



WILL JAPAN RECOVER ITS PLACE AS WORLD ECONOMIC LEADER

Japan in World Competitiveness

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After some 15 years absent from the world economy, Japan is coming back to assume its role as the second biggest economic power in the world. After struggling through this long period of stagnation, in Japan today there is a strong corporate recovery, a strengthening financial system, an increase in private consumption and a political will to push through necessary reforms. Consequently, Japan has progressively improved its competitiveness position as measured by IMD's World Competitiveness Yearbook, from 27th position in 2002 to 17th in 2006.

In 2005, Japan's real GDP growth was better than expected at 2.7% and business confidence is returning with the anticipation that deflation will soon become only a bad memory. 2006 marks the third year of healthy economic growth, spurred by exports and investment but increasingly supported by domestic spending. In addition, the business environment has been helped by a stronger financial sector no longer crippled by bad loans. Balance sheets have been cleaned up and lending is once again on the agenda. Direct investment flows inward increased 25% in 2004 after the Government implemented policies to breakdown barriers and encourage foreign investment. However, when compared to the US and Europe, levels remain very low as a percentage of GDP (0.2%).

Still problems to overcome

There are, however, some significant weak spots: Japan's high budget deficit (ranking 56th out of 61 economies at -6% of GDP) and persistently high debt levels (at more than \$5,000bn, nearly 120% of GDP). The business community also suffers from high corporate tax rates (59th) and costly levels of remuneration (58th for the services professions). Entrepreneurship is not widespread (57th), business managers are not characterized as having much international experience (52nd) and there is a low participation of women in business (47th). Skepticism about the effective implementation of auditing and accounting practices remains an issue (51st). Other obstacles to global integration include a national culture that is closed to foreign ideas (54th) and strict immigration laws (55th), despite the fact that Japan ranks higher for its "attitudes towards globalization" (14th).

Japan remains an economy whose growth still depends heavily on exports and investment, despite the recent years of structural reform and improved domestic consumption. The nation's recovery has been driven mostly by external demand – "riding the wave" of China's enormous appetite for Japanese exports, helped by a falling yen. Nonetheless, challenges exist for the country to reap the benefits from further technological advances and product innovation. This will probably entail greater deregulation and improvements to the educational system to stimulate more creativity, innovation and entrepreneurship.

More innovation and entrepreneurship needed

Fundamental to sustaining growth in Japan's economy is the need for more innovation, especially in the development and application of IT, focusing on creativity, and entrepreneurship and the ability to apply technological breakthroughs to products and services. Lagging productivity, interventionism and lack of transparency are obstacles to improving production capacity and liberalizing markets. The pursuit of structural reforms is imperative – via increased competition, deregulation and the rejection of anticompetitive policies, collusion and “hidden” protectionism, hopefully relics of the past.

It remains vital to remove cumbersome regulations and bureaucracy as well as creating a more open environment. This could comprise more equal treatment between domestic and foreign enterprises and investors and less apprehension of anything “foreign” – an especially sensitive issue with regard to immigration.

More involvement by SMEs

The lack of international experience for most managers is striking in an economy that has been so successful in launching global brands. But much of this success has been achieved by large, internationally recognized corporations and less so by smaller and medium-sized enterprises. These SMEs need to develop their own markets in Japan and abroad, establishing “stand-alone operations” independent from the larger companies. This is especially important for Japan's service industries, still immature in global markets.

Challenges on the road to recovery

Japan also needs to confront its high levels of dependency on imported oil and the necessity to pursue more diversification in energy sources. The country also faces risks in its export markets, principally the US and China, in a world where low-cost competition is increasingly menacing the developed nations' manufacturing industries and brand new competitors are emerging. Japan must seek to secure access to the large markets in South-East Asia, China, India and Russia and develop political relationships, not only economic, with these nations. Serious geopolitical challenges lie ahead such as normalizing relations with China, resolving regional territorial disputes and defining Japan's role in international relations.

All of the above challenges should encourage Japan's authorities to develop a new "mind-set", where it is no longer sufficient to rely on past successes, the legacy for which Japan remains famous today. In this new world flattened by globalization, competitiveness means adapting to change better - and faster than others.