White Paper on International Economy and Trade 2013 Contents (draft)

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Productivity improvement and economic growth that is actualized by incorporating the dynamism of world economy

I
Productivity improvement and international business development

■ Japan's current productivity in comparison with other countries

- Japan's real GDP growth rate achieved stable growth at approximately 4% until the latter half of the 1980s, except for 1974 when the growth rate dropped due to the effect of the first oil crisis. However, the GDP growth rate greatly dropped due to what is now called the collapse of the bubble economy and, after 1990, the economy continued at low growth that was less than 1% on average.
- When looking at the growth rate breakdown, contribution largely decreased since the 1990s except in the early 2000s, due to TFP increase. This decrease is the main factor for suppressing the growth rate.
- Japan's productivity is as low as around 60% of that in the United States and is also lower than that in Germany, France, and the United Kingdom. Japan tried to catch up with the United States until the mid 1990s, since then however, this disparity has not shrunk. High productivity sectors in Japan make up a low percentage of the entire economy, and the low productivity sectors make up a high percentage. For Japan to return to strong economic growth and achieve a more affluent standard of living, an increase in labor productivity and TFP, which is represented by productivity, is necessary.
- The overall productivity may be improved by, (1) the expansion of the percentage of high productivity sectors within the overall economy and, (2) productivity increase for each sector.
- In order to expand economic activities of highly-productive sectors, it is important to promote economic partnerships and strategically approach emerging countries to attract overseas demand. Productivity increase for individual businesses is also effective for the entire industry; however, low productivity sectors make up a high percentage of the entire total added value, and productivity improvement for these sectors play a large role in productivity improvement for the entire economy.

■ Roles of international business development in improving productivity

- According to regression analysis, high productivity level and growth rate have a correlation with (1) businesses that actively export, (2) businesses that actively invest overseas, (3) businesses that actively perform research and development and business that actively invest in IT even if difference in business, scale and corporate age are excluded. Foreign-affiliated companies tend to have higher productivity level and growth rate compared to the Japanese companies.
- Positive correlation is seen between business productivity and advancement into foreign markets (export and outward direct investment). If highly-productive companies that have already expanded business overseas and those that are highly-productive but have yet to expand business overseas make further efforts to improve and maintain their high productivity and expand business size by

attracting foreign demand, such efforts will surely contribute to pushing up Japan’s productivity as a whole. There is a trend that companies which started exports to North America and Europe increase their productivity increase rate having learning effectiveness in highly developed market. As emerging markets develops, learning effectiveness of exporting to emerging markets can be expected. In light of the case in which learning effectiveness gained through overseas market competition, it is effective for the increase of the productivity of overall economy to encourage such companies to gain foreign market.

- Innovation is an important factor for the increase of productivity. The amount of investment in research and development in Japan is not small compared to other countries. But on the other hand, the amount of investment in intangible assets such as human resources and organizational structure other than investment in research and development is small. Besides, industries which introduce IT have not accumulated IT assets thought the industries which produce IT have accumulated IT assets in the level which is relatively closed to the United States one. For the resolution of this problem, it is important to positively accept excellent human resources and technologies from overseas jointly with foreign partners. The following matters are important for the increase of productivity through innovation: Marketing including brand strategy and organizational reformation, development of human resources, recovery of research and development, positive acceptance of excellent human resources and technologies from overseas.
- Inward direct investment is expected to increase the productivity of overall economy having the emergence of foreign-affiliated companies with high productivity and increase the productivity of Japanese companies transferring technologies and know-how from foreign-affiliated companies. Inward FDI stocks (to GDP rate) in Japan are small compared to other countries. It is expected that further increase of inward FDI stocks will improve the productivity in Japan.

II
Future course of Japan’s international business development

■ Promotion of economic partnerships

- Japan will develop economic partnership negotiations such as TPP, RCEP, Japan-China-Korea FAT, Japan-EU EPA to build "economic partnership network" which includes most of Japanese trade partners. In addition, Japan will establish global and regional rules through WTO, APCE etc.
- At the same time, it is necessary to promote the conclusion of investment and tax agreements for the establishment of business environment in which Japanese companies can operate their business stably cultivating emerging markets.

