White Paper on International Economy and Trade 2023

June 2023
Trade Policy Bureau
Ministry of Economy, Trade and Industry (METI)
White Paper on International Economy and Trade 2023

1. Status

- Distributed at the Cabinet meeting every year (**75th publication** this year).

2. Purpose

- To contribute to forming trade strategies through analyzing international economic trends and foreign policies that affect trade, and to inform the public of the ideas that form the basis for trade policy and its directions.

- Part I analyzes the dynamics and challenges of the world economy, while Part II discusses the challenges our economy is currently facing. Part III looks at what the government is working on in relation to international trade.

**Part I: World Economy at the Crossroads**

**Chapter 1: Global Economy Slowing Further**
- Section 1: Outlook and Status Quo of the World Economy
- Section 2: Russia’s Invasion against Ukraine - Current State and its Implications
- Section 3: Escalating Inflationary Pressures
- Section 4: Rising Debt Risk in Emerging and Developing Countries
- Section 5: Fragmenting World Economy

**Chapter 2: Challenges to Restore the Functions of the World Economy**
- Section 1: Boost the Supply Side
- Section 2: Achieve a Free and Fair Trade Order and Economic Security
- Section 3: Ensure Sustainable and Inclusive Economic Development

**Chapter 3: Economic Trends by Country and Region**

**Part II: Actions Japan Should Take in the Current Global Crisis**

**Chapter 1: Building Resilient Global Value Chains**
- Section 1: Strengthening of Global Value Chain Resiliency
- Section 2: Economic Security Strategies and Challenges for Businesses

**Chapter 2: Boosting Growth Potential by Incorporating Global Growth**
- Section 1: Japan’s Current Account Balance and its Implications
- Section 2: Challenges to Building a Resilient Trade Balance Structure
- Section 3: Inbound Tourism Demand Expected to Drive Our Economic Growth
- Section 4: Overseas Expansion of Businesses and its Contribution to Our Economy
- Section 5: Promotion of Internal Internationalization by Taking in Foreign Technology, Human Resources and Innovation

**Part III: Policies**

**Chapter 1: Rule-based International Trade System**
- Section 1: G7/G20/OECD
- Section 2: Enhancing Regional Economic Integration through APEC and Promoting Economic Growth
- Section 3: WTO

**Chapter 2: Country/Region Strategies**
- The United States, Europe, China, ASEAN/Oceania, India, Latin America, Russia, the Middle East, Africa
- (including IPEF, Japan-Australia-India-US, Digital)
Chapter 1: Global Economy Slowing Further

• The world economy has further slowed down due to heightened uncertainty and spiking inflation stemming from Russia’s invasion against Ukraine as well as accelerated monetary tightening.
• Rapid monetary tightening mainly in the United States and Europe has pushed down currency values and raised interest rates, thereby elevating the debt risks mainly of the Global South.
• The world has seen the title of trade superpower shifting from the United States to China. US-China conflicts and Russia’s invasion against Ukraine in particular have caused uncertainty in the global economy. However, a complete decoupling would bring a great loss for the global economy as economic interdependence increases. Much of the Global South remains neutral, to secure their own profit.
• In recent years, the use of economic coercion, the weaponization of economic interdependence, is on the rise. Given that the WTO has become increasingly dysfunctional, Western countries have been stepping up their discussions.

Chapter 2: Challenges to Restore the Functions of the World Economy

• Lack of supply is largely the underlying cause of the inflation the world is currently facing. It is critical to boost the supply capacity through capital expenditure, improve productivity and strengthen supply chain resiliency.
• Trade openness leads to economic growth by raising productivity, while uncertainty concerning trade counterparts negatively impacts on one’s own country. Meanwhile, trade counterparts that respect fundamental values such as freedom, democracy, human rights and the rules of law are less affected by trade loss caused by heightened uncertainty.
• The global economy is on the verge of fragmentation. To restore its functions, Japan needs to rebuild a rule-based international trade order, create reliable supply chains with like-minded countries and work to strengthen its coordination with the Global South, simultaneously.
Part II: Actions Japan Should Take in the Current Global Crisis

Chapter 1: Building Resilient Global Value Chains

• Geopolitical and economic security risks have strongly impacted business decision-making. More firms are placing importance in ASEAN countries instead of China in terms of investment. The number of firms which value India as their investment destination is growing. Reshoring is gaining momentum.

