White Paper 2012

Growth frontier expanding in a linkage with the world

1
Trends in the world economy

Worrying world economy: The pace of recovery lacks momentum

- The world economy had been recovering modestly after bottoming out in the spring of 2009 but slowed down again in 2011 due to growing concerns over the deepening European debt problem, the deceleration of the US economy, and other factors.
- In 2012, concerns over a rapid business downturn eased but the world economy has been shored up by policy measures of many countries, still remaining unstable. In contrast, the economy of emerging economies has been strong since the latter half of the year while showing a slowdown trend.

European economy in chaos intensified by debt crisis

- The European economy had been recovering modestly from a slump triggered by the global economic crisis in 2008, but business sentiment plunged reflecting the emergence of the European debt crisis and demand declined mainly due to a tight fiscal policy of the governments of many countries to achieve fiscal soundness, resulting in an evident slowdown in the economy.
- In contrast, in Germany the economy has been relatively steady compared with other major countries, for example there have been signs of recovery in some economic indicators. Thus, the European economy has been polarized.

U.S. economy: Continued growth but prospects uncertain

- In 2011, the US economy slowed down in the pace of recovery mainly reflecting the soaring crude oil prices and the disruption of supply chains caused by the Great East Japan Earthquake, but the recovery accelerated from around October.
- In 2012 as well, recent economic indicators show moderate recovery as a whole, such as the move that signs of improvement have been seen in the labor market and the housing market, but consumption has fallen short of a full-scale recovery. Risk factors involve jobless rates still at a high level, stagnant housing prices, a decline in external demand stemming from the spreading European debt crisis and slowing growth of emerging countries, coupled with the surging gas prices. Thus, the US economy is expected to continue being bolstered by fiscal and monetary policies.

Chinese economy: High growth but with slower pace

- In 2011, inflation control was a top priority issue of economic policies and therefore a tight monetary policy was adopted. Meanwhile, exports to Europe began to slow down since the middle of the year due to the European debt crisis, and economic growth decelerated mainly in the coastal area that heavily relies on exports. In 2012, the domestic demand, in particular the expansion of demand for consumption, is emphasized by citing "more speedy development with economic stability" as a top priority and a stable price level as a priority issue. Immediate risk factors involve a plunge in housing prices, debt problems of local governments, and a slowdown in exports stemming from the European debt crisis.

Other Asian economies

- Asian economies continued recovering also in 2011, but the pace of recovery became moderate from around the middle of 2011 primarily due to surging resources prices, rising domestic prices and a tight monetary policy adopted in response to such price movements, as well as a slowdown in exports reflecting the deepening European debt crisis.
- For the South Korean economy as well, exports mainly bound for Europe decelerated from around the middle of the year due to refueling the European debt crisis. Around autumn, overseas investors such as European financial institutions increased a tendency to avoid risk and withdrew capital from South Korea and other Asian economies, resulting in a sharp decline in the South Korean won and a decrease in foreign currency reserves, etc. Under these circumstances, economic slowdown became evident. Recently, there are signs of some recoveries but the economy remains at standstill.

2
Structure and change of Japanese trade and investment

Change and structural change of Japanese trade and economy

- Japan's trade balance in 2011 shown in the "Trade Statistics" fell into deficit for the first time in 31 years since 1980, and the "trade balance" in the "Balance of Payments Statistics" showed a deficit for the first time in 48 years since 1963.
- Since 2000, exports and imports of intermediary goods and imports of final goods have been growing. Thus, the conventional trade pattern that was so-called "processing trade" has been changed significantly. In Japan, the "spillover" less tends to stay within the country due to the growing international division of labor. To cover this move, the extent of dependence on external demand is increasing. These trends are becoming stronger in Germany than Japan.

Structure of international division of labor in East Asia and its change

- In East Asia, overseas development of enterprises mainly by enterprises, including Japanese manufacturers, and the international division of production on the back of brisk sales and procurement activities resulting from such overseas development are now in progress. Namely, this is a trade structure in which intermediary goods are exported to the inside of the region and final goods are exported to the outside of the region.