■ Acquisition of growing market (Emerging market development)

- Emerging countries is expected to increase approximately 1.4 billion of middle and wealthy class citizens and produce at least 60% of the increase of world consumer expenditure by 2020.
- To draw on the demand of emerging markets, Japan will approach emerging countries according to

three categories ("China / ASEAN", "Southwest Asia, Middle East, Russia / CIS, and Latin America", "Africa") based on the expansion level of Japanese companies and competition with foreign countries.

■ **Support to industries and companies which have a potential to expand into foreign markets**

- Internationally, SMEs that have adjusted to globalization are growing. Medium-sized companies in Germany draw worldwide attention with excellent corporate strategies in the aspect of specialization to differentiated products, active sales to foreign markets, establishment of close relationships with their customers through after-sales care.
- There are SMEs and non-manufacturing companies in Japan which rank high worldwide in specific fields. On the other hand, there are SMEs which have yet to expand into foreign markets though they have enough potential to compete in the world market in Japan. Japan will reinforce relationships between support organizations and strengthen local support systems to draw the demand towards such SMEs.
- Though the quality of services in Japan is high, demand from overseas is not enough. Japan will increase the visibility of Japanese products and services and the understanding of Japan and its culture through the Cool Japan initiative.
- The number of million cities will increase by around 50% by 2025 and the increase of infrastructure needs is expected. Japan will develop strategy combined with economic cooperation so that Japanese infrastructure can win in the fierce competition and increase demand.

■ **Acceptance of excellent human resources and companies from overseas**

- It is necessary for the promotion of innovation activities to implement policy of global human resources such as invitation, growing, and use of high-quality human resources from overseas.
- For the purpose of promoting inward direct investment for companies with superior knowledge and know-how, special zone sweeping reforms and foreign government enticement / support system fundamental strengthening is necessary.

III
Trends in the world economy

■ **World economy still showing fragile recovery despite the mitigation of serious risks**

- The prospect of recovery is seen in the 2012 world economy; however, a heightened sense of uncertainty about the future regarding the European dept crisis and United States financial issues weigh heavy, a slow pace continues, and steps toward recovery are still weak.

■ **Trends of major countries and regions**

- The United Sates economy gradually grew in 2012. The United States economy proceeds gradually but firmly in 2013, avoiding the "fiscal cliff" problem temporarily. However, there are still concerns regarding political uncertainty about mid-term fiscal restoration plans and downturn influence caused by financial strain.

- In the European economy, financial markets have stabilized since the autumn of 2012 and the government bond yields have decreased. On the other hand, recovery of the real economy was delayed due to weak demand conditions and uncertain economic outlook. In 2013, economic performance is still fragile, including a high unemployment rate and reduced equipment investment.
- The Chinese economy has been decelerating gradually since the beginning of 2012 and a recovering trend was observed temporarily in the fourth quarter; however, deceleration is seen again in 2013.
- In 2012, emerging economies were mostly concerned with the economic slowdown; however, a sign of restoration was seen due to export recovery in the fourth quarter. Overall trends of emerging economies in 2013 are still growing as ASEAN 4 countries (Indonesia, Thailand, Malaysia and the Philippines) are growing firmly based on domestic demand, and Brazil shows gradual recovery including good consumer spending conditions. However, recovery in Vietnam is delayed, and India and Russia have continued to decelerate.

■ **Trends in Japan’s international trade and investment**

- Japan's 2013 trade balance faced its largest ever deficit as a result of the global slowdown due to export decrease as well as heat power generation LNG demand increase due to import increase.
- Exports of the major countries are currently recovering to pre Lehman Shock levels; however, Japan's levels have not yet recovered. It can be said that effects of the earthquake disaster have been seen, and when analyzing based on world export shares and trade specialization coefficient, the competitive strength of Japan’s exports is declining when looked at in the long term.
- Currently while Japan’s trade balance is trending toward deficit, the income surplus that makes up the current account surplus is high and, in addition to trade balance improvements, it is important to achieve income balance surplus expansion. Japan’s outward direct investment is at a low level compared to other advanced countries; however, use of outward direct investment with high relative investment return is effective in efficiently expanding income balance surplus.