• The pandemic has revealed supply chain vulnerability. To assess the whole supply chain, data alignment with business counterparts is critical. Japan should accelerate its efforts to develop infrastructure for integrated management of supply chains through data alignment.

• Disruptions of critical goods such as semiconductors have greatly impacted the world. Japan needs to bolster coordination with like-minded countries and strengthen the domestic production base.

Chapter 2: Boosting Growth Potential by Incorporating Global Growth

• The largest Japanese trade deficit in history is mainly due to the surging cost of importing fossil fuels. Reducing dependence on fossil fuels is a critical issue in terms of building a resilient trade balance structure.

• The Yen’s depreciation provides a good opportunity for exports, however, some 30% of items were not able to generate profits. Revision of price setting may improve profitability.

• Overseas expansion of businesses contributes to Japan’s economy in terms of revenues, employment, wages, and productivity, in addition to promoting exports in non-urban areas.

• It is vital to strongly encourage companies to expand their businesses overseas and promote internal internationalization.
Part I: World Economy at the Crossroads

Chapter 1: Global Economy Slowing Further

Chapter 2: Challenges to Restore the Functions of the World Economy

Part II: Actions Japan Should Take in the Current Global Crisis

Chapter 1: Building Resilient Global Value Chains

Chapter 2: Boosting Growth Potential by Incorporating Global Growth

Part III: Policies
The global economy is further slowing due to heightened uncertainty caused by Russia’s aggression against Ukraine, surging inflation, and accelerated monetary tightening.

Outlook for the global economy

Outlook for the global inflation rate

Policy interest rates
Global Economy Facing Fragmentation

Since the early 20th century, free trade and protectionism have been the dominant trade policies in cycles every 20 years. The title of the largest trade player has shifted from the UK to the US and then to China. **The process of decoupling is the big downside risk to the growth of world economy.** The Global South seek profits by maintaining a neutral position.

### Change of major trade players

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
<th>Trade (Trillion US$)</th>
<th>No. 1 share</th>
<th>No. 2</th>
<th>No. 3</th>
<th>No. 4</th>
<th>No. 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>1900</td>
<td></td>
<td>0.02</td>
<td>UK (18.1)</td>
<td>Germany (13.1)</td>
<td>US (11.1)</td>
<td>France (8.7)</td>
<td>Netherlands (3.9)</td>
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<tr>
<td>1914</td>
<td>World War I</td>
<td>0.03</td>
<td>UK (15.9)</td>
<td>US (13.8)</td>
<td>Germany (12.0)</td>
<td>France (7.1)</td>
<td>Netherlands (4.1)</td>
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<tr>
<td>1930</td>
<td>Great Depression</td>
<td>0.06</td>
<td>UK (13.4)</td>
<td>US (12.4)</td>
<td>Germany (9.6)</td>
<td>France (6.7)</td>
<td>Japan (3.6)</td>
</tr>
<tr>
<td>1938</td>
<td>Pre-World War II</td>
<td>0.05</td>
<td>UK (14.1)</td>
<td>US (10.7)</td>
<td>Germany (9.4)</td>
<td>Japan (5.0)</td>
<td>France (4.8)</td>
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<tr>
<td>1960</td>
<td></td>
<td>0.26</td>
<td>US (14.3)</td>
<td>UK (9.4)</td>
<td>Germany (8.6)</td>
<td>France (5.2)</td>
<td>Netherlands (3.9)</td>
</tr>
<tr>
<td>1974</td>
<td>US-Japan trade friction</td>
<td>1.6</td>
<td>US (12.8)</td>
<td>Germany (9.7)</td>
<td>Japan (7.1)</td>
<td>France (6.0)</td>
<td>UK (5.6)</td>
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<tr>
<td>1995</td>
<td>Establishment of WTO</td>
<td>10.4</td>
<td>US (13.0)</td>
<td>Germany (9.5)</td>
<td>Japan (7.5)</td>
<td>France (5.7)</td>
<td>UK (4.9)</td>
</tr>
<tr>
<td>2001</td>
<td>China’s accession to WTO</td>
<td>12.7</td>
<td>US (15.1)</td>
<td>Germany (8.4)</td>
<td>Japan (5.9)</td>
<td>France (5.2)</td>
<td>UK (4.9)</td>
</tr>
<tr>
<td>2008</td>
<td>Global Financial Crisis</td>
<td>32.8</td>
<td>US (10.5)</td>
<td>Germany (8.0)</td>
<td>China (7.8)</td>
<td>Japan (4.7)</td>
<td>France (4.1)</td>
</tr>
<tr>
<td>2017</td>
<td>US-China conflict</td>
<td>35.9</td>
<td>China (11.5)</td>
<td>US (11.0)</td>
<td>Germany (7.3)</td>
<td>Japan (3.8)</td>
<td>France (3.4)</td>
</tr>
<tr>
<td>2020</td>
<td>COVID-19</td>
<td>35.7</td>
<td>China (13.1)</td>
<td>US (10.7)</td>
<td>Germany (7.2)</td>
<td>Japan (3.6)</td>
<td>Netherlands (3.6)</td>
</tr>
</tbody>
</table>