- In recent years, the site of demand for final goods moves to the inside of the region and local and domestic suppliers are increasing. As a result, competition is prone to being intensified in stages while complementary supply of parts is maintained.

Floods in Thailand that caused a significant impact on the trade environment, etc. of Japan and neighboring nations/regions

- Last year's Thai floods caused flooding of multiple industrial complexes where many Japanese enterprises are located, leading to more-than-expected damage. After that, recovery and reconstruction are proceeding rapidly but material impacts are spreading directly and indirectly to economic activities of Japan as well as neighboring nations/regions.
- Progressing industrial agglomeration of machinery in Thailand significantly affected not only the flood directly-damaged electronics industry producing HDDs, etc. but also automobile industries worldwide resulting from a stagnation in exports of parts of intermediary goods caused mainly by the supply disruption of specific-use electronics parts as with the case of the earthquake that occurred in Japan.
- For Japanese enterprises, the investment environment in Thailand has concerns about human resources but the competitive edge remains unchanged in terms of infrastructure and a base for exports to third countries, as long as drastic countermeasures against floods are taken in the future. It is of importance to make advance discussions to ensure that measures against disaster risk lead to fundamental business improvements and the strengthening of competitiveness.

Events that caused a material impact on Japan's trade environment, etc.
----- Trade deficit, earthquake, and higher yen -----

- Last year's trade deficit resulted from a combination of various factors, such as the earthquake and Thai floods together with the higher yen trend and a slowdown in the growth of the world economy. In particular, despite the higher yen trend, last year as well, soaring prices of various forms of energy, including crude oil and LNG, raised import prices, constituting a significant structural factor behind the recent deterioration in trade balance.
- The decrease in production in Japan due to the impact of the earthquake has recovered as a whole across Japan. Bright signs of recovery are seen in the livelihood of the damaged areas. While some industries are increasing overseas procurement in the wake of the earthquake, etc., such a move existed also before the earthquake.
- The more-than-predicted appreciation of the yen seen since last year also entails the worsening terms of trade, leading to a serious situation for exporting companies such as the electric/electronics industry. The profitability of the industries in Japan, which continue price competition with emerging economies and regional products mainly by cutting costs, are getting chronically worse, but in Germany, etc., a certain extent of increased prices of imported materials has been passed on to export prices.
- When comparing the relative trend in export prices of machinery of the three countries, Japan,

South Korea and Germany, the export prices of German products, unlike those of Japan and South Korea, remain remarkably stable centering on major export items such as transportation machinery and general machinery, regardless of exchange rate fluctuations. Factors behind this gap could be export strategies containing an increase in brand value and a focus on the innovation specific to the enterprise, as well as the maintaining and strengthening of pricing power.

3
Development of overseas business activities of Japanese enterprises

Current situation of overseas business activities of Japanese enterprises and the problems involved

- In recent years, overseas business activities of Japanese enterprises, including the non-manufacturing sector such as service industry and mid-sized enterprises are broadening both geographically and functionally.
- Japan's overseas production ratio is rising, backed by the higher yen and other factors, leading to growth in outward foreign direct investments in recent years. The relation between overseas business activities and domestic employment of Japanese enterprises also shows that enterprises producing overseas are expanding sales and increasing jobs more than others even in Japan.
- In recent years, outward foreign direct investments has grown in Germany, South Korea and other countries, and at the same time domestic investments are also on the rise. Thus, expansion both at home and abroad is called on.

International comparison of overseas business activities

- Despite the recent years' expansion of overseas business activities, Japan may not be a nation with a high level of overseas business activities compared with other major countries, even judging from economic indicators for trade amount, direct investment stocks, investment income, etc.
- In Germany, mid-sized enterprises called "Hidden Champions" are aggressively expanding business to the outside of the country in their specific field without depending on price competition. South Korea is also actively assisting domestic enterprises including not only large firms but also SMEs, thereby helping increase their presence in overseas markets.
- In Japan as well, many mid-sized enterprises that have not made a step in overseas business activities are found, even though they have excellent technologies and products. Thus, there is room for increasing Japan's growth potential by further broadening the base of overseas business activities.

