Can Japan Compete?

• What is the state of Japanese competitiveness in 2013? How has Japan progressed since 2000?

• What is Japan’s strategic agenda for 2014 and beyond?

• Is Abenomics sufficient?
Can Japan Compete?

1. Japan’s Economic Performance

2. Competitiveness and Economic Growth: The New Learning

3. The Strategic Agenda for Japan in 2014
Japan’s Economic Performance

• Overall economic performance has been disappointing, reflecting a poor macroeconomic environment and continuing microeconomic weaknesses
Prosperity Performance
OECD Countries

PPP-Adjusted GDP per Capita, 2012 ($USD)

$70,000
$60,000
$50,000
$40,000
$30,000
$20,000
$10,000

Growth in Real GDP per Capita (PPP-adjusted), CAGR, 2000-2012

1.0%
2.0%
3.0%
4.0%
5.0%
6.0%
7.0%
8.0%

OECD Average: 3.49%
OECD Average: $34,439

Note: Luxembourg Excluded
Source: EIU (2013), authors calculations
Japan’s Economic Performance

• Overall economic performance has been *disappointing*, reflecting a poor macroeconomic environment and continuing microeconomic weaknesses

• While growth in *productivity of existing workers* remains in line with many advanced OECD peers, Japan has suffered from *declining workforce participation*
Japan’s Economic Performance

• Overall economic performance has been **disappointing**, reflecting a poor macroeconomic environment and continuing microeconomic weaknesses.

• While growth in **productivity of existing workers** remains in line with many advanced OECD peers, Japan has suffered from **declining workforce participation**.

• Japan’s share of world export share has continued to **gradually fall**, in line with advanced OECD countries besides Germany.
Share of World Exports
Selected Countries, 1980 - 2012

Share of World Exports of Goods and Services

Source: UNCTADstat (2013)
Japan’s Economic Performance

- Overall economic performance has been disappointing, reflecting a poor macroeconomic environment and continuing microeconomic weaknesses.

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- Japan’s share of world export share has continued to gradually fall, in line with advanced OECD countries besides Germany.

- Imports into the Japanese economy have grown, reflecting gradual opening.
Import Performance
OECD Countries

Imports of Goods and Services (% of GDP), 2012

OECD Average: 5.38%

OECD Average: 47.36%

Change in Imports of Goods and Services (% of GDP), 2000-2012

Note: Luxembourg omitted
Source: EIU (2013), authors calculations
Japan’s Economic Performance

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- Japan’s share of world export share has continued to **gradually fall**, in line with advanced OECD countries besides Germany.

- Imports into the Japanese economy have grown, reflecting **gradual opening**.

- FDI inflows into the Japanese economy **remain the lowest** of any OECD country. Outbound FDI has grown but **lags all other advanced economies**.
Inbound Foreign Investment Performance
Stocks and Flows, OECD Countries

Inward FDI Stocks as % of GDP, Average 2000-2011

FDI Inflows as % of Gross Fixed Capital Formation, Average 2000-2011

OECD Average: 22.71%

Netherlands (95.21%, 139.07%)
Ireland (45.26%, 110.22%)

OECD Average: 48.01%

Belgium
Ireland

Note: Luxembourg omitted
Japan’s Economic Performance

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• Imports into the Japanese economy have grown, reflecting gradual opening

• FDI inflows into the Japanese economy remain the lowest of any OECD country. Outbound FDI has grown but lags all other advanced economies

• Japan continues to be among the top innovators in the world, but some other countries are more rapidly increasing R&D spending
Average U.S. patents per 1 million population, 2010-2012

Innovative Output
Selected Countries

Source: USPTO (2010), Groningen Growth and Development Centre, Total Economy Database (2010)
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Competitiveness and Economic Growth

A nation or region is competitive to the extent that firms operating there are able to compete successfully in the regional and global economy while maintaining or improving wages and living standards for the average citizen.