Explanatory Notes

1. Abbreviated expressions

The main abbreviations used are as follows.

ADB: Asian Development Bank
APEC: Asia-Pacific Economic Cooperation
ASEAN: Association of South-East Asian Nations
BIS: Bank for 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 Services
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 Commision
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
World Bank: an abbreviation for the International Bank for Reconstruction and Development and the International Development Association.

* EPAs/FTAs

A "Free trade agreement (FTA)" is an agreement which proposes to abolish tariffs and other restrictive trade laws between the contracting countries. An "Economic partnership agreement (EPA)" is a wide-ranging series of agreements seeking to integrate market systems and economic activities into the elements of an FTA. Unless otherwise specified, this White Paper uses the FTA/EPA as a collective term inclusive of the tariff agreements under both the EPAs and FTAs (agreements to abolish tariffs and other restrictive trade laws within the region, and to establish the region as a uniform tariff region which applies the same tariffs and other restrictive trade laws toward countries outside the region).

2. Materials

The abbreviations of the main foreign statistics used are as follows.

(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
  PS&D: Production, Supply and Distribution Database (United States Department of Agriculture)

3. Figures/ mathematical expressions, etc.

(1) A year, written within the text or within a statistical table, is a calendar year (January-December) unless stated otherwise. Likewise, a financial year (FY) is the 12-month period from April 1 to March 31 of the following year, unless stated otherwise.

(2) Figures are rounded, as a general rule. Therefore, there are cases where figures are not consistent with the corresponding total.

(3) When used alone, with no values following it, the symbol “-” indicates that a value is unclear, cannot be reported, or does not exist for the relevant item, unless stated otherwise. A “0” indicates a value of less than one.

(4) This White Paper is based on the statistics, etc. available at the time of the writing. Later revisions, etc. are not reflected in this document.

4. Classification of countries and regions

(1) In some cases, the term “country” includes regions.

(2) The definitions of NIEs and ASEAN are as follows:

(a) NIEs are four countries/regions: South Korea, Taiwan, Hong Kong and Singapore.

(b) The first three of these countries/ region (South Korea, Taiwan and Hong Kong) are referred to as “NIEs3” in this White Paper.

(c) ASEAN is 10 countries: Thailand, the Philippines, Indonesia, Malaysia, Singapore, Vietnam, Brunei, Laos, Myanmar and Cambodia.

(d) The first four of these countries (Thailand, the Philippines, Indonesia, and Malaysia) are specially referred to as the “ASEAN 4”, and the first six countries/ region (Thailand, the Philippines, Indonesia, Malaysia, Singapore and Vietnam) are specially referred to as the “ASEAN 6” in this White Paper.

(3) “BRICs” refers to 4 countries (Brazil, Russia, India, and China) is referred to as.

(4) The European Union (EU) was founded when the Treaty on European Union came into effect in November 1993. The 12 countries of the EU at the time of foundation are referred to as “the EU12”; the 15 countries from January 1995, as “the EU15”; the 25 countries from May 2004, as “the EU25”; and the 27 countries from January 2007, as “the EU27.”

(5) In some cases, the term “Germany” indicates West Germany before the unification of the country. Because of this, there are cases where the figures for each year are not consistent.

(6) “OPEC” has 11 members: Iraq, Iran, Kuwait, Saudi Arabia, Venezuela, Qatar, Indonesia, Libya, the United Arab Emirates (UAE), Algeria and Nigeria. In many cases, however, the statistics from Iraq are lacking. Therefore, OPEC is deemed to include only 10 countries, excluding Iraq, in the analyses of statistics, as a general rule.

(7) “GCC” refers to 6 countries/regions: Saudi Arabia, Kuwait, Bahrain, Qatar, UAE and Oman.