Towards overseas development of the service industry

- Currently, Japan's service trade is not large compared with major countries in terms of both export and import, and the service trade balance suffers deficit but the deficit is decreasing. Signs of change are seen, for example surplus is recorded for Asia.

- Model cases are also increasing where a company in the service industry gained success by providing to overseas the “intellectual service industry” on the basis of intangible value, such as knowhow, and brand, that have long been fostered by the service industry of Japan. Also, connections of service functions and manufacturing industry are expected to strengthen a competitive edge through promotion of producing high value-added products and conversion of the manufacturing industry to service industry.

Towards strengthening locational competitiveness

- Germany is actively working to improve the business environment, including labor market reforms, corporate tax reductions, and promotion of research and development. South Korea is also pushing forward with the enhancement of the business environment, including corporate tax reductions, FTA, and encouragement of starting a company while aggressively supporting the sophistication of domestic industries.
- In Japan as well, in an effort to eliminate concerns over the hollowing out of industries and reinforce locational competitiveness, it is important to improve the export/import environment, reduce domestic business costs, create higher value-added industries, and enhance an environment that supports creation of new industries.

4
Towards new growth of the Japanese economy by linkages with outside of Japan

Improvement of trade and the investment environment bolstering Japanese enterprises’ initiatives

- Promotion of FTA, EPA, etc. to strengthen linkages with the world economy and creation of rules on a world and regional scale through the WTO, etc. are indispensable for improving Japanese trade and investment environment.

Support for overseas business activities in response to changing needs

- Importance is continuously placed on linking the growth of other countries to the growth of Japan by capturing demand for infrastructure improvements in emerging economies, etc. centering on Asia and promoting a package-type infrastructure overseas development.
- It is expected to expand overseas business activities under the Cool Japan strategy that takes advantage of the appeal of Japan long fostered by traditions and cultures as a growth locomotive of the Japanese economy.
- Though SMEs are increasing overseas business activities in recent years, support measures are needed to lower the hurdles for a start of the activities.
- Securing and fostering “global human resources” are important issues to shore up the global development of SEMs.

Urgent measures to strengthen locational competitiveness

- Corporate tax will be reduced in fiscal 2012. In addition, towards making Asia a hub, importance is placed on efforts to promote global enterprises’ locations and improve location subsidies.
- As future growth fields, problem solution-type industry (healthcare, child-rearing service, medical equipment, energy conservation), creative industry (tourism, culture), and leading-edge industry (next generation vehicles, aircrafts, space industry, etc.) will be expected.

Chapter 1 Trends in the World Economy

Chapter 2 Structure and change of Japan’s trade and investment

Explanatory Notes

1. Abbreviations

The following are the formal names of principal abbreviations used in this White Paper:

ADB	: Asian Development Bank
APEC	: Asia-Pacific Economic Cooperation
ASEAN	: Association of South-East Asian Nations
BIS	: Bank of International Settlements
DBJ	: Development Bank of Japan
ECB	: European Central Bank
ECLAC	: UN Economic Commission for Latin America and the Caribbean
EFTA	: European Free Trade Area
EPA	: Economic Partnership Agreement
ERIA	: Economic Research Institute for ASEAN and East Asia
EU	: European Union
FAO	: Food and Agriculture Organization of the United Nations
FRB	: Board of Governors of the Federal Reserve System
FTA	: Free Trade Agreement
GATS	: General Agreement on Trade in Service
GATT	: General Agreement on Tariffs and Trade
GCC	: Gulf Cooperation Council
GDP	: Gross Domestic Product
GNI	: Gross National Income
IEA	: International Energy Agency
IEC	: International Electrotechnical Commission
ILO	: International Labour Organization
IMF	: International Monetary Fund
ISO	: International Organization for Standardization
JBIC	: Japan Bank for International Cooperation
JETRO	: Japan External Trade Organization
JICA	: Japan International Cooperation Agency
JOGMEC	: Japan Oil, Gas and Metals National Corporation
JST	: Japan Science and Technology Agency
M&A	: Merger and Acquisition
NAFTA	: North American Free Trade Agreement
NEDO	: New Energy and Industrial Technology Development Organization
NEXI	: Nippon Export and Investment Insurance
NIEs	: Newly Industrializing Economies
OECD	: Organization for Economic Co-operation and Development
PPP	: Purchasing Power Parity

