

Japanese FDI in Asia and Asian FDI in Japan, a Locomotive to Promote Increasing Interconnected Prosperity

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I Introduction

We are living in a globalized world. Japan Economic Foundation has hosted a number of business executives roundtable discussions these several years on how they could achieve business expansion. All the representatives from the ten large Japanese companies, mostly multinationals, have responded to the question by saying that it would be crucial for their business to take full advantage of the benefits of globalization and minimize the cost of globalization. Their concerns in trying to do so have been how they could educate their employees to communicate well with their business partners overseas, how to increase non-Japanese staff and directors in their companies for strengthening their global marketing capacity and how to promote well their products in the overseas market. Some companies recruit actively non-Japanese staff not only in their overseas subsidiaries but also in their Japanese headquarter offices. Some companies set up a special PR team for their products not only in their headquarter offices but also in their overseas offices and try to coordinate their different needs for PR and create a common message to promote their product all over the world. At the same time, they are also working on somewhat differentiated marketing approach by country of their clients.

What is to be noted from those roundtable discussions is in particular that those companies are considering much higher overseas subsidiaries' business rather than trade business. FDI seems to be, in this regard, a more important vehicle to promote globalization. It is a bit more difficult for our business executives to be successful in FDI rather than in trade. Because, business by FDI such as setting up a subsidiary in a host country would necessitate much more knowledge and understanding of the host country's culture, economy as well as politics. They would also need a knowledge and good understanding of the host country's foreign relations and thus they would need a good understanding of global economy and politics as well.

This is the reality that our Japanese business executives are facing now. The rising risk of geopolitics today such as terrorism, North Korea, Ukraine, the global energy and the Middle East, China's aggressive foreign policy, refugees in EU etc. has added a point to be considered in their list of the factors for business decision making process and increased the need for the multinationals' business executives to be well aware of the global geopolitics as well. The question of geopolitics is not just a fire to be watched on the other side of the river but a serious factor for business decision making. They may not have to know well the functions and qualities of the weapons owned by the US Army but know well about foreign relations

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among the Asian countries.

Above all, we must add one more factor to be considered in the business decision, namely how populism, anti-elitism or anti-globalization would affect a nation's domestic politics.

Trade liberalization has been a locomotive to promote globalization. In order to maximize the benefits of trade liberalization and thus benefits of globalization, we would need to promote domestic structural economic reform in each country. To achieve a dynamism of the economy, we would need the industries and the companies losing their international competitiveness by free trade smoothly exiting the market and the new industries or companies with international competitiveness entering into the market.

Domestic structural economic reform encourages such smooth mobility of resources by deregulations or labour market policies encouraging labour mobility. However, those losing international competitiveness would tend to be a political interest group pressuring the government not to adopt such globalization friendly policies. Today, the group of people particularly feeling they are left out as losers in the race of globalization seems to be building up a strong political power all over the world. Providing a necessary safety net such as subsidy or grants to them would not be good enough to modify their anti-free trade sentiments. This phenomenon world widely observed today is rooted in increasing income inequality and it is further strengthened by its expansion.

This is a social phenomenon and could be closely connected with the aging society that is observed among the many countries in the world. Having this as a big political issue today in the world in their mind, our business executives would have to learn about it also as the factor for their business decisions.

Today our business executives would need to know about so many things, not only business and economy but also, politics, geopolitics and social issues. Besides, they are living in a global-

ized world where any country cannot survive solely but must pursue their position in the multilateral context such as in regional community or global community. In the case of Asia, for example, the manufacturing business among all the East Asian nations are building up so-called product value chain, a division of labour among the nations, the ones producing parts and components and the others engaged in final assembling to produce one single final product such as smart phone. Thus, it would be important to address all the questions of economy and business in the regional context rather than in the bilateral context.

To look at the issues a business company is facing, I believe in this way a holistic approach would be relevant rather than a single facet approach. Thus Japan-China business issue is also to be addressed in the regional context and also to be analysed holistically, not only in the context of business and economy but also in the context of politics and geopolitics.

This has been our Foundation's approach to any policy issue today and my paper is along with it.

1 Reality of Japanese outward FDI in Asia and inward FDI from Asia

Assuming that FDI is a new locomotive to achieve closer economic relations and growth and prosperity through it, what would be the reality of the interconnectivity between Japan and Asia through FDI?

On the statistics of FDI, we have limited availability of the updated data, which makes our discussion on FDI a bit outdated. However, the data, though not updated, would show you the trend in the long-run during the recent years.

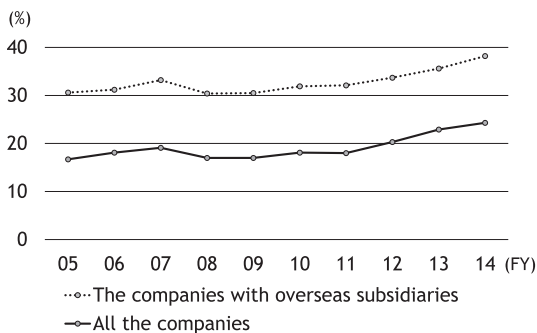
First of all, the Japanese outward FDI, seemingly a good indicator telling us Japanese companies' readiness to transfer their business overseas, has been steadily increasing today, contrasting to the age when Japanese business mind was more closed to the international

business environment than the other developed nations' ones about two decades ago. According to JETRO's report on World Trade & Investment in 2016, it reached to the amount of around 131 billion US\$ in terms of net flow in 2015, having decreased slightly, by 4.1% over 2014. However, it has exceeded 100 billion US\$ during the most recent five years in a row since 2011.

That resulted in having made the ratio of Japanese manufacturing industry's overseas production amount to total production reach 24.3% in 2014. This is the increase during the recent three years in a row.

Chart 1 shows you the recent trend of the ratio of Japanese manufacturing industry overseas production to total production. You can

Chart 1 Trend of the Ratio of Japanese Manufacturing Industry Overseas Production to Total



Source: METI "Basic survey of Japanese overseas subsidiaries' business activity"

see a steady increase of this ratio, implying that Japanese business activity today is steadily globalizing and its level of the internationalization is very close to the global standard, assuming that on an average, this ratio among the developed nations is around 25%.

Looking into a destination of Japanese FDI, Table 1 shows you US and ASEAN are the main destinations of Japanese FDI, occupying almost half of the total Japanese outward FDI in 2015. In the same year, Japanese FDI into China recorded about 9 billion US\$. In Table 2, you can compare the recent 10 years trend of Japanese FDI into China and the one into ASEAN, Both are the important destinations for Japanese FDI overall Japanese FDI into both regions have been increasing in the trend of 10 years from 2005 to 2015, implying both have increased their presence significantly in Japanese economy.

In this table, you cannot find the most recent trend of Japanese FDI. We do not know yet if

Table 1 Japanese FDI in 2015 by Destination

US	45 billion US\$
ASEAN	20 billion US\$
China	9 billion US\$
Total	131 billion US\$

Source: JETRO "Report on World Trade & Investment" 2016

Table 2 Trend of Japanese FDI (net, flow) to China and ASEAN

	2005	2011	2012	2013	2014	2015
China (million US\$)	6,575	12,649	13,479	9,104	10,389	8,867
ASEAN (million US\$)	5,002	15,721	14,349	23,619	23,134	20,244
Singapore	11.1	28.6	10.9	15.0	35.6	32.1
Thailand	42.5	20.4	29.4	43.1	24.8	18.8
Indonesia	23.7	23.0	26.6	16.5	21.3	17.6
Malaysia	10.5	9.2	9.1	5.4	5.6	14.0
Philippines	8.8	6.5	5.1	5.3	4.0	7.2
Vietnam	3.1	11.8	17.9	13.8	6.9	6.7
Others	0.3	0.6	1.0	0.9	1.8	3.6

Sources: "Statistics of Balance of Payments" (MOF, BOJ)

the slowdown of FDI from Japan into China and ASEAN observed in 2014 and 2015 would mean that Japanese business interest in both China and ASEAN has been cooled down. Our talk with the Japanese business executives reveals that their significant rise of the interest in Vietnam and Myanmar and saturation of the interest in China due to a rise of their wages urging them to search for another low wage country where they can take advantage of the low labor cost.