Right figures: Kumagai et al. (2023): Impact of Global “Decoupling” on the World Economy Using the IDE-GSM.

### Impact of “decoupling” on the world economy

**Scenario 1:** When each side imposes additional non-tariff barriers, equivalent to the tariff increase during US-China trade war, the impact on GDP in 2030 would be −2.3% (about 2.7 trillion dollars).

**Scenario 2:** When the additional non-tariff barriers are equivalent to 100% tariffs, the impact would be −7.9% (about 8.7 trillion dollars).
The WTO Dispute Settlement System and the Crisis of Rules-Based Governance

- With the absence of a functioning Appellate Body, 19 "appeals into the void" have already piled up and cannot be further advanced.
- The number of disputes initiated has dropped to less than half of what it was before the absence of a functioning Appellate Body. (From an average of about 20 cases each year to 5 in 2020, 9 in 2021, and 8 in 2022.) There are concerns that confidence in rule enforcement is waning.
- Of the cases that Japan has appealed to the WTO, 3 cases have already become appeals into the void and cannot be further advanced.

**Number of disputes initiated since the establishment of the WTO**

**Disputes brought by Japan (which reached to the establishment of the panel)**

<table>
<thead>
<tr>
<th>Stage in which panels are established</th>
<th>Stage of being considered by the Appellate Body (but cannot be further advanced)</th>
</tr>
</thead>
<tbody>
<tr>
<td>China AD on Stainless Steel (DS601)</td>
<td>India Tariffs on ICT Goods (DS584)</td>
</tr>
<tr>
<td>*The panel report was released on June 19, 2023.</td>
<td></td>
</tr>
<tr>
<td>Korea AD on Stainless Steel Bars (DS553)</td>
<td>India SG on Iron and Steel Products (DS518)</td>
</tr>
</tbody>
</table>

(Source) Left table: WTO. Right table: Ministry of Economy, Trade and Industry
Reference: The EU’s Response to Economic Coercion and Market Distorting Measures

In recent years, the EU has announced unilateral instruments that can counteract economic coercion or market distorting measures against the EU and its member states. These instruments have entered into force in sequence, after the proposals submitted by the European Commission were approved by the Council and the European Parliament.

**<Entered into force>**

- **Enforcement Regulation for Trade Disputes (Amended) (Countermeasures against appeals into the void)**
  
  The amended regulation empowers the EU to take countermeasures, based on its own initiative, regarding countries which filed appeals into the void to the Appellate Body of the WTO Dispute Settlement Procedures or to those that blocked the dispute settlement procedures by not taking the steps that are necessary to select mediators in FTA dispute settlement proceedings. The amended regulation entered into force in February 2021.

- **International Procurement Instrument (IPI)**
  
  The Commission may initiate an investigation into a non-EU country which restricts the access of EU businesses to its public procurement market. If not resolved by bilateral consultations, the EU can adopt a measure to limit the access of businesses of that country to the public procurement in the EU. The IPI applies to all public procurement procedures above a threshold of €15 million for works and concessions, or €5 million for goods and services. The IPI entered into force in August 2022.

- **Foreign Subsidies Regulation (FSR)**
  
  The Regulation allows the Commission to impose redressive measures or restrict foreign businesses making procurement contracts, when concentrations (e.g., mergers) and public procurement in the EU by entities granting foreign subsidies are most likely to distort the economic activities of the EU’s internal market. The Regulation entered into force in January 2023. It shall apply from July 2023, with a transition period.