- Competitiveness depends on the long-run productivity of a location as a place to do business:
  - The productivity of existing firms and workers
  - The ability to achieve high participation of citizens in the workforce

- Competitiveness is not:
  - Low wages
  - A weak currency
  - Jobs per se
What Determines Competitiveness?

• Endowments, including **natural resources, geographical location, population, and land area**, create a **foundation** for prosperity, but true prosperity arises from **productivity in the use of endowments**
What Determines Competitiveness?

- Macroeconomic competitiveness sets the \textit{economy-wide} context for productivity to emerge, but is \textbf{not sufficient} to ensure productivity.
- Endowments, including \textit{natural resources}, \textit{geographical location}, \textit{population}, and \textit{land area}, create a \textit{foundation} for prosperity, but true prosperity arises from \textit{productivity in the use of endowments}. 

[Diagram showing Macroeconomic Competitiveness and Endowments]
Productivity ultimately depends on improving the microeconomic capability of the economy and the sophistication of local competition revealed at the level of firms, clusters, and regions.

Macroeconomic competitiveness sets the economy-wide context for productivity to emerge, but is not sufficient to ensure productivity.

Endowments, including natural resources, geographical location, population, and land area, create a foundation for prosperity, but true prosperity arises from productivity in the use of endowments.
Improving the Quality of the Business Environment

- **Context for Firm Strategy and Rivalry**
  - Local rules and incentives that encourage investment and productivity
    - e.g., incentives for capital investments, IP protection
  - Sound corporate governance
  - Open and vigorous local competition
    - Openness to foreign competition
    - Strict competition laws

- **Demand Conditions**
  - Sophisticated and demanding local needs
    - e.g., Strict quality, safety, and environmental standards

- **Factor (Input) Conditions**
  - Improving access to high quality business inputs
    - Qualified human resources
    - Capital availability
    - Physical infrastructure
    - Scientific and technological infrastructure
    - Efficient regulatory system
  - Availability and quality of suppliers and supporting industries

- **Related and Supporting Industries**
  - Many things matter for competitiveness
  - Successful economic development is a process of successive upgrading, in which the business environment improves to enable increasingly sophisticated ways of competing

- **Sophisticated and demanding local needs**
  - e.g., Strict quality, safety, and environmental standards
Developing Clusters: Tourism in Cairns, Australia

Sources: HBS student team research (2003) - Peter Tynan, Chai McConnell, Alexandra West, Jean Hayden
Prosperity of Japanese Prefectures

Gross Domestic Product per Capita, 2010 (Current $US at PPP)

Source: OECD iLibrary (2013)
The Role of Regions in Economic Development

- Many essential levers of competitiveness reside at the *regional level*
- Regions *specialize* in different sets of clusters

- Regions are a **critical unit** in competitiveness
- Each region needs its own distinctive **strategy and action agenda**
  - Business environment improvement
  - Cluster upgrading
  - Improving institutional effectiveness
Geographic Influences on Competitiveness

- Economic coordination and integration with neighboring countries is a **major force of productivity and competitiveness**
Japan’s Competitiveness Profile, 2001
ISC Competitiveness Model

Country Competitiveness 23

Macroeconomic Competitiveness 28
- Political Institutions 32
  - Rule of Law 22
- Human Development 15

Microeconomic Competitiveness 17
- Macroeconomic Policy 66
- National Business Environment 22
- Company Operations and Strategy 9

Japan’s GDP per capita rank is 18th versus 71 countries

Note: Rank versus 71 countries; *Color coding based on comparison relative to income;
Can Japan Compete?  
The Corporate Agenda in 2001

1. Shift the goal from growth to profitability
2. Create distinctive, long term strategies
3. Expand the focus of operational effectiveness to IT
4. Understand the role of industry structure
5. Reduce unrelated diversification
6. Update the Japanese organizational and governance model
7. Develop a stronger role for the private sector in economic development
Can Japan Compete?
Government Agenda in 2001

