EXECUTIVE SUMMARY

Japan is the world's second largest economy after the USA, accounting for nearly one fifth of world GDP and more than two thirds of East Asian GDP. Its individual regions alone constitute major Asian markets in their own right. Japan has been Australia's largest trading partner for three decades, and is its third largest foreign investor. Japan buys one fifth of Australian exports, supplies nearly one sixth of Australian imports, provides one fifth of inbound tourists, is Australia's principal market for major commodities and is an increasingly important buyer of high-value-added goods and services. Japan and Australia also enjoy strong people-to-people, cultural, academic and strategic ties, creating the basis for an increasingly important partnership in the twenty-first century.

The significance of this relationship makes it important for Australians to understand the dynamics of the Japanese economy and society. This report analyses the changes occurring in Japan today, highlighting the implications for Australia of socioeconomic and political trends, economic and structural reform, liberalisation priorities and sectoral developments.

The report is divided into five parts. The first evaluates the major issues facing Japan and examines the socioeconomic, political and economic environment, in effect setting the scene for the rest of the book. The second part analyses the international side of the Japanese economy and the factors contributing to changing trade and investment patterns. It discusses how this can translate into bilateral business opportunities, as well as joint projects in third countries. The third section studies major domestic influences on the structure and competitiveness of Japanese industry, revealing how reform is proceeding quite differently in finance and distribution.

The fourth part of the report deals with market access. It examines the market liberalisation measures that Japan has adopted to date and major issues in bilateral and multilateral trade negotiations. This section also looks at market access techniques, evaluating the advantages of entering the Japanese market through some of its smaller regions, each of which is larger in terms of consumer purchasing power than many other Asian economies. The final part examines issues and opportunities in sectors of particular interest to Australia: agriculture and food, energy, transport and services. The report concludes with a summary of the major findings and their possible implications for Australia.

CHOICES FOR THE TWENTY-FIRST CENTURY

A number of major issues are confronting Japan as it heads into the twenty-first century. The choices it makes will determine its direction over the next 10 to 15 years and will have an important impact on Australia. Most of the key issues facing Japan are not new; many have been debated for years. While some are being addressed effectively, others may not be resolved in the short to medium term. The central themes and issues explored in this report include:

- socioeconomic change
- the broad impact of a declining labour force and a rapidly growing proportion of aged people
- the role of government in the economy
- macroeconomic management and sustainable growth
- factors influencing the exchange rate
- globalisation and the impact of changing trading and investment patterns
- the direction of deregulation and reform in government administration, financial markets, transport and distribution, agriculture, industry and education
- market protection and access
- innovation and emerging industries.

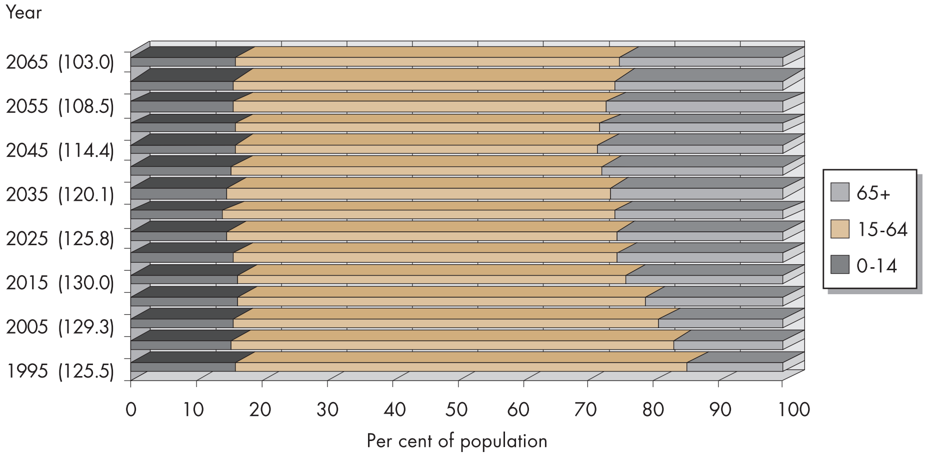
SOCIOECONOMIC CHANGE HAS BROAD IMPACT

A sluggish economy, a dramatic increase in the population aged over 65 years, internationalisation and unprecedented affluence are challenging Japan's socioeconomic fabric. At home, at work and at leisure, rising expectations and changing attitudes are affecting the labour market, the role of women and consumer preferences.

The rising share of the elderly in the population will have the broadest impact. Indeed, it is the imperative underlining many current reforms. With one third of Japanese expected to be over 65 years of age in 2040, double the 1995 level, and with the population peaking around 2010, Japan must prepare for a potentially serious labour shortage, declining savings and investment, and heavy pressure on health and welfare facilities. Companies are already preparing for the opportunities, targetting the 'silver market' with a range of new goods and services. The need to bolster national savings to fund future retirees is also influencing macroeconomic policy.

Proportion of Elderly to Rise Dramatically

Japan's Population by Age Bracket (1995 to 2065)



Note: Figures in parenthesis indicate the total population (millions) projected for that year. Other projections from the Ministry of Health and Welfare, 1997, show the population peaking as early as 2007.

