Chapter 2 Incorporating global growth and responding to risks

If the Japanese economy, with its population expected to shrink, is to maintain sustainable growth, it is essential to incorporate global growth and also to appropriately respond to the risks inherent therein. This chapter will show that Japan tends to depend on specific countries for imports compared with the G7 as a whole, the United States, and Germany, so promoting the diversification of procurement sources is an urgent challenge. The chapter will also make clear that Japanese global companies face challenges in reducing procurement dependency on specific countries and that it is necessary to assess risks inherent across entire global value chains.

Regarding the need to incorporate global growth, we will look at the close relationship between Japanese companies and overseas markets and the challenges that stand in the way of promoting further overseas expansion in accordance with the circumstances of companies. This chapter will also show that competitive Japanese manufacturing companies are operating globally and contributing to employment and investments in Japan and that they are achieving further growth and expansion while using intangible assets. It will indicate the importance of fostering companies that can survive global competition by strongly supporting domestic companies, including mid-sized enterprises, in enhancing competitiveness.

Section 1 Major countries' import dependency on specific countries

Because of the effects of the COVID-19 pandemic, supply chains were disrupted and thrown into turmoil on a global scale, a situation that exposed the problem of countries concentrating on trade with specific countries as procurement sources in line with the globalization trend. In response to this situation, countries are stepping up efforts to increase supply chain resiliency regarding critical goods and other items, but the dependency on specific countries as procurement sources is still continuing. In addition, in recent years, some countries have frequently engaged in acts of so-called economic coercion, such as exploiting economic dependencies to undermine other countries' foreign and domestic policies and positions. Therefore, it has become an urgent challenge to closely analyze the status of dependency on specific countries as procurement sources and accelerate efforts to deal with the situation based on the analysis.

Therefore, this section will look at the import dependency of the G7, the United States, Germany and Japan on specific countries, using data on the import value in 2022 at the six-digit HS (HS6) code level. First, we will explain the method of identifying the import dependency on specific countries. We use the Herfindahl-Hirschman Index (hereinafter "HHI"), which is an indicator of concentration, to identify the import dependency on specific countries on an item-by-item basis at the HS6 code level. The items covered by the analysis in this section are industrial goods, which correspond to items other than those classified as 01 to 24 at the two-digit HS (HS2) code level. A country's import concentration as measured by the HHI is calculated by dividing by 100 the sum of the squares of shares of import source countries in the country's overall imports on an item-by item basis. The value of the HHI comes to 100 when the country in question has a total dependence on a specific country. As the diversification of import sources proceeds, the value approaches zero. For example, an HHI value higher than 50 indicates the presence of at least one import source country with an import share higher than 50%. An

HHI value lower than 25 indicates the absence of any import source country with an import share higher than 50% and the presence of at least four import source countries.

Figure II-2-1-1 shows the distribution of item-by-item HHI values regarding imports by the G7 as a whole, the United States, Germany, and Japan.



Figure II-2-1-1. Distribution of the Herfindahl-Hirschman Index values in major countries

Note: The data in this figure are aggregated based on all 4,344 items falling under the 6-digit HS codes that have been imported in Japan, the U.S. and Germany, excluding the items falling under the 2-digit HS codes 1 to 24.

Source: Global Trade Atlas.

The distribution of item-by-item HHI values²⁰⁸ regarding imports by the G7 as a whole shows that items with an HHI value higher than 50 account for 5% of the total, which means that there is at least one import source country with an import share higher than 50%. By country, items with an HHI value higher than 50 make up around 10% of the total in the case of Germany and around 20% in the case of the United States, but the ratio is nearly 40% for Japan, indicating a high level of import concentration on specific countries. On the other hand, items with an HHI value lower than 25 account for around three-quarters of the total in the case of the G7 as a whole, indicating the absence of any specific country with an import share higher than 50% and the presence of at least four import source countries. By country, items with an HHI value lower than 25 account for around 60% in the case of Germany and around 40% in the case of the United States, while the ratio is around 20% for Japan. This indicates that in the case of Japan, the number of items for which import sources have been diversified sufficiently is small compared with the cases of the United States and Germany.

²⁰⁸ As explained above, the value of HHI is calculated by dividing by 100 the sum of the squares of shares of import source countries. It should be kept in mind that under that definition of HHI, the value of HHI for the G7 as a whole are inherently smaller than the respective values of HHI for Japan, the United States, and Germany because the number of countries used in the calculation of the values for the three individual countries is one less than the number used in the calculation of the value for the G7.

Figure II-2-1-2 shows the numbers of items for which the G7, Japan, the United States and Germany depend on specific import sources for 50% or higher of imports, tallied by import source country.



Figure II-2-1-2. Number of items for which the countries depend on specific import sources for 50% or higher of imports (tallied by import source country)

Note: The data in this figure are aggregated based on all 4,344 items falling under the 6-digit HS codes that have been imported in Japan, the U.S. and Germany, excluding the items falling under the 2digit HS Codes 1 to 24.

Source: Global Trade Atlas.

In the case of imports by the G7 as a whole, China has by far the largest number of items with an import share higher than 50%, followed by the United States, Germany, Canada, and India. Regarding Japan, China has by far the largest number of items, followed by the United States, the Republic of Korea, Germany, and Italy. Regarding the United States, China has the largest number of items, followed by Canada, Mexico, Germany, and India. As for Germany, China has the largest number of items, followed by the Netherlands, Italy, Belgium, and Switzerland.

Next, Figure II-2-1-3 shows the number of items with an HHI value higher than 50, tallied by category of products at the HS2 code level.

Figure II-2-1-3. Characteristics of items whose HHI value is higher than 50 (tallied based on the products falling under the 2-digit HS code)



Note: The data in this figure are aggregated based on all 4,344 items falling under the 6-digit HS codes that have been imported in Japan, the U.S. and Germany, excluding the items falling under the 2digit HS Codes 1 to 24.

Source: Global Trade Atlas.

In the case of the G7 as a whole, the organic chemicals category (HS29) accounts for the largest portion of the total number of items, as it does in the cases of Germany and the United States. On the other hand, in the case of Japan, the machinery category (HS84) makes up the largest portion, followed by the organic chemicals category. In the case of Germany, the machinery category accounts for the second largest portion, after the organic chemicals category. For all of Japan, the United States, and Germany, the category of products including rare metals and rare earths (HS28) makes up the third largest portion. In the case of Japan and the United States, the level of import dependency on specific countries is high with respect to items in the electrical machinery category (HS85) and the steel category (HS72).

To sum up the above findings, Japan has a high level of import dependency on specific countries compared with the G7 as a whole, the United States, and Germany. China has the largest number of items with an import share higher than 50% in imports by Japan, the United States, and Germany. At the HS2 code level, the level of import concentration is high with respect to the organic chemicals category, the machinery category, the category of products including rare metals and rare earths, the electrical machinery category, and the steel category. Japan appears to have a high level of import dependency on China compared with the United States and Germany. However, it should be kept in mind that, generally speaking, the larger the economic size of two countries and the closer the geographic distance between them, the larger the volume of bilateral trade between them tends to be. It should also be kept in mind that even in the case of items for which a certain country has a high level of dependency on a specific import source, import disruptions would not necessarily have negative effects on the importing country's economic and social activities. While this section focused on the status of import dependency on specific countries, the next section will look at the status of Japanese global companies' procurement dependency on specific countries and the challenges faced by them while taking into consideration the results of a questionnaire survey.