**<Under negotiations>**

- **Anti-Coercion Instrument (ACI)**
  
  The Instrument is designed to deter and nullify the effect of economic coercion against the EU and its member states by non-EU countries by swiftly creating policy measures on trade and investment. The instrument was proposed by the Commission in December 2021, and the Council and the European Parliament reached a provisional political agreement in March 2023.

(Source) Ministry of Economy, Trade and Industry
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Part III: Policies
Importance of Expanding Supply Capacity to Control Inflation

- **Supply-side shortfalls are a major factor** in the recent world-wide inflation. It is important **to expand supply capacity through capital investment, to increase productivity** and **to strengthen resilience of supply chains**.

Pricing mechanism by demand and supply curves

Policy to control inflation

① Before COVID-19
② Both demand and supply shrank due to the pandemic.
③ While demand has gradually recovered, supply has not.
④ Decreasing demand due to monetary tightening and/or austere fiscal policy
⑤ Increasing supply through capital investment

(Source) Ministry of Economy, Trade and Industry
The Relation of Investment and TFP to Inflation

- Inflation rates tend to be lower when year-on-year change of capital stock per employee or that of TFP are higher.

**Capital stock per employee and inflation**

![Graph showing the relationship between capital stock per employee and inflation.](image1)

**TFP and inflation**

![Graph showing the relationship between TFP and inflation.](image2)

- Estimated with data from 118 countries for 1950 to 2019

1. Impacts of other variables (e.g., TFP, elderly rate) are controlled based on regression results

(Source) University of Groningen: Penn World Table 10.01; UN: World Population Prospects
The Importance of Fundamental Values as the Basis of Free Trade

- Trade openness has a greater effect on TFP in OECD countries.
- The loss caused by uncertainty is lower in the trade with countries which have high ratings in Worldwide Governance Indicators (WGI), an index which reflects fundamental values such as freedom, democracy, human rights and rule of law.

**Trade openness and TFP**

- Higher trade openness (1)
- Higher TFP (2)

**WGI and trade loss**

- Higher WGI (3)
- Lower trade loss (4)

Notes:
1. Using the logarithm of the Composite Trade Share (CTS) suggested by Squalli and Wilson (2011)
2. Impacts of other variables are controlled based on regression results standardized with the TFP of the U.S. in 2017 = 1 as the logarithm
3. Principal component analysis for all 6 indexes in WGI
4. Standardized with the expected loss in trade with Japan=1 as the logarithm

(Source) Left figure: CEPII: Gravity Dataset, Policy Uncertainty, WB: Worldwide Governance Indicators
Right figure: University of Groningen: Penn World Table 10.01, UN: World Population Prospects
Major countries including the EU have developed their own measures to supplement the WTO, leveraging their industrial policies. In addition, countries have begun to work on consensus with like-minded countries to build reliable supply chains.

Based on these efforts, Japan will simultaneously **rebuild the rules-based international trade order**, **build reliable supply chains with like-minded countries**, and **strengthen cooperation with the Global South**.

### Rebuilding the Rules-Based International Trade Order
- **WTO reform**
  - Transparency, rule-making (especially plurilateral), dispute settlement
- **Complementary to the WTO**
  - Countermeasures for economic coercion (EU)
  - MPIA (Japan, EU, China, Australia, Canada, etc.)
  - Countermeasures for appeals into the void (EU and Brazil)
  - Rules for foreign subsidies (EU)
  - Development of new rules through economic partnership agreements (Japan, EU, etc.)

### Building Reliable Supply Chains
- **Cooperation on critical minerals between like-minded countries and Japan-US**
- **Cooperation in responding to economic coercion (G7)**
- **Strengthening economic partnership agreements (TPP UK, Bangladesh, Israel, etc.)**
- **Indo-Pacific Economic Framework (IPEF)**
  - Supply Chain Resilience Initiative (SCRI)
- **Cooperation with India** (Japan, US, Australia)
- **Cooperation with ASEAN** (Japan, Korea, US, Australia, New Zealand, China, etc.)
- **Cooperation with Africa** (Japan (TICAD), US, EU, China, etc.)

(Source) Ministry of Economy, Trade and Industry: The 10th Meeting of the Trade Committee of the Industrial Structure Council
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Part III: Policies
Growing Awareness of Supply Chain Risks

- Japanese companies are **deeply concerned about geopolitical and economic security risks with China**. Less companies are interested in China as an investment destination and **more companies are interested in ASEAN and India**.
- To strengthen domestic procurement, production and sales in Japan is also strongly recognized as a critical issue for supply chain resilience.