1. Open up domestic competition and reduce government intervention
2. Open trade and foreign investment
3. Modernize archaic and inefficient domestic sectors
4. Build a world class university system
5. Create new models of innovation and entrepreneurship
6. Encourage decentralization, regional specialization, and cluster development
7. Create stronger corporate accountability
Japan’s Competitiveness Profile, 2012
ISC Competitiveness Model

Country Competitiveness
18

Macroeconomic Competitiveness
24
  Political Institutions
22
  Rule of Law
17
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Microeconomic Competitiveness
14
  Macroeconomic Policy
68
  National Business Environment
16
  Company Operations and Strategy
4

Japan’s GDP per capita rank is 18th versus 71 countries

Note: Rank versus 71 countries; *Color coding based on comparison relative to income;

Significant advantage
Moderate advantage
Neutral
Moderate disadvantage
Significant disadvantage
Company Progress since 2001

1. Shift the goal from growth to profitability
   – More businesses are being divested due to inadequate profitability, but Japanese ROIC remains low

2. Create distinctive, long term strategies
   – The Porter Prize has recognized 41 companies with distinctive strategies since 2001
   – Many companies have become more focused

3. Expand the focus of operational effectiveness to IT
   – The utilization of IT has increased substantially, improving productivity

4. Understand the role of industry structure
   – Industry attractiveness has become a larger factor in corporate choices

5. Reduce unrelated diversification
   – Many corporate portfolios have been pruned

6. Update the Japanese organizational and governance model
   – The number of executive board members has been reduced
   – The number of companies with outside board members have substantially increased
   – Cross shareholding has fallen

7. Develop a stronger role for the private sector in economic development
   – Business leaders are becoming more involved in national and regional economic development
   – Shared value has become a major new thrust in Japanese corporations
Government Progress Since 2001

1. Open up domestic competition and reduce government intervention
   - Stricter anti-trust laws and enforcement has brought Japan closer to world standards
   - Government still prone to intervention and government solutions (e.g. electronics)
   - Targeting persists in “growth industries”

2. Open trade and foreign investment
   - FTAs signed with many nations, with the TPP being discussed
   - FDI restrictions have been partially reduced, but barriers remain

3. Modernize archaic and inefficient domestic sectors
   - Rules governing construction improved
   - Protection for small scale retailing reduced
   - Agriculture largely unchanged

4. Build a world class university system
   - Some steps have been taken to raise university standards and accountability
   - Archaic rules still disadvantage students studying outside Japan

5. Create new models of innovation and entrepreneurship
   - Rules for starting businesses have improved, though still not world class
   - IP protection strengthened
   - Access to public listing by newer companies has improved

6. Encourage decentralization, regional specialization, and cluster development
   - Cluster initiatives have proliferated, but progress remains uneven
   - Only modest delegation of central government powers has occurred

7. Create stronger corporate accountability
   - At least one independent board member is recommended for TSE-listed companies
   - Few companies still have effective corporate governance
## Trajectory of the Japanese Business Environment

<table>
<thead>
<tr>
<th>Component</th>
<th>Rank in 2012</th>
<th>Change in Rank</th>
</tr>
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<tbody>
<tr>
<td>Overall Business Environment</td>
<td>16</td>
<td>+7</td>
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<tr>
<td>Supporting and Related Industries and Clusters</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>Logistical Infrastructure</td>
<td>12</td>
<td>-4</td>
</tr>
<tr>
<td>Demand Conditions</td>
<td>16</td>
<td>+3</td>
</tr>
<tr>
<td>Capital Market Infrastructure</td>
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<td>+7</td>
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<tr>
<td>Communications Infrastructure</td>
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<td>0</td>
</tr>
<tr>
<td>Factor Conditions</td>
<td>21</td>
<td>+1</td>
</tr>
<tr>
<td>Context for Strategy and Rivalry</td>
<td>22</td>
<td>+7</td>
</tr>
<tr>
<td>Innovation Infrastructure</td>
<td>23</td>
<td>-2</td>
</tr>
<tr>
<td>Regulatory Infrastructure</td>
<td>38</td>
<td>-2</td>
</tr>
</tbody>
</table>