Source: Management and Coordination Agency, Statistics Bureau, 1997, p. 33.

Family life is changing as nuclear families replace extended families as the norm, and more people live alone. Consumers are increasingly sophisticated and discriminating, demanding value-for-money above all. This has altered the traditional preference for Japanese-made goods and has intensified competition.

Labour practices are undergoing fundamental changes as companies endeavour to become more efficient and innovative in a fiercely competitive business environment. Performance and merit will increasingly determine advancement, better suiting a younger generation seeking more rewarding careers and workers willing to retrain to meet increasingly sophisticated employment needs. With the looming labour shortage, some companies have begun to evaluate how they might better utilise female employees. In addition, the stigma of working for foreign companies is fading as ambitious younger people value their more flexible, merit-oriented labour practices, making it easier for foreign firms to recruit quality staff.

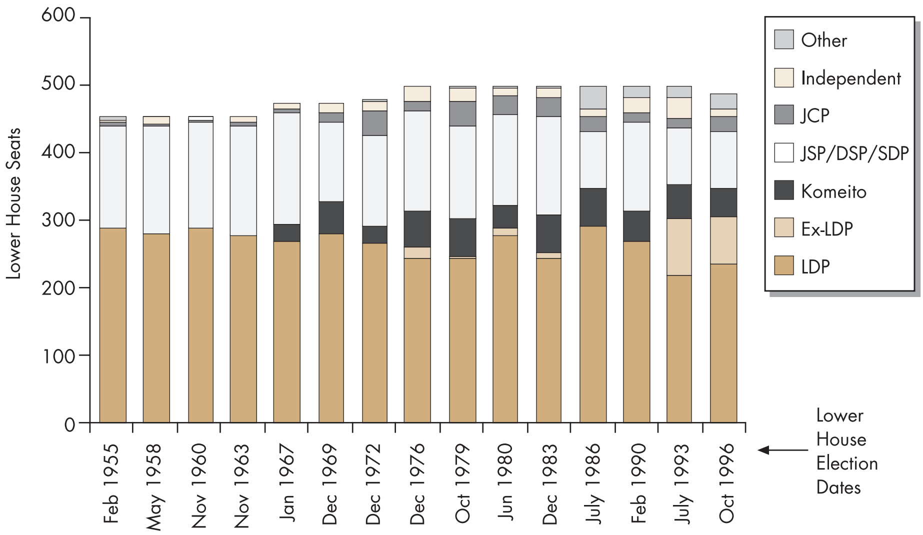
CONSERVATIVES CAN PRODUCE REFORM

Following four years of political instability, the Liberal Democratic Party (LDP) is back in power, albeit in a minority government. Its survival will depend on how successfully the Hashimoto Government manages political dynamics in the Diet and the electorate, and delivers administrative and economic reforms.

The LDP held power for 38 years (1955 to 1993), fulfilling its main policy goals of catching up with the West economically and improving Japanese living standards. It achieved these by the 1980s, but failed to reach a consensus on how to deal with new problems that emerged. In the midst of a major recession, policy-making paralysis and numerous scandals weakened the conservatives' long-standing unity. Several groups broke away from the LDP, forming new conservative parties with reformist platforms. As a result of this split, in the 1993 elections, the LDP was replaced by an eight-party coalition government led by pro-reform conservatives. However, in the next three years, four coalition governments achieved little policy unity and few reforms, apart from electoral reform. A record low turnout in the 1996 election underlined voter disillusion. Lack of viable alternatives and a desire for stability helped the LDP win enough seats to form a reasonably stable minority government. The Hashimoto Government has targetted six key areas for reform: public administration, banking and finance, the fiscal system, social security, education, and general economic and structural problems.

Conservatives Remain Dominant

Japanese Lower House Elections 1955 to 1996
Party Votes by Number of Seats



Source: compiled by East Asia Analytical Unit from various sources.

With conservative forces expected to continue to dominate the Lower House of the Diet, several patterns of government could emerge: a single large conservative party (effectively a reunified LDP); two medium-sized parties (traditional conservatives and more progressive conservatives); or fluid alliances of several conservative parties. In the first case, if a majority of conservatives can agree on a new central policy platform with broad appeal (for example, continued reform, but with minimal social cost), chances for stability will be enhanced. However, the process of consensus decision-making that this could entail would reduce the pace of reform. In the case of other regroupings, the party in control would set the pace for reform.

GROWTH DEPENDS ON REFORM AND DEMOGRAPHICS

Following a prolonged recession, Japan's broad macroeconomic environment is now reasonably attractive, with improved growth prospects and negligible inflationary pressures. Over the longer term, however, the potential growth rate will decline unless deregulation, innovation, and structural and fiscal reform offset the economic impact of a higher ratio of elderly to working-age population.

Demographics will have a number of further longer-term macroeconomic implications. A shrinking workforce combined with a growing proportion of elderly will have enormous budgetary implications. The savings rate will decline as retirees draw on savings, making recourse to fiscal stimulus more difficult. In addition, as the savings rate decreases, the current account surplus and capital outflows could shrink.