The significant decline of FDI from Japan into China in 2013 could be partly explained by an increase of political tension between China and Japan due to a rise of the territorial issue between the two countries followed by a rise of anti-Japanese riots and demonstrations in China.

The data of Japanese FDI into China by industrial sector is shown in Table 3. It is to be noted that while manufacturing FDI has been decreasing in the 10 years trend from 2005 until 2015, non-manufacturing FDI has been increasing significantly during the same period.

This could be a reflection of the increasing weight of non-manufacturing sectors in both nations. It is also to be noted that the weight of wholesale and retail sector has been significantly rising among the non-manufacturing sectors. This could be a reflection of the Chinese

wealthy consumers' rising preference for the Japanese food and the other products for daily use and the Japanese wholesale and retail companies like Seven & I Holdings are expanding their business in China.

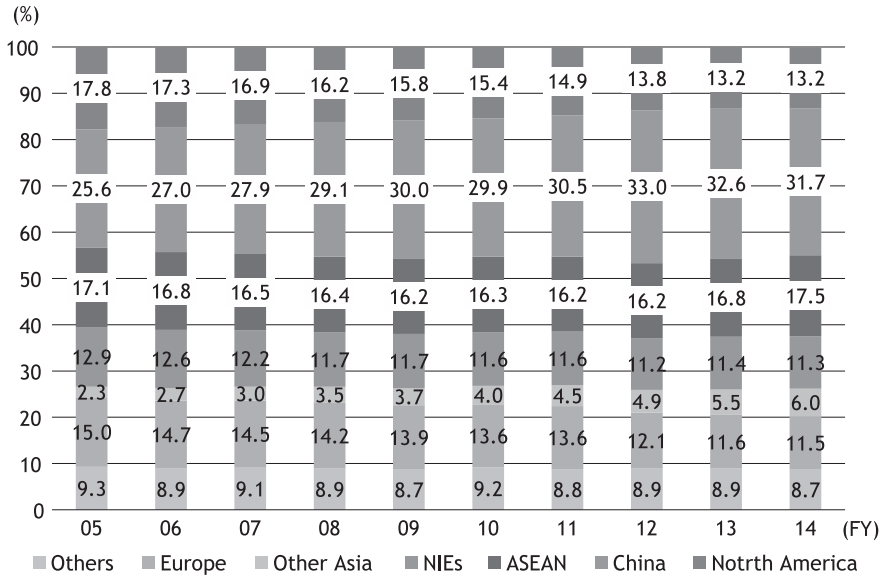
These are the observations based upon FDI data on net and flow. Since FDI is to be planned and executed in the long-run in a sense that the subsidiaries are planned to be engaged in production, sales and the other business activities for many years, we would need to see the data on the stock. One of those stock-based indicators is a variety of data concerning subsidiaries themselves. Chart 2 shows us the trend of regional allocation of Japanese overseas subsidiaries. China always occupies the largest percentage of the total overseas subsidiaries of the Japanese firms as a host country, followed by ASEAN 4 (Malaysia, Thailand, Indonesia and Philippines), NIES3 (Newly Industrialized Economies, Singapore, Taiwan and Korea). This means China is the most important business partner for Japan. However, looking at the percentage of the newly established subsidiaries by the host country, the weight of China has been decreasing from 2007 until 2014, in particular with notable decrease in 2014 (from 20.9% in 2013 to 11.3%). It is not clear yet if this decline has been caused by a rise of political tension between

Table 3 Japanese FDI to China by Industry

Industry	2005	2011	2012	2013	2014	2015
manufacturing	77.5	69.3	68.2	62.2	60.1	60.5
food	3.4	1.7	2.0	3.6	2.7	3.3
textile	4.3	4.3	1.7	1.0	△0.0	△ 0.6
chemicals & medicines	9.5	8.2	6.4	5.9	6.0	4.1
steel & non-ferro metals	5.8	10.1	6.8	7.3	5.0	2.7
general machinery	7.0	14.1	12.8	11.9	12.8	16.7
electric machinery	13.1	8.0	9.6	6.8	8.5	10.5
transportation machinery	15.7	11.7	21.0	17.6	16.2	14.2
non-manufacturing	22.5	30.7	31.8	37.9	39.9	39.5
whole sale & retail	7.3	14.9	14.6	12.2	18.8	20.1
finance & insurance	87.2	5.9	4.6	10.9	15.0	11.3
real estate	2.0	5.1	7.4	10.1	2.6	4.9
services	1.5	1.8	2.8	2.9	1.7	1.9
Total	100.0	100.0	100.0	100.0	100.0	100.0

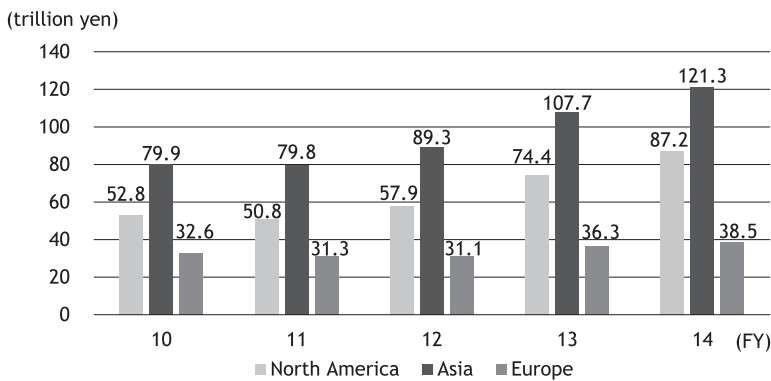
Sources: "Statistics of Balance of Payments" (MOF, BOJ)

Chart 2 Trend of Regional Allocation of Japanese Overseas Subsidiaries



Source: METI "Basic survey of Japanese overseas subsidiaries' business activity"

Chart 3 Trend of Sales of Japanese Overseas Subsidiaries (by Region)



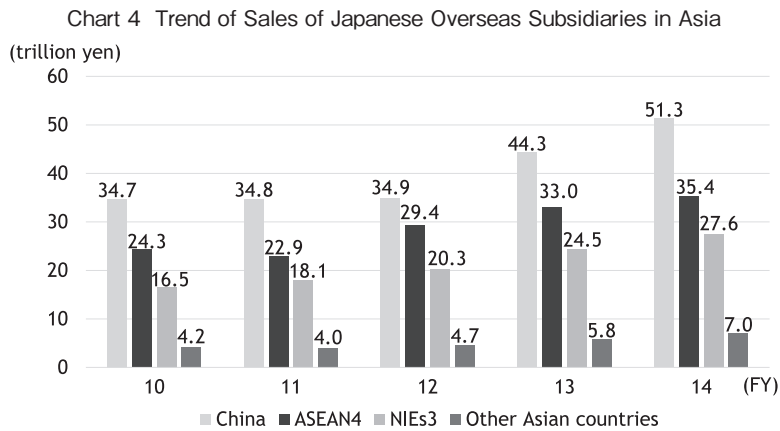
Source: METI "Basic survey of Japanese overseas subsidiaries' business activity"

China and Japan on the territorial issue or other reasons like a significant rise of Chinese labour cost.