RIETI : Research Institute of Economy, Trade and Industry
TFP : Total Factor Productivity
UNCTAD : United Nations Conference on Trade and Development
USDA : United States Department of Agriculture
USTR : Office of the United States Trade Representative
WIPO : World Intellectual Property Organization
WTO : World Trade Organization
UN : United Nations
WB : World Bank*

* A collective term for International Bank for Reconstruction and Development and International Development Association

EPA/FTA:

A free trade agreement (FTA) refers to an agreement aimed at abolishing tariffs and other trade-restrictive regulations between contracting states. An economic partnership agreement (EPA) means a broad-based agreement that also includes measures designed to integrate market systems and economic activities in addition to measures that are contemplated in an FTA. Unless otherwise specifically provided, in this White Paper we will use EPA/FTA as a collective term that includes a customs union (based on an agreement aimed at abolishing intra-regional tariffs and other trade-restrictive regulations, establishing thereby a single customs area that adopts common external tariffs and other trade-restrictive regulations) added to an EPA or FTA.

2. Data source abbreviations

The following are the abbreviations of the principal sources of data used in this paper:

(1) World Bank statistics

WDI: World Development Indicators

(2) IMF statistics

DOT: Direction of Trade Statistics
IFS: International Financial Statistics
BOP: Balance of Payments Statistics
WEO: World Economic Outlook

(3) Other statistics

USDA “PS&D”: U.S. Department of Agriculture Production, Supply, Distribution Database.

3. Numbers, formulas, etc.

(1) Unless otherwise specified each time, a year mentioned in the text or a statistical table shall mean a calendar year that runs from January to December, and a fiscal year, a year that runs from April of a year to March of the next.

(2) As a general rule, all numbers given in statistical tables or elsewhere have been rounded. Consequently, the sum of the constituent items may not agree with the total shown for the same

items.

(3) Of the symbols used in figures or tables, the symbol "—" that is used alone without being followed by a number means "not available," "not reportable" or "not applicable" unless otherwise specified. "0" means a number less than one unit.

(4) This White Paper has been prepared using statistics and other data effective as of its writing. No subsequent revisions or modifications of statistical numbers are reflected.

4. Classification of "country/region"

(1) In some cases a "country" includes a "region."

(2) Definition of NIEs and ASEAN

   (i) NIEs means four countries/regions; namely, South Korea, Taiwan, Hong Kong and Singapore.

   (ii) Of the above four countries/regions, the first three (South Korea, Taiwan and Hong Kong) will specifically be referred to as NIEs3.

   (iii) ASEAN means ten countries; namely, Thailand, the Philippines, Indonesia, Malaysia, Singapore, Vietnam, Brunei, Laos, Myanmar and Cambodia.

   (iv) Of the above ten countries, the first four (Thailand, the Philippines, Indonesia and Malaysia) will specifically be referred to in this White Paper as ASEAN4, and the first six (Thailand, the Philippines, Indonesia, Malaysia, Singapore and Vietnam), as ASEAN6.

(3) BRICs means Brazil, Russia, India and China (four countries).

(4) The EU (European Union) was created in November 1993 upon entry into force of the Treaty on the European Union. In this White Paper we will refer to the initial 12 member states as "EU12," the 25 member states in and after May 2004 as "EU25," and 27 member states in and after January 2007 as "EU27."

(5) In some cases we refer to Germany meaning West Germany that existed before the German unification. Consequently, annual numbers related to "Germany" may not be consistent between one year and another.

(6) OPEC is made up of eleven member countries; namely, Iraq, Iran, Saudi Arabia, Venezuela, Qatar, Indonesia, Libya, United Arab Emirates (UAE), Algeria and Nigeria. Because statistical data is largely deficient on Iraq, for purposes of statistical analyses in this White Paper "OPEC" generally refers to ten countries exclusive of Iraq.

(7) GCC means six countries/regions; namely, Saudi Arabia, Kuwait, Bahrain, Qatar, United Arab Emirates (UAE), and Oman.