Note: Rank versus a consistent sample of 71 countries

Microeconomic Competitiveness Indicators
Ease of Doing Business Rankings – Japan

Favorable

Unfavorable

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Japan’s Strategy under Prime Minister Abe
The “Three Arrows” of Abenomics

- Monetary Expansion
- Temporary Fiscal Expansion, then Consolidation
- Structural Reforms
Japan’s Strategy under Prime Minister Abe
The “Third Arrow”: Structural Reforms

Plan for the Revitalization of Japanese Industry

1. Accelerate structural reform program
   (Speed up the restructuring)
   of industries

2. Reform the employment system and reinforce human resource capabilities

3. Promote scientific and technological innovations

4. Become the world’s leading IT society

5. Further strengthen Japan’s international competitiveness as a business hub

6. Innovate SMEs and small businesses

Strategy of Global Outreach

1. Establish strategic commercial relations and promote economic partnerships

2. Strategic initiatives to capture global markets

3. Develop funding and human resource bases that support the growth of Japan

Strategic Market Creation Plan

1. Extend the nation’s healthy life expectancy

2. Realize clean and economical energy demand and supply

4. Build regional communities that use their unique local resources to appeal to the world

3. Develop next-generation safe, convenient and economical infrastructure
The “Three Arrows” of Abenomics: Progress to Date

**Monetary Expansion**
- Fully implemented
- Promising Results

**Temporary Fiscal Expansion, then Consolidation**
- Expansion implemented
- Consolidation beginning
- Success unclear

**Structural Reforms**
- An extensive list of suggested actions, few steps taken so far
The Japanese Corporate Agenda for 2014

1. Accelerate the shift to **strategic thinking**

2. Accelerate **globalization**, making greater use of M&A

3. Encourage fast track **leadership development** and **mid career recruiting** to complement internal promotion
   - **Mobility of talent** will dramatically improve Japanese company performance

4. Simplify and streamline **decision making** while continuing to improve accountability and governance

5. Evolve **executive compensation practices** to incentivize risk taking

6. **Embrace shared value** as the guiding principle for Japanese business
The National Agenda in 2014

1. **Continue opening** domestic and international competition
   - Eliminate remaining barriers to FDI and imports
   - Reduce government subsidies and intervention in companies

2. Lower the **unnecessary high costs of doing business** in Japan
   - Regulation and bureaucracy is Japan’s greatest weakness

3. **Deregulate the key Japanese sectors** to unlock growth, productivity and innovation
   - Agriculture
   - Health Care

4. **Continue decentralizing resources and responsibility** to Japanese prefectures and metropolitan regions
   - Let regions compete to develop clusters, attract investment and upgrade their business environment

5. **Restructure** Japan's fiscal structure
   - Lower the corporate tax rate while eliminating tax breaks
   - Reduce capital gains taxation
   - Moderate taxes on earned income
   - Increase consumption based and non-renewable energy use taxes
The National Agenda in 2014

6. Set a pragmatic long term energy strategy
   – The cost of energy is a major competitiveness issue
   – Transitional solutions and carbon taxes will be needed to bridge the present and the future
   – Energy efficiency must become a national priority

7. Connect Japan to the rest of the world
   – Raise language skills
   – Support international education
   – Welcome skilled immigration
   – Embrace the internationalization of knowledge
   – Encourage deeper globalization by Japanese companies
   – Move from politics to building economic partnership with other Asian countries

8. Tap the talent and potential of Japanese citizens and enrich the nation’s human resources
   – Embrace and enable women’s participation in the workforce
   – Open up labor mobility
   – Welcome skilled expatriates from abroad
   – Encourage and support Japanese students studying abroad
   – Raise the standards in Japanese universities and business schools

9. Deepen economic integration of Japan in the Asian region