These long-term pressures will drive economic reforms aimed at allocating savings more efficiently, increasing productivity, raising the potential growth rate and reducing the need to resort to regular fiscal stimulus measures.

CHANGING TRADE STRUCTURE MEANS NEW BUSINESS

Yen appreciation, investment overseas (especially in Asia) and a more streamlined distribution sector have altered substantially Japan's trade structure over the last decade. Exports of high-value-added parts and capital goods are becoming more significant than final products, particularly consumer goods. At the same time, purchases of intermediate and final products, especially consumer goods and processed foods, are surging, while imports of raw materials are expanding more slowly. Trade in services is expanding rapidly.

Despite rapidly growing exports of higher-value-added manufactured items and processed food, Australia's share of Japanese imports declined from 5.8 per cent in 1985 to 4.8 per cent in 1996. This is because primary commodities continue to dominate Australia's exports to Japan while their share in Japanese imports is declining overall. While such commodity trade remains vital to Australia, excellent opportunities exist to tap into Japan's fast growing demand for high-value-added products. Processed foods, housing and construction materials, alcoholic beverages, jewellery, cosmetics, fashion apparel, even refined copper, are growth segments in which Australia has a comparative advantage.

JAPAN'S GLOBALISATION CAN BENEFIT AUSTRALIA

Although Japan's overseas production (based on foreign assets) is a small proportion of its total output and less than half that of other major industrialised nations, Japanese firms are the fastest growing group among the world's 100 most internationalised companies (UNCTAD, 1996). Rising import penetration and strengthening global competitive forces will drive internationalisation and liberalisation in Japan. Outbound direct investment will continue to be motivated by overseas market development opportunities and the need to transfer offshore labour-, land- and energy-intensive processes which have become unviable at home.

After bottoming out in 1993, Japanese foreign direct investment (FDI) has resurged, with new outlays exceeding US$20 billion in 1995. This FDI is shifting from an emphasis on mass consumer goods assembly to a focus on higher-value-added goods and services. As with trade, these changing patterns have affected Japanese direct investment in Australia. While this generally has declined since 1989, due to contracting property and financial sector interests, Australia has attracted more export-oriented manufacturing and mining investment. Sustaining this trend in the face of strong competition from other host countries will require persistent microeconomic reform aimed at providing an internationally competitive business environment. Surveys of Japanese companies in Australia reveal that Australian suppliers also need to lift their performance.

FDI inside Japan totalled just US$5.3 billion between 1988 and 1995, or 2.5 per cent of Japanese outbound FDI over the same period. It represents just 0.02 per cent of GDP, compared to 0.77 per cent in the G7 less Japan (USA, Canada, UK, France, Italy, Germany) and 1.33 per cent in Australia. Australia accounted for just under 1 per cent of FDI in Japan between 1988 and 1995.

Although low, foreign direct investment in Japan can still play a critical role in facilitating trade and establishing specialised distribution networks. Over the past 15 years, regulatory and bureaucratic barriers to foreign investment have eased significantly under a policy officially encouraging inbound investment.

Key success factors for investors in Japan include strongly differentiated product portfolios (such as unique technology), ability to effectively transfer core competences, appropriate structure, realistic goals, a positive corporate image, good management, quality staff and the right partners. Given the relatively strong 'trade-pull' effect associated with FDI in Japan to date, Australian companies may find that a stronger presence in Japan will greatly assist their business efforts. Both the Australian and Japanese Governments offer assistance to potential investors, as well as to exporters. (See *Information for Companies*, at the back of the book.)

Japanese trading houses are important potential partners for Australian businesses. In reducing their reliance on low-margin trading activities, the *sogo shosha* are moving into more sophisticated intermediary functions (such as setting up infrastructure financing consortia), and investing directly in resource processing, manufacturing, services and infrastructure development. Australia and Australian companies are well placed to attract trading company investment and to engage in joint activities in third countries.

FINANCIAL REFORM IS CRUCIAL

Japan's financial sector, burdened by heavy regulation and inefficiency, constrains economic revitalisation. Liberalisation to date has intensified competition; however, faster reform is required if Japan is to meet retirees' needs and cope with constant innovation in international financial markets. The Hashimoto Government's 'Big Bang' 1996 to 2001 financial market liberalisation plan, if fully implemented, will be an important step forward and should serve as a catalyst for futher reform.

While gradual and incremental in nature, reforms are producing change in the financial sector. Diversification of funding sources has reduced large firms' dependence on banks, forcing banks to develop new services to sustain relationships and broaden their client base. Many financial institutions are restructuring to improve efficiency and overcome bad loan problems, and compete in a fast-moving, increasingly sophisticated market. Foreign financial firms are establishing a stronger presence. Indeed, for many years, some have been at the forefront of financial market innovation, particularly in the securities sector. Foreign companies, with lower costs and stronger capacity to price risk, are expanding their share in the insurance and pension markets, which are under considerable pressure to reform.