### Countries and regions with rising supply chain risks

#### Past 10 years (n=198)
- China
- US
- Russia
- Other Asia
- Vietnam
- Taiwan

#### Next 5 years (n=198)
- China
- US
- Russia
- Other Asia
- Vietnam
- Taiwan

* Deviation values of weighted scores for top 3 (1st: 3 points, 2nd: 2 points, 3rd: 1 point). Countries/regions higher than the average (deviation value: 50) are displayed.

### Reasons for risks rising in China

- Geopolitical risk
- Environmental risk
- Economic security risk
- Macro economic risk
- Supply chain risk
- Human rights risk
- Financial risk

*Environmental risk includes COVID-19.

### Interesting countries/regions for direct investment

#### Past 10 years (n=621)
- ASEAN6
- China
- North America
- NIEs3
- Europe
- India

#### Next 5 years (n=621)
- ASEAN6
- China
- North America
- NIEs3
- Europe
- India

* Deviation values of weighted scores for top 3 (1st: 3 points, 2nd: 2 points, 3rd: 1 point). Countries/regions higher than the average (deviation value: 50) are displayed.

### Issues for supply chain resilience (n=621)

- Strategic inventory build-up
- Decentralization of procurement and sales bases
- Strengthen procurement, production and sales in Japan
- Localization of procurement, production and sales bases
- Securing and build-up of working capital
- Automation of production processes and investment for labor-saving
- Reconsideration of distribution network and securing alternative transportation

* Deviation values of weighted scores for top 3 (1st: 3 points, 2nd: 2 points, 3rd: 1 point).

(Source) Nomura Research Institute Singapore Pte. Ltd
In addition to Rapidus, which decided to build a manufacturing base for next-generation semiconductors in Hokkaido, and JASM in Kyushu, Kumamoto, we will develop semiconductor design and manufacturing bases that take advantage of the characteristics of each region throughout Japan.

- As well as semiconductors, we will also promote the development of world-leading bases for storage batteries against the backdrop of regional industrial clusters. In addition, in computing, we aim to become a global computing hub by linking domestic bases.

![Diagram of implementation areas of each project.](image)

**Reference: Strengthening Domestic Manufacturing Bases for Critical Products such as Semiconductors**

- **Design and manufacturing base for next-generation semiconductors** (Hokkaido, Chitose city)
  - Starting with the design and manufacturing of next-generation semiconductors, toward a base for new users such as ventures that utilize them.

- **Advanced specialty base** (Kyushu, Kumamoto)
  - Global hub for advanced semiconductors for industrial use.

- **Advanced package cluster**
  - Collaborate with material and equipment manufacturers and academia to build a base for advanced integration and packaging cluster hubs.

- **Trusted memory bases** (Hiroshima, Yokkaichi, Kitakami)
  - Design and manufacturing bases for next-generation memory.

- **Next-generation computing hub**
  - Real/virtual linkages of Kobe (RIKEN), Shin-Kawasaki (IBM), Tsukuba (AIST), etc.

- **Green power cluster**
  - The whole of Japan becomes a global hub for power semiconductors.

- **Development and production base for storage batteries** (Kansai)
  - A world-leading base for the development and production of storage batteries.

- **Cyber security infrastructure bases**
  - Building a place to improve capacity of Japan as a whole.

*Circles indicate the implementation areas of each project.*

(Source) Ministry of Economy, Trade and Industry
The Foreign Exchange and Foreign Trade Act (FEFTA) provides the legal basis for export controls (List Controls and Catch-all Controls) in Japan.

FEFTA requires exporters to obtain an export license from the Minister of Economy, Trade and Industry before exporting certain goods and technologies subject to the regulations.

