to May 2007)	<ul style="list-style-type: none"> ○ Accompanied by 180 member economic mission. Mission attends a number of meetings with leaders of each country and attends business forum with business figures in countries visited. ○ For example, in Saudi Arabia, there was agreement on a "Public-Private Industrial Cooperation Framework" to support enhanced diversification in industry
Visit by METI Minister Amari to Uzbekistan, Kazakhstan, Saudi Arabia and Brunei (April to May 2007)	<ul style="list-style-type: none"> ○ Accompanied by a large-scale public-private mission to Kazakhstan, Minister Amari reached agreement with Kazakh leaders on the advance of strategic cooperation and cooperation to enhance diversification in the area of the peaceful use of nuclear energy, and also reached agreement on 24 specific nuclear energy-related projects ○ Agreement to hold the 2nd Public-Private Business Forum with Uzbekistan in the autumn of 2007 ○ In Saudi Arabia, Minister Amari discussed specific proposals for the "Public-Private Industrial Cooperation Framework" and the way forward for public-private cooperation ○ In Brunei there was an exchange of opinions between ministers on cooperation towards enhanced diversification in Brunei industry

Source: METI.