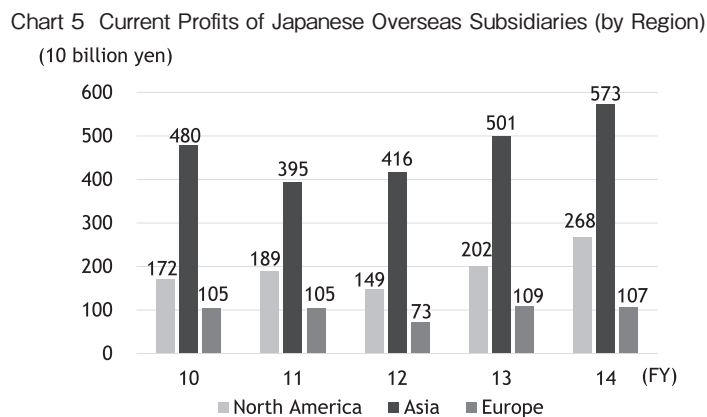
Next, I would like to show you the business performance of those Japanese overseas subsidiaries by location. As in Chart 3, in terms of sales, a basic indicator showing you the business performance, Asia occupies the largest share of the total Japanese overseas subsidiaries' sales among Asia, North America and Europe. Among the Asian nations, as in Chart 4, China has the largest share of the sales in Asia in comparison to the groups like ASEAN and NIEs 3.

Chart 5 shows us current profits of Japanese overseas subsidiaries by region, another indicator showing you their business performance. The Japanese subsidiaries located in Asia have been enjoying the largest current profits among Asia, North America and Europe from 2010 until 2014.

In terms of the number of the employees of those subsidiaries and their private investment in business and production facilities, Asia has been always excelling over the other two regions, North America and Europe. Thus, the Japanese subsidiaries have contributed well to



Source: METI “Basic survey of Japanese overseas subsidiaries’ business activity”



Source: METI “Basic survey of Japanese overseas subsidiaries’ business activity”

job creation in Asia.

Among the Asian countries, China has been the largest beneficiary of the Japanese subsidiaries in terms of job creation, however, in terms of created private investment by the Japanese subsidiaries, ASEAN 4 has been its largest beneficiaries.

2 Outlook of Japanese outward FDI in the future

Will this trend of Japanese outward FDI continue in the foreseeable future as well?

Asia and China will continue to be principal partners for Japanese business in terms of FDI? Those are the questions crucial in talking about the future perspectives of Japan-Asia or Japan-China economic relations.

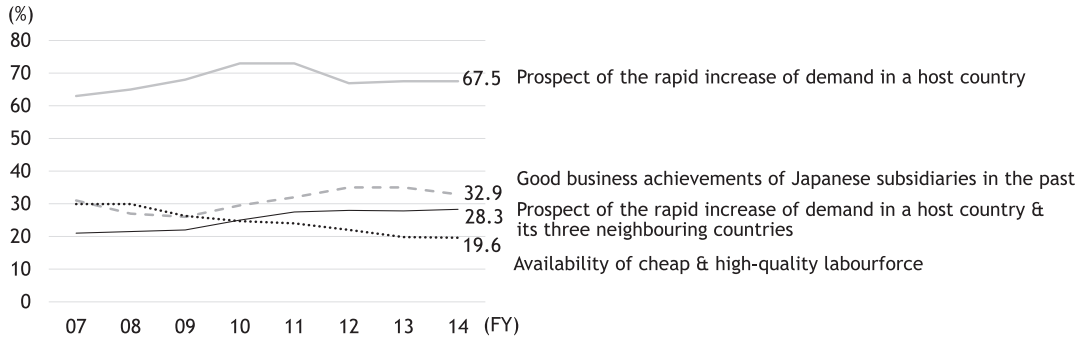
My answer is: Yes, this trend will continue

and Asia and China will continue to be the Japanese business companies’ principal partners.

Firstly, trade is now increasingly replaced by FDI, as the developed nations’ domestic markets are saturated and the business would not expect a rise of the significant market growth there, there would be very little choice for the business in the developed nations but to pursue new markets in the developing nations with rapidly expanding domestic markets. Setting up their subsidiaries in those countries and starting a business there would be the best business option for gaining the competitive edge in the international competition rather than export and import. The Japanese firms are no exception.

Chart 6 shows you different motivations of the Japanese firms for outward FDI, setting up overseas subsidiaries etc. Prospect of the rapid

Chart 6 Trend of the Motivation for Outward FDI of Japan



Source: METI "Basic survey of Japanese overseas subsidiaries' business activity"

increase in demand in a host country has the highest proportion among the different motivations to determine FDI. This motivation is to be fulfilled in the rapidly growing Asia and China in the future as well.

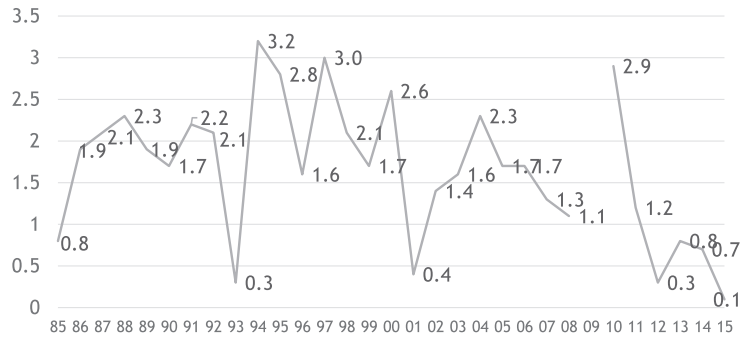
Good business achievements of the subsidiaries would be the second strongest motivation to determine FDI. As we saw, Japanese subsidiaries in Asia and China have achieved good business performance in terms of sales and current profit. Thus this motivation will continue to work well in promoting Japanese FDI in Asia and China. The third motivation, prospect of the rapid increase in demand in a host country and its three neighboring countries, would also work well in the future as well in favor of China, since its neighbors will also enjoy a prospect of high growth in the future. The last one, availability of cheap and high-quality labor force, is decreasing its weight in determining FDI these recent years. This means that Japanese firms today would increase their overseas subsidiaries regardless of the labor cost, if they can expect high growth of the host country's market. This would work well in favor of China as a destination for FDI, though its labor cost is rising today.

We have Quarterly Statistical Review of Japanese overseas subsidiaries business performance made by METI. We can have a short-term prospect of their business performance by DI of sales amount (Diffusion Index=the number of

the subsidiaries with positive prospect of their sales- the number of the subsidiaries with negative prospect of their sales). According to this review announced in September 2016 featuring April-June Quarter in 2016, sales DIs in Asia and China for July-Sept. Quarter and Oct.-Dec. Quarter were positive and increasing, while the ones in the US and Europe were decreasing. Thus we have a positive outlook for the Japanese subsidiaries in Asia and China both in the short-run and in the long-run.