General framework of Japan's security export control

**Aim**
Maintain the peace and security of Japan and of the international community

**Tool**
Implement export controls to prevent the transfer of weapons and/or goods and technology with potential military applications to parties that may carry out acts of concern including states and terrorists that may threaten the security of Japan

### List Controls
1. Weapons
2. Dual-use goods and technology with high specifications that have potential military applications (weapons or their parts)
3. Dual-use goods and technology with high specifications that can also be used for developing weapons

### Catch-all Controls
- WMD Catch-all Controls and Conventional Weapon Catch-all Controls
- Export of goods or transfer of technology of non-listed items (excluding timber and food products) with potential military end-use and/or end-users

### Examples of potential military applications of civilian technology

**Act (FEFTA)**

**Cabinet Order**
Export Trade Control Order Article 48 (1)
Foreign Exchange Order Article 25 (1)(3)

**The Appended Table 1 lists the controlled goods**
1. Arms
2. Nuclear power
3. Chemical weapons
4. Missiles
5-15. Conventional weapons
16. Catch-all Control

**The Appended Table lists the controlled technologies**
1. Arms
2. Nuclear power
3. Chemical weapons
4. Missiles
5-15. Conventional weapons
16. Catch-all Control

If subject to either of the controls, an export license from the METI minister is required prior to exporting.

(Source) METI
COVID-19 exposed supply chain fragility. **Data alignment is indispensable for grasping the structure of supply chains.** We need to accelerate the construction of infrastructures for integrated management of supply chains through data alignment.

### Experience of supply chain disruption (2020 onwards)

- **Total** (n=621):
  - Experienced: 35.6%
  - No experience: 64.4%
- **Manufacturing** (n=361):
  - Experienced: 41.6%
  - No experience: 58.4%
- **Non-manufacturing** (n=260):
  - Experienced: 27.3%
  - No experience: 72.7%

### Regions experiencing supply chain disruption

- **FY2020**
  - China: 35.7%
  - Japan: 25.8%
  - ASEAN6: 20.4%
  - North America: 8.1%
  - Other Regions: 7.2%
  - Europe: 3.6%
  - Other ASEAN: 5.9%
  - India: 2.7%
  - Total: 18%
- **FY2021**
  - China: 40.3%
  - Japan: 29.9%
  - ASEAN6: 21.3%
  - North America: 9.5%
  - Other Regions: 5.9%
  - Europe: 3.6%
  - Other ASEAN: 5.4%
  - India: 4.1%
  - Total: 14.4%
- **FY2022**
  - China: 43.4%
  - Japan: 31.7%
  - ASEAN6: 14.9%
  - North America: 8.6%
  - Other Regions: 5.9%
  - Europe: 5.4%
  - Other ASEAN: 5.4%
  - India: 3.2%
  - Total: 9%

### Tasks for grasping the status of supply chains

- **Co-operation of partners**: 45%
- **Data alignment with partners**: 40%
- **Methods management**: 35%
- **Digitalizing partners’ information**: 30%
- **Resources for management**: 25%
- **Infrastructure for sharing information**: 20%

(Source) Nomura Research Institute Singapore Pte. Ltd.
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Part III: Policies
Toward a Stable Current Account Surplus

- From the viewpoint of maintaining a stable balance of payments surplus, it is necessary to improve the balance of trade and services while sustaining investment income.

Trends and direction of the trade and services balance, investment income, and current account balance

- **Investment income**
  - Stabilize investment income by improving productivity and acquiring innovation overseas
  - Our primary income balance, including dividends and interest, is one of the largest in the world

- **Trade balance**
  - Improve the trade balance by promoting exports
  - The pandemic, high resource prices, and a weak yen have caused the current trade deficit to be the largest in history

- **Service balance**
  - Improve the service balance by acquiring digital and intellectual property revenues and strengthening inbound tourism
  - Deficit expected to increase due to higher payments for overseas cloud services
  - Decrease in inbound traffic due to intensified border control measures caused by COVID-19

(Source) Ministry of Finance, Bank of Japan: Balance of Payments Statistics
Tasks for a Resilient Trade Balance

- The record-high trade deficit was brought on by **surging import prices for fossil fuels**. **Lowering dependency on imported fossil fuels is an important task** for a resilient trade structure.

### Detailed changes in the trade balance in 2022 from 2021*

*Percent change in trade balance = (Percent change in real exports – Percent change in real imports) + (Percent change in yen-denominated export prices – Percent change in contract currency-denominated export prices) – (Percent change in yen-denominated import prices – Percent change in contract currency-denominated import prices) + (Percent change in contract currency-denominated export prices – Percent change in contract currency-denominated import prices)

Trade balance = (Real exports * Yen-denominated export price) / (Real imports * Yen-denominated import prices)

Percent changes are approximated by differences in logarithmic terms

(Source) Bank of Japan: Real Exports and Real Imports, Corporate Goods Price Index