BARRIERS HURT COMPETITION AND EFFICIENCY

Although Japan is perceived as a very difficult and complex market, its tariff and core nontariff barriers are often lower and less distorting than those of the European Union (EU) and the USA. Even some Japanese business practices, widely regarded as unofficial entry barriers, are similar to EU and US practices. The major barriers to market access arise from Japan's excessive regulation, lack of transparency, weak enforcement of competition policy and numerous exemptions to the Antimonopoly Act. These barriers affect local as well as foreign companies, reducing competition and efficiency in the economy in general.

Over the years, commercial and economic necessity and foreign (especially US) pressure have combined to produce varying degrees of liberalisation in many sectors. Indeed, deregulation now is increasingly accepted as beneficial, and foreign goods encounter far fewer barriers to entry than in the past. The Hashimoto Government strongly supports deregulation and is widely expected to achieve more than previous governments. Nevertheless, the pace and substance of reform remain major issues. Some commercial pressure for deregulation has eased with the weakening of the yen, and strong links among government, bureaucracy and business interests continue to stall deregulation in key sectors. In addition, some parts of the bureaucracy, reluctant to trust the market and facing reduced influence under regulatory and administrative reform, may reregulate as it deregulates.

Despite these cautions, liberalisation has gathered momentum, and major reversals are unlikely to occur, particularly under the current Government. In coming years, many existing barriers will weaken or disappear.

STREAMLINING DISTRIBUTION CUTS COSTS

A fragmented, multitiered distribution system has contributed significantly to Japan having the highest prices in the OECD. Since the 1980s, external pressure, deregulation and especially market forces (yen appreciation, recession and consumer and business pressure) have combined to bring about change. This has produced more streamlined distribution networks, strong emphasis on efficiency and costs, technological innovation, greater choice and above all, lower prices. Prominent Japanese retailers such as Daiei and Ito-Yokado lead the change.

The previous retail structure of a few department store and supermarket chains alongside hundreds of thousands of very small shops is changing as large-scale stores and shopping complexes burgeon and the small-retailer sector shrinks. The wholesale tier similarly is reshaping into fewer, larger players. Having gained control over pricing and merchandising, the largest retailers are replacing manufacturers as controllers of the distribution system. They are acquiring products more directly, often bypassing wholesalers to take delivery straight from manufacturers and, increasingly, from overseas suppliers. Japanese retailers and wholesalers also are expanding offshore, not only to actively source cheaper products, but also to invest in fast-growing Asian distribution systems. These trends will continue, producing fewer but larger retail and wholesale companies over the medium term. Foreign firms should consider these trends in reviewing their Japan distribution strategies.

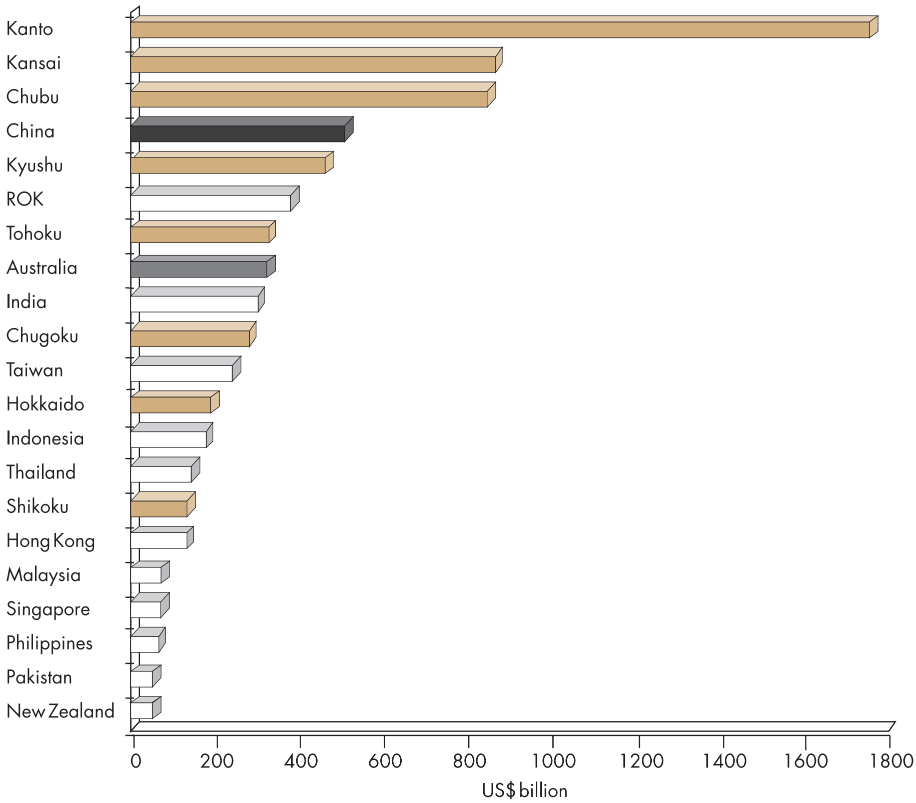
JAPAN'S REGIONS ARE ATTRACTIVE MARKETS

Each of Japan's eight regions constitutes a major Asian market. The Kanto (surrounding Tokyo), Kansai (centring on Osaka-Kobe) and Chubu (extending from Nagoya) economies each far surpasses any other Asian market, including China. Even the smallest region, Shikoku, has a higher per capita income than any other Asian economy.