There is one concern about the slow trade today. Chart 7 shows us the ratio of the world trade growth to the world GDP growth rate is recently decreasing, implying that the global trade growth is significantly lower than the world GDP growth rate. One explanation is that this is to be caused by the slowdown of the development of global value chain created by the division of labor of producing parts and assembling the final pieces among the subsidiaries by FDI and their headquarters. This could mean a slowdown of FDI as well as trade. However, this is probably not the case. According to METI's Basic Survey of Japanese overseas subsidiaries' business activity, the local procurement ratio of the Japanese subsidiaries in Asia to the total procurement of parts and materials has increased from 67.0% in FY2005 to 74.3% in FY2014. The increased production capacity in the Asian host countries including China for Japanese subsidiaries would enable the Japa-

Chart 7 The Ratio of the World Trade Growth Rate to the World GDP Growth Rate



Sources: "WEO, April 2016" (IMF) & "IFS" (IMF)

Table 4 The Structure of the Inward FDI in Japan by Region

	2000	2010	2011	2012	2013	2014
World	100.0	100.0	100.0	100.0	100.0	100.0
Asia	7.8	10.8	11.8	13.5	14.4	15.5
North America	32.3	34.4	32.2	30.8	31.6	29.8
Europe	51.6	42.9	45.1	46.1	46.3	46.6
Latin America	7.0	11.0	10.0	8.6	6.7	5.9
Oceania	1.1	0.6	0.6	0.8	0.9	1.8
Middle East & Africa	0.2	0.2	0.3	0.1	0.1	0.4
The ratio of the inward FDI in Japan (stock) to GDP of Japan	1.2	3.9	4.0	4.0	4.1	4.9
Inward FDI in Japan (stock, 100 million yen)	60,958	187,353	188,238	192,273	195,510	237,480

Sources: MOF, BOJ, Cabinet Office

nese subsidiaries to work on production with less dependency upon the imported parts and components from home country, which has led to decrease of trade.

The slow trade would be also explained by cheaper primary commodities including petroleum which are the main exporting items from the developing nations.

Table 4 shows us that the inward FDI in Japan is steadily increasing, however it still remains to be low. The ratio of the inward FDI in Japan (stock basis) to GDP of Japan has been increasing since 2000 and finally having reached almost 5% in 2014, however, it is still much lower than in Europe or the US where the figure reaches higher than 20%.

But it is also to be noted in this table that the percentage of Asian FDI in Japan in total inward FDI into Japan has steadily increased towards 2014, showing us an increasing pres-

ence of Asian countries in Japan.

As the number of the tourists visiting Japan has been increasing and having finally reached 20 million recently, it is pointed out that the success cases of the inward FDI into Japan are increasing in the tourism area. In the case of Chinese FDI in Japan, large duty-free shops from China are expanding their business facilities all over Japan and Chinese companies are increasingly acquiring Japanese hotel facilities. Towards 2020 when the Olympics and Paralympics Games will be held in Tokyo, the number of the visiting tourists in Japan will significantly further increase and we expect many more companies overseas will be involved in the tourism business in Japan.

3 How to solve "Asian paradox"?

Through FDI, Asian economy and Japanese economy are tightly interconnected as the

abovementioned. However, we see political tension rising in the Asia, in particular among China, Japan and Korea often provoked by the territorial issues between China and Japan or between Japan and Korea, history issues during the era of the Japanese occupation of Korea and China, the issue of Japanese responsibility for the damage suffered by China and Korea during the World War II etc.

While business interlinkage is closer, political confrontation is rising. This is what we call "Asian Paradox". How can we solve it for the interest of the business in Japan and Asia overall enjoying the benefits of the business and economic interlinkage emerging in this area by increasing FDI?

The most serious political tension hampering the close business interlinkage in the East Asia (ASEAN plus China, Japan and Korea) is observed among China, Japan and Korea. And at the same time, it is true that the weight of those three nations' economies and trade is the most significant in the East Asia.

With mitigation of the existing political tension among the three nations, economic integration of the East Asia including ASEAN countries would be promoted. The regional FTA would be a key to achieve such economic integration which could facilitate a good business environment for the product value chain expanding all over those nations in the East Asia through FDI.

Japanese foreign policy would need to pursue a mitigation of political tension among the three nations in the East Asia in order to facilitate the East Asian economic integration. This would be also necessary for the interest of Japanese economy as well. It would be crucial for the Japanese economy to take full advantage of the Asian economic dynamism by strengthening trade and investment relations with the East Asian countries.

There is an argument on a possible option of Japanese foreign policy for achieving it that it

would be important to create an international opinion encouraging China to join more actively a multilateral rule making or discussing venue such as APEC and thus provide an opportunity for them to learn about the international rules. The advocates for this argument would hope Chinese aggressive foreign policy could be modified by participating in such an international discussion. On the other hand, Chinese interest in participating or initiating a multilateral institutional framework must be welcome by the rest of the members of the international community. In this light, the recent Chinese initiative to found AIIB (Asian Infrastructure Investment Bank) aiming at providing social infrastructure for the poor Asian countries, a possible contribution on the Chinese side to establishing an institution for peace and prosperity in Asia must be appreciated.

However, apart from this approach, we would need to continue our efforts to ameliorate the foreign relations among the three nations by ourselves.

Before mentioning about a possible prescription to ameliorate political tension among the three nations, I would like to review the current global economic situation and each of the three countries' recent economic trends and the interlinkages between the three nations.

II The Global Economy

Looking at the growth potential of the global economy, it is on a long-term downward trend, caused by a decline in the productive working population and private investment. In this light, we can say the world economic outlook is under increasing downside risk. Under these circumstances, particularly since the Lehman shock in 2008, most of the major OECD countries are pursuing growth by expanding exports. Thus, FTAs like the TPP and RCEP are increasingly expected to play a pivotal role in achieving

robust global economic growth.

Meanwhile, the newly emerging nations like the ASEAN countries, having shown high economic growth even after the Financial Crisis, are now facing a decline in the working-age population. With the slowdown of economic growth as a result of this working population decline and also a price fall of natural resources like crude oil, coal, and iron ore due to excess supply of these resources caused by the Shale gas revolution, even countries like Russia and Brazil that are rich with natural resources have recently seen negative growth rates.

In such a situation, I believe Japan, China and

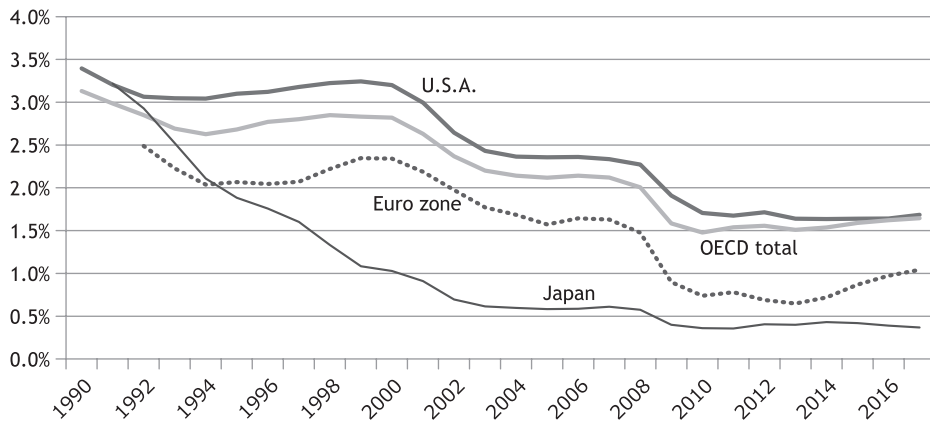
Korea must be a locomotive to promote world economic growth.

III The Japanese Economy

The Abe administration is making every effort to realize “the new three arrows” as the second stage of Abenomics.

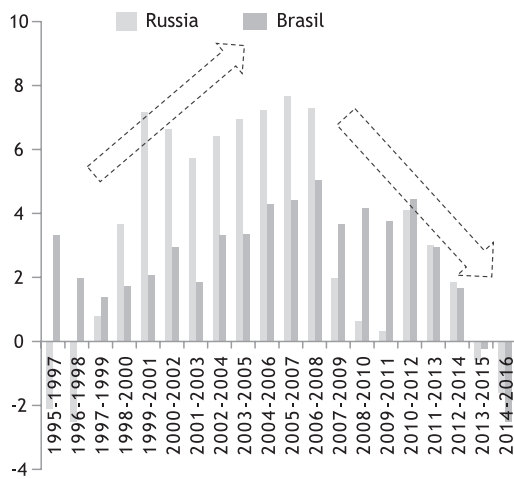
As a matter of fact, in the three years since the change of administration at the end of 2012, our nominal GDP has increased by around 26 trillion yen to achieve a total of more than 500 trillion yen for the first time in eight years.