### Approximation based on MoF’s Trade Statistics (Changes in 2022 from 2021)

<table>
<thead>
<tr>
<th></th>
<th>Changes in real volume</th>
<th>Changes in FX</th>
<th>Changes in contract currency-denominated prices</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Exports</strong></td>
<td>JPY 800 bln</td>
<td>JPY 10 trln</td>
<td>JPY 4 trln</td>
<td>JPY 15 trln</td>
</tr>
<tr>
<td><strong>Imports</strong></td>
<td>JPY 4 trln</td>
<td>JPY 12 trln</td>
<td>JPY 17 trln</td>
<td>JPY 33 trln</td>
</tr>
</tbody>
</table>
**Tasks for Improving Export Profits**

- Depreciation offers chances for exporting but **is not leading to improved yen-denominated export profits for about 30% of goods.**
- Among goods that experienced reduced yen-denominated export profits, **export profits could be improved by raising USD-denominated unit prices for goods that experienced declines in prices and by cutting USD-denominated unit prices for goods that experienced rising prices.**

### Yen-denominated export profits (2022)

<table>
<thead>
<tr>
<th>Category</th>
<th>Decline in unit price, Increased profits</th>
<th>Decline in unit price, Decreased profits</th>
<th>Rise in unit price, Increased profits</th>
<th>Rise in unit price, Decreased profits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>38%</td>
<td>44%</td>
<td>20%</td>
<td>11%</td>
</tr>
<tr>
<td>Petroleum and coal products</td>
<td>18%</td>
<td>64%</td>
<td>4%</td>
<td>14%</td>
</tr>
<tr>
<td>Transportation machinery</td>
<td>43%</td>
<td>33%</td>
<td>18%</td>
<td>6%</td>
</tr>
<tr>
<td>Precision machinery</td>
<td>48%</td>
<td>27%</td>
<td>19%</td>
<td>7%</td>
</tr>
<tr>
<td>Steel, nonferrous metal, metal products</td>
<td>33%</td>
<td>41%</td>
<td>14%</td>
<td>13%</td>
</tr>
<tr>
<td>Others</td>
<td>44%</td>
<td>30%</td>
<td>19%</td>
<td>8%</td>
</tr>
<tr>
<td>General machinery</td>
<td>44%</td>
<td>28%</td>
<td>22%</td>
<td>6%</td>
</tr>
<tr>
<td>Plastic products</td>
<td>34%</td>
<td>34%</td>
<td>17%</td>
<td>14%</td>
</tr>
<tr>
<td>Chemical products</td>
<td>28%</td>
<td>40%</td>
<td>18%</td>
<td>15%</td>
</tr>
<tr>
<td>Food and tobacco</td>
<td>45%</td>
<td>21%</td>
<td>20%</td>
<td>14%</td>
</tr>
<tr>
<td>Electrical machinery</td>
<td>35%</td>
<td>31%</td>
<td>24%</td>
<td>10%</td>
</tr>
<tr>
<td>Textile products</td>
<td>45%</td>
<td>21%</td>
<td>23%</td>
<td>12%</td>
</tr>
<tr>
<td>Ceramics • Stone • Clay products</td>
<td>37%</td>
<td>28%</td>
<td>27%</td>
<td>8%</td>
</tr>
<tr>
<td>Paper • Pulp • Wood • Wood products</td>
<td>33%</td>
<td>30%</td>
<td>26%</td>
<td>11%</td>
</tr>
</tbody>
</table>

(Source) Global Trade Atlas database
The Globalization of Firms and its Benefits for the Domestic Economy

- The globalization of firms has positive effects on profit, employment, investment, wages and productivity.
- Also, it promotes exports of neighboring local firms.

The impacts of starting FDI
(growth after 5 years, manufacturing)

The impacts of offshoring on exports of neighboring local firms

Ordinary income to sales ratio (manufacturing)

TFP (manufacturing)

Wage per employee (manufacturing)

(Source) METI: Kigyou Katsudou Kihon Chousa Houkokusou, Kaigai Jigyou Katsudou Kihon Chousa Houkokusou, Kogyo Toukei Hyo, BOJ: Tankan
For SMEs facing domestic demand constraints, starting to export is a great opportunity for growth.

The Japanese government supports preparations for exports and negotiations through the 10,000 New Exporters Support Program.