Each Region a Major Asian Market in Its Own Right

Japanese Regional Economies Compared to the Rest of Asia

GRP / GDP, US$ billion, 1994



Note: GRP: Gross Regional Product; GDP: Gross Domestic Product (measured in terms of official exchange rates); GDP for India and Pakistan are for their respective (March, June) financial year 1994.

Source: International Monetary Fund, 1997; Economic Planning Agency, 1997.

The regions play a pivotal role in Japanese life. Historically the main instigators of change, today the regions are taking an increasingly independent approach to revitalising their economies, actively encouraging both local and foreign investment and forging closer ties with Asia. Many companies based in Tokyo and Osaka are developing regional strategies, seeking growth opportunities and lower production costs.

Foreign companies, too, should consider the advantages of adopting a regional approach to the giant Japanese market. Distribution systems are not so entrenched, companies are not so huge, and competition, while strong, is not so fierce as in the main centres. Indeed, numerous Australian small and medium-sized companies have forged lucrative business ties with Japanese SMEs (although what is 'small' in Japan may be relatively large in Australia). The Australian Government encourages such an approach through its network of regional Austrade offices. Direct Qantas and Ansett services to Japan's major regional gateways bypass the congested Narita Airport and facilitate doing business in the regions.

AGRIFOOD CHALLENGES REMAIN

Despite very high rates of protection, Japan relies heavily on imported food. Indeed, it is Australia's most important agrifood market. Except for 1995 and 1996, agrifood exports to Japan have grown strongly over the past decade, especially in the higher-value processed food category. Dependence on beef, which comprises nearly half of the value of Australia's agrifood exports to Japan, has recently declined, and the variety of nontraditional products has expanded.

Traditional ties to the land and the weighting of the rural vote make agricultural policy sensitive, despite the irrefutable economic arguments favouring reform. However, with the younger generation leaving the fields for the cities and the proportion of elderly in the farming population increasing rapidly, the urgency for reform may eventually overcome political wariness.

Demand for imported food will continue to grow, stimulated by changing lifestyles and the shrinking agriculture sector. The planned reform of Japan's Agricultural Basic Law offers some hope of fundamental policy change. However, the pace is likely to be slow and the reforms incremental.

ENERGY REFORM MAY LOWER PRICES, RAISE IMPORTS?

Japan's ongoing energy market reform and restructuring is vital to Australia, which supplies 56 per cent of Japan's coal and a rising share of its liquid natural gas imports. Indeed, Japan takes nearly half of Australia's energy exports. Industry's share in energy consumption is falling as manufacturing shifts from heavy to less energy-intensive industries. At the same time, the energy share of the residential, commercial and transport sectors is growing, reflecting rising living standards and an expanding services sector. Dependence on oil will continue to decline slowly, as nuclear energy and gas become more prevalent in electricity generation. While a declining population may lower energy demand in the long term, this will probably be outweighed by the relatively strong growth in consumption per capita, particularly in the residential sector.

Japan's electricity and gas tariffs, and petroleum product prices are among the highest in the OECD. With manufacturing facing stiffer competition, the business community is pressing for deregulation and reform of energy utilities to reduce their production costs. Reforms allowing new entrants and imports are now underway in the electricity, gas, coal and petroleum refining and distribution industries. While reform plans in sectors like electricity and household gas are cautious, industrial gas, petroleum products and retail gasoline prices could decline significantly, potentially increasing import demand. Phasing out domestic coal industry subsidies in 2001 should benefit Australian coal exporters. However, if Japan achieves its target of stabilising greenhouse gas emissions at 1990 levels by 2000, it could have a significant negative impact on energy exporters.

TRANSPORT PROBLEMS POSE A LONG-TERM CHALLENGE

Economic recovery will place Japan's transport infrastructure under significant pressure. Even during recent years of sluggish economic performance, heavily regulated and unionised transport systems have hindered companies' efforts to streamline distribution and cut costs. It still costs twice as much to move a container within Japan as to ship it from Australia to Yokohama. International shippers and even firms shipping goods from one port to another often use cheap feeder lines out of Pusan (Republic of Korea) into less expensive, less congested Japanese regional ports.

To reduce these constraints, the Japanese Government is encouraging a modal shift in domestic distribution systems, including greater use of rail and coastal shipping to ease road congestion. Restrictions on road freight (such as limitations on vehicle size, container cargoes, regional service boundaries) are gradually being eased. Nevertheless, road transport's reliability, speed (despite congestion) and convenience will be difficult for rail and coastal shipping to match unless the authorities resolve important regulatory and efficiency issues. While progress on rail freight may remain stymied by entrenched interests, coastal shipping may be sufficiently liberalised to become an efficient mode within 10 to 15 years. Australia's fast ferry industry is in a good position to participate in the revitalisation of this sector.