Chart 8 Economic Growth Potential Rate of the Major Developed Nations



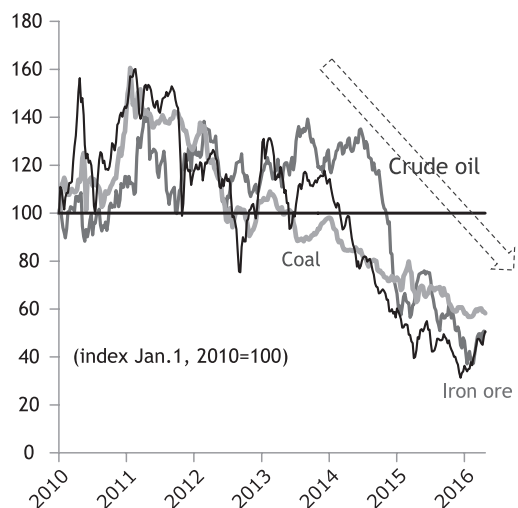
Note: simple moving average during each tem. The figure in 2016 is predicted by IMF.
Source: IMF World Economic Outlook Database April 2016

Chart 9 Real Economic Growth Rate of the Major Natural-Resource Rich Countries



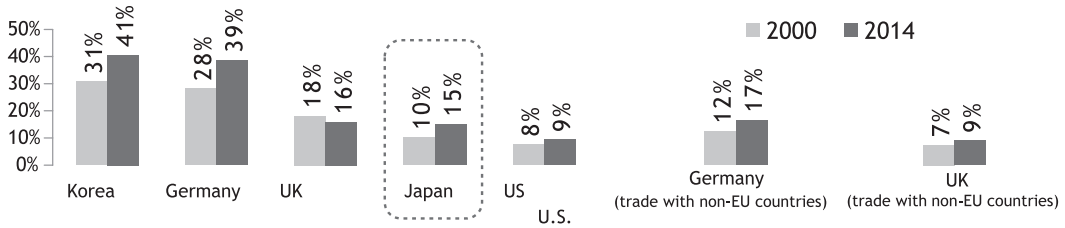
Source: IMF World Economic Outlook Database April 2016

Chart 10 Trends in Major Commodity Prices



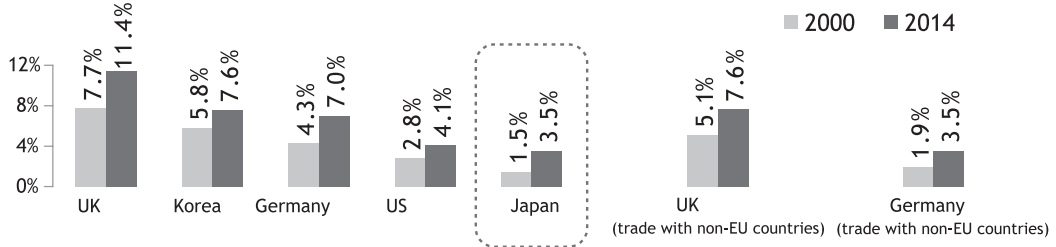
Source: UNCTAD

Chart 11 The Level and Trend of the Ratio of Exports of Goods to GDP



Sources: Ministry of Finance "Trade Statistics"

Chart 12 The Level and Trend of the Ratio of Exports of Services to GDP



Sources: Ministry of Finance "Trade Statistics"

Corporate performance in terms of profits has recently improved significantly and the sum of current corporate profits was 16.7 trillion yen in April-June 2016, the most recent figure, having increased by around 4.6 trillion yen over the same quarter of 2012.

Reflecting such a stable trend in the economy, data such as the unemployment rate or the effective job openings-to-applications ratio are today showing positive signs. The unemployment rate was 3.0 % in July, the lowest in about 21 years, and the effective job openings-to-applications ratio was 1.37, the highest in about 25 years. This ratio has exceeded 1.0 among all the prefectures in Japan for the first time in our history.

At this moment, we are now seeing a labor shortage all over the nation. In coping with this, the introduction of labour-saving technologies such as robots or AI and labour-market reform to take full advantage of the diversity of the workforce is a big issue for Abenomics.

Our private investment has exceeded 10 trillion yen since the second half of 2015, but at this moment it is flattening. The Japanese gov-

ernment is thinking about promoting business investment to boost productivity and pursue a further increase in corporate and private investment through close collaboration between business and government.

On international trade, though our exports ratio to GDP has been slightly increasing in recent years, it still remains at a low level compared with other OECD nations. In order to achieve sustainable growth from now on, we will need to raise productivity by taking full advantage of overseas demand.

IV The Chinese Economy

On the Chinese economy, China achieved high economic growth in the 2000s by export expansion through attracting FDI as well as active investment in infrastructure and production facilities.

In particular, in coping with the world economic crisis triggered by the Lehman shock, the Chinese government implemented a variety of counter-cyclical measures including a 4 trillion

yuan policy package, and it was successful in sustaining its high growth and working as an engine of global growth.

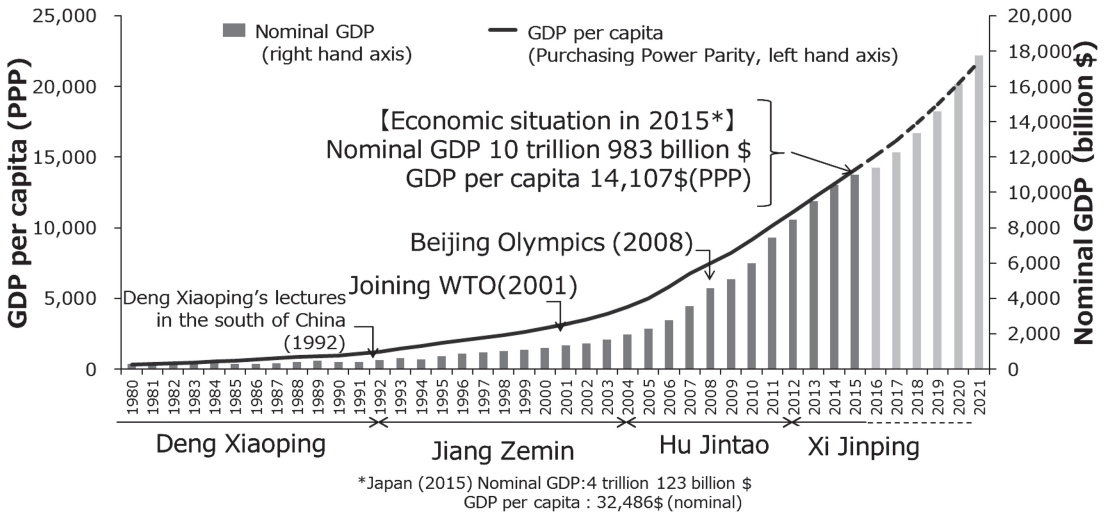
However, in this process, in my view, they are now facing difficulties such as over-production capacity due to the significant expansion of production capacity brought about by those policies, as well as an expansion of the debt of national corporations and local governments.

Looking into GDP by region, the coastal areas

or the inland areas in the West are maintaining growth, but in areas like the Northeast with many industries suffering from excess production capacity, growth is declining.