**The impact of starting to export**

* Firms with 50-99 employees

**10,000 New Exporters Support Program**

(Growth from one year prior to the start of exporting)

**Firms starting to export**

(Firms not starting to export)

(Growth from one year prior to the start of exports)

**Firms starting to export**

(Firms not starting to export)

(Source) METI: Kigyou Katsudou Kihon Chousa Houkokusho
Promoting Economic Growth through Startups

- Startup investment promotes economic growth through innovation. On the other hand, startup investment in Japan as a percentage of GDP is low compared to other major countries. By implementing the Startup Development Five-year Plan, we aim to achieve startup investment of 10 trillion yen by FY2027.

Venture capital investments and total factor productivity

![Chart showing the relationship between venture capital investments and total factor productivity across various countries.](chart-1)

- High total factor productivity
- Large amount of venture investment by VC

(Source) Left figure: OECD Statistics; University of Groningen: Penn World Table 10.01

**Total factor productivity adjusted for factors other than venture capital investments (e.g., aging rate); logarithm of index value with total factor productivity of U.S. in 2017 = 1.

**Venture investment ($1 million) in logarithmic scale.

Venture capital investments by VCs as % of GDP

![Chart showing venture capital investments by VCs as a percentage of GDP for various countries.](chart-2)

- Japan: 0.06% (2021)

(Source) Right figure: OECD Statistics

**Venture investment ($1 million) in logarithmic scale.
Promoting Overseas Expansion of Japanese Companies

- Through overseas expansion, the following effects are expected: (1) creation of a virtuous cycle to promote trade in products and services originating from overseas investment and advancement, (2) creation of innovation and improvement of productivity and competitiveness, and (3) contribution to strengthening international relations among like-minded countries and the Global South.

### A virtuous cycle of promoting trade in products and services, starting with overseas investment and expansion

<table>
<thead>
<tr>
<th>Promoting exports</th>
<th>Overseas investment and expansion</th>
<th>Promoting trade in services</th>
</tr>
</thead>
<tbody>
<tr>
<td>● Expand exports of products, material supplies, etc. between overseas production bases and domestic bases</td>
<td>● Promoting the return of profits from overseas subsidiaries to the domestic market through dividends and other means</td>
<td>● Provision of services from Japan through overseas service centers (use of digital technology)</td>
</tr>
<tr>
<td>● Promote export of related equipment along with provision of services through overseas bases</td>
<td>● Expansion of profits and creation of innovations by companies operating overseas, including startups</td>
<td>● Increase in inbound demand by raising awareness through the development of attractive Japanese products and services</td>
</tr>
</tbody>
</table>

### Improve innovation creation, productivity and competitiveness

<table>
<thead>
<tr>
<th>Development of new products &amp; services</th>
<th>Pursuit of optimal location</th>
<th>Pursuit of scale</th>
</tr>
</thead>
<tbody>
<tr>
<td>● Development of products and services that meet needs based on local social issues, etc.</td>
<td>● Improve competitiveness by manufacturing and supplying products at optimal locations, including costs</td>
<td>● Increase added value and productivity by securing business scale in anticipation of overseas markets</td>
</tr>
<tr>
<td>● Collaboration with local creators</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Contribution to strengthening international relations

<table>
<thead>
<tr>
<th>Strengthening relations with like-minded countries</th>
<th>Collaboration with the Global South</th>
</tr>
</thead>
<tbody>
<tr>
<td>● Strengthening collaboration by building trustworthy supply chains among like-minded countries</td>
<td>● Japanese companies contribute to solving social issues facing the Global South</td>
</tr>
</tbody>
</table>

(Source) Ministry of Economy, Trade and Industry: 14th Meeting of the New Opportunities Subcommittee for Economic and Industrial Policy, Industrial Structure Council
Evaluation of Japan in Terms of Business Bases and Issues for Internal Internationalization

- According to a survey of foreign companies, Japan has a good reputation as an R&D base.
- Compared to other developed countries, Japan has strengths in infrastructure, market size, social stability, consumer income levels, etc., while there are issues with English, business activity costs, and tax rates, etc.
- Promoting internal internationalization is important to improve productivity and innovation, and to create a virtuous cycle of income and investment, including addressing these issues.

Countries and regions that foreign companies consider most attractive as business locations

The strengths and weaknesses of the Japanese market perceived by foreign companies compared to developed countries

*Each company answered with up to three strengths and weaknesses

(Number of respondents: 98. Number of answers: 540) (Source) Nomura Research Institute Singapore Pte. Ltd