Australia-Japan trade and tourism flows are directly affected by problems in international aviation and shipping. These include capacity constraints at Japan's main air and seaports, especially Narita Airport, which handles 60 per cent of outbound passengers and 70 per cent of international air cargo with only one runway. Other major issues include rigid fare structures, high operating and expansion costs, low labour flexibility and productivity, lengthy and opaque customs clearance and quarantine procedures, and ineffective use of electronic data networks.

Over the next 10 to 15 years, many of these problems will be tackled. Additional runways are planned for all major airports by 2010, and 15-metre deep berths are being developed at ports around Japan to accommodate the most modern container vessels. Customs clearance will become increasingly automated, reducing approval times (especially important for perishables) and improving regional port procedures. Competition is being introduced in domestic aviation, including easing the rigid fares and slots systems, and allowing new discount carriers. In addition, government and business are encouraging airlines and shipping companies to tackle labour rigidities and install new technology to improve productivity. Costs, however, will remain high, primarily because many new runways, airports and container terminals will be built on costly reclaimed land sites.

CONSIDERABLE SCOPE EXISTS FOR TOURISM GROWTH

Japanese tourism to Australia is rising steadily, totalling 800 000 in 1996 and expected to exceed 1 million by 2000. This represents an approximate 5 per cent share of Japan’s outbound tourism, indicating considerable scope for development. Although Australia remains a popular destination, competition from other countries is intensifying. With pricing and packaging the key determinants of tourists’ choice of destination, innovative marketing and industry cooperation are vitally important. Bilateral negotiations on Japanese pricing and packaging restrictions should eventually produce a more competitive environment.

SERVICES SECTOR OFFERS NEW OPPORTUNITIES

Within the broad tertiary sector, which represents 54 per cent of Japan’s GDP, ‘miscellaneous services’ are a major engine of growth, providing 86 per cent of employment expansion from 1991 to 1996 and accounting for 16 per cent of GDP in 1995. These services include:

- leisure
- leasing
- information industries, such as information technology and multimedia
- cleaning, catering and linen services
- broadcasting
- advertising
- entertainment venues, such as theme parks, cinemas and sporting facilities
- personal services, such as childcare, hairdressing and housekeeping
- professional services such as legal, accountancy and consulting
- business support services such as temporary staffing, logistics, building maintenance and security
- education and training
- environmental management such as waste disposal
- health care and pathology services.

While some areas are regulated tightly, the general trend toward deregulation in nonmanufacturing will facilitate growth and innovation. Some newer segments, such as personal services and certain leisure and information areas, enjoy minimal government intervention (so far) and virtually nonexistent traditional barriers; these offer particularly attractive opportunities for international companies to develop innovative goods and services for the Japanese market. Importantly, changing attitudes toward foreign companies over the past decade or so should help investors in the services sector. Consumers and businesses increasingly view foreign companies not only as sources of new products, technologies and services, but also as important contributors to competition, employment and innovation.

TAKE A GOOD LOOK AT JAPAN

A New Japan? Change in Asia's Megamarket encourages Australian companies to take a new look at Japan. While the business environment in Japan is expensive, competitive and challenging, it is in many ways less complex than other markets in the region. Japan has a strong institutional framework; regulation is being reduced and becoming more transparent; and business practices are becoming less opaque. Consumer tastes are changing, making foreign products easier to market. The distribution system is becoming more streamlined and the financial sector is more internationalised. Regional Japan offers attractive gateways to the market, and niche segments are emerging that are often unfettered by the restrictions that hinder access to more traditional sectors. In planning for the coming decade, companies should seriously assess the Japanese market for trade and investment opportunities, as well as for strategic alliances.

The report also has messages for Australian state and federal governments which are seeking to increase exports to and investment from Japan. Japanese investors in Australia generate strong net exports and are major users of locally sourced inputs. However, governments and industries alike will find it a major challenge to attract quality Japanese investment in coming years, due to competition from countries offering lower costs, higher returns and faster growing domestic markets. Australia must therefore continue to market strongly in Japan its strengths and comparative advantages, while proceeding with microeconomic reform at home. As Japan-Australia trade and investment move up the value chain, important new opportunities will emerge in a variety of complementary areas. The government can assist in facilitating market access and identifying opportunities; however, it is up to companies to capitalise on them.

Chapter 1

JAPAN AT THE CROSSROADS

Japan is at an important turning point. It is a challenging time, perhaps the most challenging since the postwar period when Japan set in place the institutions and practices that allowed it to rebuild and catch up with the West economically in less than 50 years. Today Japan must reshape those institutions and practices to meet the requirements of the twenty-first century. This time, however, the challenges differ significantly and the goals are not so clear cut.

How Japan addresses these challenges in the next few years will significantly affect Australia. Japan is our largest trading partner and our third largest foreign investor. Japan buys one fifth of our exports, supplies nearly one sixth of our imports, provides one fifth of inbound tourists, and is our principal market for coal, beef, gold, iron ore, LNG, aluminium, petroleum, uranium, cotton, seafood, cheese and animal feeds. It is also a major market for wool, sugar and wheat, and for an expanding range of high-value-added products and services.