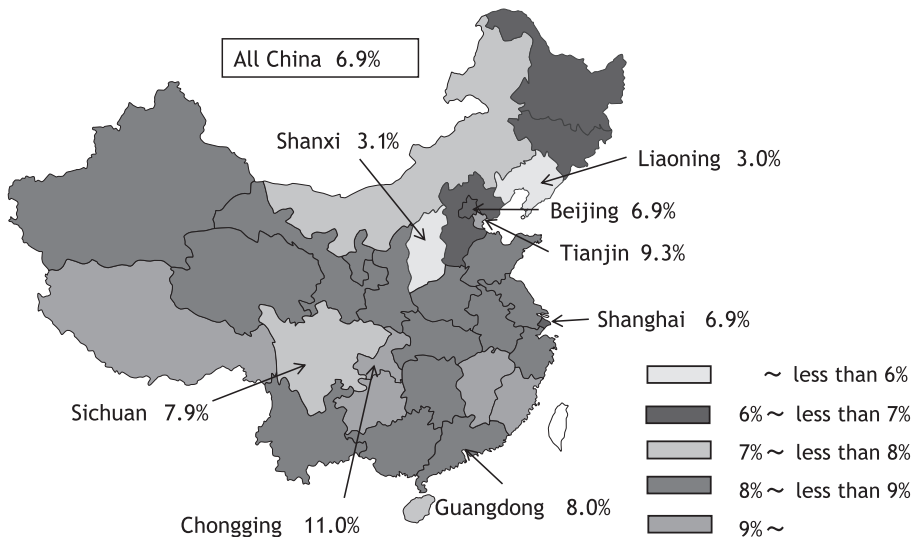
Under such circumstances, I understand that the Chinese government recommends business firms to get rid of old and inefficient production facilities and continues to restrain new investment in those industries with excess production capacity.

Chart 13 Long-term Trend of Chinese GDP



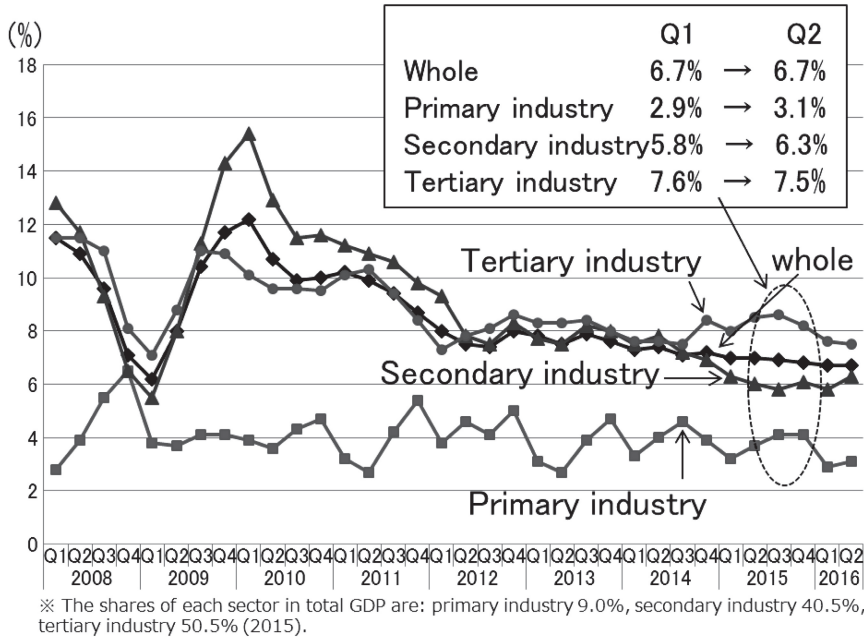
Sources: IMF World Economic Outlook Database (April 2016)

Chart 14 Real GDP Growth Rate of Each Region (2015)



Sources: National Bureau of Statistics of China

Chart 15 Trend of Chinese Real GDP Growth (quarter)



Sources: National Bureau of Statistics of China

Thus, the Chinese economy is now facing a wide range of structural issues including a need to get out of the investment-oriented growth model with excess production capacity. In coping with these issues, the Chinese government, perceiving this transition from high-speed growth to medium high-speed growth as the “new normal” state, is now changing its basic policy direction. Particularly, the 13th Five-Year Economic Plan adopted by the National People’s Congress in March 2016 set an annualized economic growth rate target of more than 6.5% during the five years from now on towards realization of the ultimate goal, which is to double the GDP and national income of 2010 by 2020. As for other policy goals in 2016, to achieve “new normal” growth the government lowered the targeted growth rates for GDP, investment and consumption and showed a policy stance to support the economy for macroeconomic stability by raising the rate of increase in money supply or stabilizing the value of the currency. In addition, it is also working on the elimination of excess production capacity, reform of national

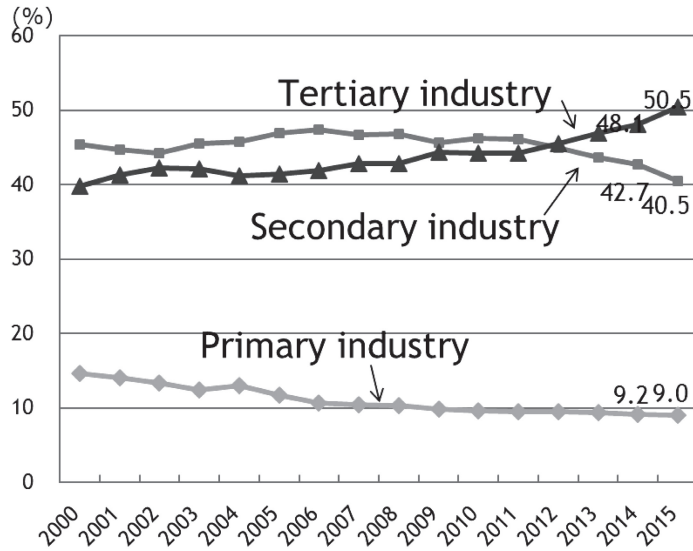
enterprises and enhancing added value in the manufacturing industry as part of structural reform.

In reality, though, the second industry’s growth is slowing down, and the economy is undergoing a transformation into a more tertiary industry-led economy. This resulted in the tertiary industry’s proportion of GDP having exceeded 50% in 2015 for the first time in history. This shows that the economic structure heavily dependent upon investment growth is now being transformed from an “investment-oriented one” to a “consumption-leading one”.

V The South Korean Economy

On the Korean economy, the GDP growth rate has been gradually recovering since 2012. However, the growth rate in 2015 was only 2.6% over the previous year due to stagnant domestic demand brought about by the spread of MERS (Middle East Respiratory Syndrome). The latest economic growth forecast seems to

Chart 16 Trend of Share of Sector to GDP in China



Sources: National Bureau of Statistics of China

be on a downward trend, but it is still maintaining higher growth than Japan.

I understand that the South Korean government is now engaged in dealing with the issues of structural reform related to trade structure and industrial structure. Korea has long had a competitive strength in trade, and more specifically half of its GDP is created by trade and it is particularly notable that it enjoys a large trade surplus with China, a big market for its exports.

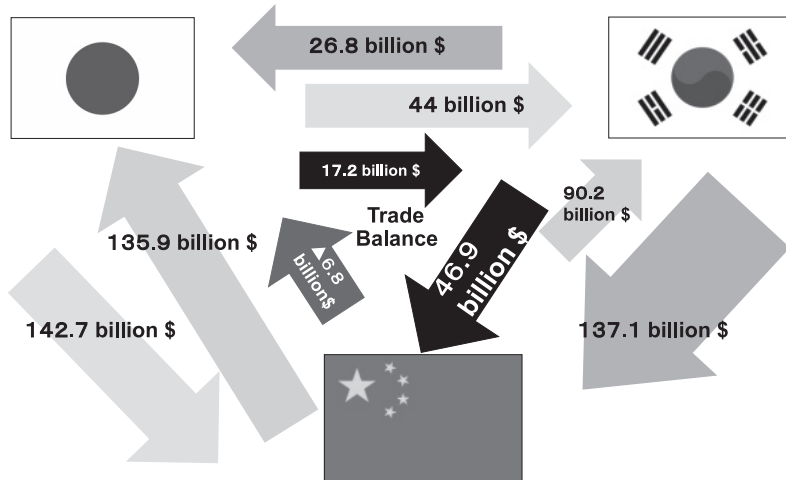
In addition, it is also to be noted that Korea is building up FTA networks with the rest of the world to take advantage of this strength. At the end of March 2016, the trade amount to be covered by FTAs put into effect reached 67.3% in the case of South Korea, while in the case of Japan it is only 22.7%. Therefore, Korean companies are in a better environment to engage in broader overseas business activities. In recent years, their exports to Vietnam and Mexico have been increasing. Through the expansion of investment in Vietnam by Korean business firms, many products are exported from South Korea to Vietnam and in 2015 exports to Vietnam surpassed those to Japan.

Against this background of an accelerated

increase in transfers of automobile production facilities to Mexico, Korean FDI in Mexico has increased as well as exports including auto parts.

As well as such a structural change in trade, South Korea's industrial structure is also in a transition period. Being affected by the worldwide excess supply capacity of industries, there are some businesses falling into a management crisis in principal industries such as shipbuilding, the third-biggest exporting industry in South Korea, petrochemicals (the fifth) and steel (the ninth). In coping with this situation, the government, I understand, is steadily working on industrial structural reform in order to lead an autonomous adjustment to promote new growth industries by implementing the "Business Vitalization Act" this August, which aims at supporting business restructuring in the five industries – steel, petrochemicals, construction, shipbuilding and marine transportation – designated by this law as the five biggest business-cycle sensitive industries.

Chart 17



Sources: GTA (based upon each nation's data of imports)

VI Economic Interlinkages

Now I turn to the question of economic interlinkages between these three economies. Japan, China and South Korea together constitute one of the engines of the global economy. In 2015, the total GDPs of the three nations accounted for 22.6% of global GDP and their total goods trade amounted to 18.4% of global trade. So the three countries' market is a gigantic one. Looking at their respective trade relations, the Japanese trade amount with China is approximately four times as big as that with South Korea, while South Korean trade with China is around three times larger than with Japan. Both nations are thus more linked to China than to each other.

I believe it is important and critical in terms of Asian economic development and eventually global economic growth that these three nations achieve regional economic development by FTAs and other economic alliances and collaborations in a wide range of areas.

In October 2015, in Seoul, the "Japan, China, Korea Trade Ministers Meeting" was held after a lapse of three and a half years to discuss

trade, investment and economic cooperation. Korean Minister of Trade, Industry and Energy Mr. Yoon Sang-Jick chaired the meeting and our METI Minister Mr. Motoo Hayashi and Chinese Trade Representative Mr. Zhong Shan also participated. They agreed to make further efforts to accelerate trade negotiations to conclude a CJK FTA and the RCEP, and also promote further collaboration to strengthen multifaceted cooperation towards "enhanced connectivity of supply chains" through trade facilitation for physical distribution and customs services.

The conclusion of the meeting was announced in the appendix to the joint declaration of the "Japan, China, Korea Leaders Meeting" held in November 2015 in Seoul, also after a three-and-a-half-year gap.(ref.1&2) I understand that the next meeting will be chaired by Japan and Japan invites the Chinese and South Korean heads of government as well as the ministers in charge of trade and economy here to Japan for the Japan-China-Korea Summit Meeting and the three countries' Economy and Trade Ministers Meeting.

In the previous section, we learned that all the three nations are currently facing an urgent need for structural reform and trade and economic policy would be their key interest in

achieving it. In addition, environmental policy is also an urgent need for the three nations, in particular for China suffering from the serious air and water pollution due to a rapid economic growth. It would be useful to open a trilateral policy discussion to mitigate those urgent challenges. We can expect amelioration of the political relations by organizing a venue for the exchange of views and information on each country's policy experiences concerning those challenges, since they can learn from each other well and take advantage of the knowledge acquired in those venues for mitigating those challenges they are facing now.

I would like to introduce you one of those attempts by Japan Economic Foundation as follows. JEF started this attempt as "China-Japan-Korea Policy Dialogue" in 2014 and following the first two meetings, one in Korea in 2014 and one in China in 2015, Japan(JEF) hosted the third meeting.

The 3rd CJK (China-Japan-Korea) Cooperation Dialogue was held at International House in Roppongi, in Tokyo, on Oct. 20 and 21, 2016 through close collaboration between the Japan Economic Foundation, the China Foreign Affairs University and the East Asia Foundation of South Korea, the three co-sponsoring organizations. Whereas the preceding two dialogues mainly focused on sharing information about trade and economic policies and environmental policies, this dialogue tried to achieve mutual trust through more in-depth discussions of the domestic policy agendas for structural reform that all three nations share.

VII Discussions on Economy

I have been working for METI and JEF for nearly 40 years, with a strong focus on trade policy based upon free trade and investment principles. In my work experience I learned neo-

classical economics, paying respect to the role of market mechanisms in international trade in achieving optimal allocation of resources. With this in mind, I would like to start my comments on the trade part of the discussions.

The JETRO Report on International Trade 2016 pointed out the slow growth of global trade in 2015, namely a 12.7% decrease over the previous year, the first negative growth in the past six years. They call the phenomenon of global trade growth being lower than world GDP growth slow trade. Surprisingly, this trend of slow growth has been continuing consistently since 2012 and the ratio of global trade growth rate in real terms to world GDP growth in real terms has been around 0.5. Looking at regions, we see significantly slow growth among the developing nations and the newly emerging economies. A cyclical factor causing this may be the stagnant growth of private investment worldwide, reflected in the global stagnation of trade in capital goods or intermediary goods since 2012, while a structural factor of this slow growth is the increase in production capacity of parts and components among developing countries, including China. This could result in the slowdown of intraregional trade in Asia between company headquarters and their subsidiaries in host countries. Thus, what we call the global value chain process may have been significantly decelerated.

In our conference, we discussed trade issues mostly from the perspective of political economy, namely free trade and structural economic reform worldwide. First, it was noted that trade liberalization is an important vehicle to promote economic growth. Until today OECD countries have been achieving growth during this decade through increasing dependence upon exports. Asian countries, in particular China, Japan and South Korea, will need to promote their structural economic reforms to take full advantage of the merits of international trade.

Our CJK delegations all agree to promote

regional FTAs. Mega-regional FTA such as RCEP – should be the leading engine for Asian regional trade liberalization in the light of trade promotion in this region. The consensus in our group was that regardless of who is leading each mega-regional FTA, the possible delay in ratification of the TPP would retard RCEP or CJK FTA negotiations, which would have a negative impact upon the Asian economy. In particular, a possible US withdrawal from TPP would be considered a negative sign for all three countries' trade and investment promotion aimed at expanding supply chains in this area.

This discussion showed us how crucial the role of the US is in our region. Many of our participants in the panel discussion expressed concern about the future of US trade policy and the delayed mega-regional FTA negotiations and mentioned the need to quickly promote other sectoral multilateral trade agreements such as the Information Technology Agreement (ITA) with expanded coverage of trading items, or the agreement on trade of environmental products, since they would get a consensus much more easily than with the TPP or RCEP.