Japan's impact goes well beyond trade. The Japanese economy makes up around 18 per cent of world GDP and over 70 per cent of East Asian GDP (CY1995 data, World Bank, 1997). Its current account surplus totals a massive US$70 billion and its foreign assets exceed US$800 billion. Japan plays a major role in the Asia-Pacific region, and its future direction will affect the region's prosperity and stability. With Asia increasingly dominating Australian trade, investment and bilateral relations, developments in Japan will have a far-reaching effect on Australia in the twenty-first century. Australians therefore need to understand the challenges and choices Japan faces and how Japan is likely to approach them.

This report analyses the major economic, socioeconomic and political issues facing Japan. Focusing on structural reform, deregulation, market access and business opportunities arising from liberalisation and socioeconomic change, it identifies likely trends and also explores why some issues may take years to resolve.

TAKE ANOTHER LOOK AT JAPAN

A key message of the report is that Japan, the world's second largest economy with a GDP of US$5.1 trillion in 1995,[1] offers a huge market that Australian companies should not ignore. Alone, the Kanto region surrounding Tokyo is a larger, wealthier market in terms of GDP than the combined economies of China, the Republic of Korea and Australia. The Kansai region around Osaka has a larger economy than ASEAN. Moreover, Japan is no longer the tightly closed market it once was. It is opening up in many ways.

1 The US GDP was US$7 trillion in 1995 (World Bank, 1997).

Is Japan Too Difficult?

In the past, many foreigners accepted the thesis that Japan was unique and that foreigners would never be able to comprehend its complexity. Many concluded that doing business in Japan would be too difficult, and some confirmed this through experience. However, many foreign companies have done well in Japan, including Australian firms.[2]

The attitude that Japan is too complex and difficult persists today, although circumstances have changed. Import acceptance and penetration have expanded rapidly, for example. Japan has opened up considerably in recent years and, with its well developed institutional and legal framework, offers a more transparent, less risky business environment than many other Asian markets. While doing business in Japan remains challenging, companies are encouraged to look closely at the opportunities that this major market offers. (See Chapters 5 - *Trade*, 6 - *Internationalisation*, 7 - *Finance*, 8 - *Market Access*, 9 - *Distribution*, 10 - *Regions*, 11 - *Agriculture*, 13 - *Transport* and 14 - *Services*.)

Attitude toward Foreign Products Improving

One important recent shift affecting overseas suppliers and investors in Japan is the changed attitude toward things foreign. In the past, local goods and services were clearly preferred, while foreign ones, apart from well known brands, were suspect. This posed a major barrier for foreign suppliers and investors. This attitude, combined with market protection, *keiretsu* relationships and a tightly controlled distribution system, gave Japanese companies considerable leeway in maintaining high prices. Consumers were offered little choice, high prices and medium quality.[3]

Today, while national pride remains strong, people recognise that foreign inputs and products can equal and at times surpass Japanese ones. The key criterion is increasingly value for money, not origin of product. Foreign products' success is reflected in rapidly growing import penetration ratios. Exporters to Japan must pay close attention to developments in-market to ensure that their products continue to represent the best possible value. (See Chapters 5 - *Trade*, 6 - *Internationalisation*, 8 - *Market Access*, 9 - *Distribution* and 10 - *Regions*.)

In summary, companies could benefit by taking another look at Japan: the timing is right, the market is more accessible than in the past, and good opportunities abound.

KEY ISSUES

This chapter highlights the key issues confronting Japan today. Some have been debated for years without significant action. Others are relatively new, arising from the uncertainty of recent times. Japan's responses to these issues will largely determine its direction over the next decade.

2 See Kishi and Russell, 1996, for some interesting case studies.

3 Many goods destined for the domestic market were not of the same quality as those made for export.

This chapter first looks briefly at the 'big picture' issues, such as national identity and international relations. It then examines the Hashimoto Government's deregulation agenda, and the political, economic and structural factors that will affect its achievement. Finally, the chapter assesses some of the challenges that Japan will face as it heads into the twenty-first century.

REDEFINING IDENTITY: A NEW JAPAN MODEL?

Japan is undergoing a period of introspection, reflecting on its national identity and its place in the world. It is reviewing the model which achieved past goals, seeking one which will provide it with the flexibility and innovation needed to progress in the twenty-first century. Other countries, especially in Asia, look to Japan for models of, for example, business management, industry policy, administration and environmental management. They are observing keenly as Japan progresses to the next stage of its development; lessons learned eventually will apply to them.[4] Major Japanese companies, too, are redefining and differentiating themselves as they become increasingly global. (See Chapter 6 - *Internationalisation*.)

SHOCK TREATMENT

A number of 'shocks' have buffeted Japan in the 1990s, including the collapse of the bubble economy, major currency fluctuations, a prolonged recession, the Great Hanshin (Kobe) Earthquake, scandals involving leading politicians, bureaucrats and corporations, the Aum Shinrikyo cult gas attacks, and increased violence and drug-related crime.[5] These have affected the very cohesion that helped Japan achieve economic success in the postwar period, eroding self-confidence and leading to reflection on the state of society. On the positive side, shocks have also precipitated necessary change.