For the three nations, the weight of digital trade is increasing and thus we will need rules on e-commerce as quickly as possible. This is important for the interests of SMEs in particular, to encourage them to join in the international or intraregional trade between the three countries.

The three nations' economic growth is slowing down and whether or not their trade liberalization efforts will need structural reforms to their domestic economies to maximize the benefits of free trade, they will have to proceed with structural reforms to achieve robust economic growth for their welfare and prosperity. It was noteworthy in our discussions that all three nations had no doubts about the need for growth, which is somewhat different from similar policy discussions in Europe where they

make a distinction between economic growth and social welfare. They assume that the latter should be the ultimate goal of economic policy, and so the former would not be absolutely necessary to achieve this.

All three nations now face structural impediments to growth and so need to eliminate them to achieve it. Japan will need to stimulate innovation to raise its labor productivity, which would also respond to the declining labor force due to aging and depopulation. It will have to eliminate so-called bedrock regulations to stimulate innovation and entrepreneurship. China will need to rationalize its state enterprises to eliminate its over-production capacity and orient its economy towards a more consumption-led one. Shipbuilding and some other heavy industries in South Korea which used to have a strong edge in international trade are now losing their competitiveness. The government has just started a smooth industrial adjustment policy to eliminate inefficient companies in those sectors losing competitiveness and achieve a transition of industrial structure from heavy industries to high technology-oriented ones.

In discussing these issues related to growth strategy, other socioeconomic issues came up, such as aging and depopulation, rising income inequality, and how to promote and take full advantage of the fourth industrial revolution, in other words data-driven innovation such as AI and robots. These new issues were outside the scope of our two preceding dialogues, but without discussing them now we cannot gain a full picture of growth strategy over the long term. In this regard, it was very encouraging for us to get into discussions on these new issues at this stage, and we can continue to deepen our thoughts on them at future meetings. Aging and depopulation will enhance the need to raise our labor productivity in order to maintain growth, and income inequality will hamper our personal consumption, as the less wealthy middle class would consume more than most wealthy people

do. Data-driven innovation will be, needless to say, a good potential source of future growth.

VIII Discussions on Environment

The second part of the dialogue was devoted to discussions on the environment. Whereas the preceding two dialogues focused on the exchange of information on past experience of environmental policies, this one highlighted the future, in particular how to achieve green growth, assuming that economic growth and the environment are compatible. This discussion also saw a striking difference from what dominates policy discussions among OECD countries, namely that pursuing growth is not a relevant goal anymore.

All three nations agreed that green innovation, environment-friendly technological innovation, should offset the cost of strengthened environmental regulations and could enhance industrial competitiveness. They also agreed that increased demand for environmental amenities could create new business opportunities. On the question of environmental regulations, what we call the Michael Porter hypothesis was mentioned in the discussions – that is that well-designed environmental regulations could stimulate technological innovation. The Japanese regulation on automobiles' CO₂ emissions was mentioned as a good example of how this principle can work well in reality.

Carbon pricing is perceived by all as an effective means of CO₂ reduction, assuming that market mechanisms function well in the carbon market to minimize the cost to the environment, since such costs need to be counted in any industrial activity and if they are not minimized, industry could lose its competitiveness. Possible differences in pricing among nations could provoke arguments over international competition, and therefore international harmonization of carbon pricing would be necessary to avoid them.

On a different note, the low-carbon infrastructure we will need from now on is very costly and how to finance it should be a crucial policy agenda issue. In this light, it would be important to recalculate the green value of economic growth which is expected to be bigger than the cost of CO₂ emission reductions. In achieving a green environment consistent with economic growth, one business representative highlighted the role of local communities. We will need a broader scale of cooperation among businesses, universities and policy practitioners in order to reduce air pollution or water pollution. In addition, we will need a local community's perspective to create amenities for the local residents' welfare.

We also discussed some specific issues related to the environment. Many expressed satisfaction at the smooth ratification of the Paris Convention for Global Climate Change which was agreed upon in 2015. This was a significant difference from the usual FTA ratification process today. The Paris Convention will bring huge business opportunities for technological and social innovation for green growth.

On possible collaboration among the three countries in the energy and environment area for achieving green growth, the Asian super grid aimed at achieving interconnections in electric power supply from renewable energy sources among Asian countries, proposed by Softbank CEO Son Masayoshi in June 2016, was mentioned as a mutually beneficial idea and on the issue of PM_{2.5}, air pollution from the rapidly industrializing China affecting neighboring nations, China will need to learn about environmental protection mechanisms from Japan in order to reduce it.

In concluding, all supported a holistic approach to the global environment by balancing all interests of economy, energy, environment and society, and we should rely on an interdisciplinary approach rather than a segmented one.

IX Overall observation

We have been successful in expanding the common agenda at our dialogues. In our earlier dialogues, discussions focused on sharing information and experiences on trade and economic policies and environmental policies, but in this dialogue we expanded our topics towards growth strategy overall, including the concept of green growth. We will now discuss any issue related to our economic growth and prosperity, or even happiness, if achieving income equality and a green environment can be considered a way to happiness. In discussing this broader range of issues, we can deepen our understanding of each other's culture, values and way of thinking. So I believe that we can transform our dialogues from simple exchanges of information into discussions for creating mutual trust and friendship.

Asia, at this moment seemingly one of the largest beneficiaries of globalization, should play a more pivotal role in maximizing the benefits of globalization that would exceed its cost and thus show the rest of the world that globalization can work well for their benefit. China, Japan and South Korea are responsible for promoting this role.

We will continue our dialogues to enhance the three nations' contribution to global peace and prosperity. We will also continue to adopt a holistic and balanced approach to all issues, not only the environment but also trade and economy, since I believe that today all economic, social and political issues are connected and we cannot separate them in pursuing the best solutions.

Meanwhile, I took a note of one Korean delegate's opinion about our future dialogues. He said to me at our dinner table that we should have more lawyers in our dialogues. Given that lawyers may be in a better position to provide

an institutional perspective on policy issues, this certainly deserves attention. Institutional comparisons between the three nations on economic and environmental policy issues could be another way to strengthen mutual trust and friendship.

How should the business community cope with the current globalization?

First, they would need to try to achieve better communication with people in their host country, since their overseas business is to be mainly promoted by FDI. More specifically, there are two ways to achieve it. One way is to employ more people in a host country for their subsidiaries and headquarters to facilitate good communication between the Japanese business community and the non-Japanese business partners and clients. The other way is to post their Japanese employees in an overseas subsidiary or office for a longer time than now. Ten years' working experience in a host country would be able to make them adjust well to a host country's culture and they can work well as a communication mediator between the Japanese headquarter offices and their subsidiaries.

Second, the business community would need to understand well the whole picture of global economy and geopolitics. They would need a comprehensive knowledge and wisdom to cope with the world where politics and economy are closely interlinked.

Segmented approach to any business issue would be dangerous. They would have to be accustomed to a holistic approach to any challenge, since they cannot understand a host country's economy without good knowledge and understanding about the background of global economy and geopolitics.

Third, they would need to be well prepared for any geopolitical risk, including terrorism. Today, there are increasingly high risks of geopolitical challenges and as far as they are engaged in the business anywhere in the world under FDI initiating globalization, they would

need to think about how to overcome them. If they avert the risk all the time, they will lose a business opportunity. Thus, they would have to bear a wide range of the risks in their mind and blueprint the business strategy by setting up a variety of scenarios depending upon the nature

and the prospect of risks and in line with their blueprints, they occasionally have to take risks. Good preparations for risks by dwelling upon well the risk scenarios would make business people courageous enough to take necessary risks and secure their business opportunity.