INTERNATIONAL ROLE

Internationalisation has acted as a catalyst on business and the economy, prompting a more assertive foreign policy. A more mature and confident Japan is taking a more proactive and constructive role in international and regional affairs. Asia will be a major focus in the next century, reflecting Japan's growing trade and investment interests in this region. One of Japan's main concerns is how to handle relations with China, with which it has had an ambiguous relationship, recognising China as a 'mother culture', but also seeing it as a major future competitor (East Asia Analytical Unit, 1996).

4 Countries and companies alike have adopted many successful elements of the 'Japan Model' (including industrial development, quality control circles, team management, just-in-time systems).

5 'Shock' is used in Japan to refer to major unexpected events which have a significant impact.

THE JAPAN-AUSTRALIA PARTNERSHIP

Strong trade, investment, tourism, people-to-people and official ties should continue to underpin the Japan-Australia relationship. Close business and government cooperation in regional and international activities and fora further strengthens the partnership.

Japan has been Australia's most significant trading partner for three decades. Indeed, this report is being released in the lead-up to the fortieth anniversary of the landmark Commerce Agreement between Australia and Japan, signed by Japanese Minister for Foreign Affairs Minister Nobusuke Kishi and Australian Minister for Trade John McEwen on 6 July 1957.[6] While the relative weight of the economic relationship may decline somewhat over time, reflecting structural changes in the Japanese economy and changing trading patterns between Japan and Australia, it will remain significant in absolute terms. As a reliable supplier of vital resources, Australia will continue to be acknowledged, *inter alia*, for its contribution to Japan's economic development.

Other important links are developing and broadening between Australia and Japan. The Asia-Pacific Economic Cooperation (APEC) group is a good example of successful joint endeavour, as are the earlier Pacific Basin Economic Council (PBEC) and Pacific Economic Cooperation Council (PECC) initiatives. In addition, Japan is Australia's strongest, most vocal and most consistent supporter in the Asian region, including supporting Australia's bid to join the Asia-Europe Meeting (ASEM). Similarly, Australia supports Japan's bid for a permanent seat on the United Nations Security Council and a more active Japanese contribution to regional stability and security.

Australia and Japan share common positions on many important issues, making them effective partners to promote shared objectives, not only in the Asia-Pacific region. To further strengthen this, the two countries are developing a 'Partnership Agenda' setting out in a broad framework a working agenda covering economic, political and security issues. One significant new initiative concerns mutual recognition arrangements, which, if agreed, would facilitate merchandise trade. Other initiatives envisage closer cooperation in defence and security.

DEREGULATION PROGRAM TARGETS SIX AREAS

Japan's deregulation program aims to improve competition, efficiency and flexibility in areas of the economy plagued by structural rigidity, inefficiency and regulatory constraints. A key objective is to enhance the competitiveness of export-oriented industries and progressively expose protected sectors to market forces. Commercial imperatives and overseas pressure are driving much of the recent liberalisation, which is proceeding despite efforts by entrenched political and economic interests to maintain the status quo in some cases.

6 While they signed the Agreement in their respective capacities of Foreign Minister and Trade Minister, Kishi was at the time Prime Minister of Japan (February 1957 to July 1960) and McEwen Deputy Prime Minister of Australia. This agreement recognised the advantages and potential benefits to both countries of embarking on a new era of closer economic interaction as they attempted to put behind them the lingering antagonisms engendered by the Pacific War.

The Hashimoto Government has targetted six major areas for reform: public administration, fiscal policy, economic and industry policy, the financial sector, health and welfare, and education. Determining the right pace and depth of liberalisation, however, remains a major challenge. (See Chapters 4 - *Macroeconomics*, 7 - *Finance*, 8 - *Market Access* and 13 - *Transport*.)

Administrative Reform

While Japan's bureaucrats contributed much to the country's postwar development, they no longer are regarded as an omniscient elite; many Japanese regard them, along with politicians, as being at the core of Japan's problems. Indeed, the substantive reform that Japan needs may not occur if bureaucrats in certain ministries retain their strong authority. Recognising this, Prime Minister Hashimoto made administrative reform a key policy of his Government, creating widespread uncertainty in the bureaucracy, which had been largely immune from structural change. To cut costs and streamline government administration, the number of ministries may be reduced from 22 to between 11 and 14. However, the bureaucrats are survivors, and some analysts suspect that they may be re-engineering their roles to retain as much influence as possible; they also suspect that some deregulation may really be reregulation in disguise.

Nevertheless, progress is occurring. The Fair Trade Commission, for example, is asserting its role and taking on previously unmovable interests and groups, including ministries. The Office of the Trade and Investment Ombudsman also is becoming more effective. In addition, 'administrative guidance', the unwritten law through which the bureaucracy exercised considerable power, is increasingly being forced into the open, and is being either legally enacted or rejected. (See Chapters 4 - *Politics*, 7 - *Finance* and 8 - *Market Access*.)

Fiscal Reform

Achieving sustainable growth is a growing concern. Managing fiscal policy, including reducing public debt, reversing the declining savings rate and easing budgetary pressures occasioned by the ageing population, will remain major challenges in coming decades. Stop-gap solutions, such as regular minibudgets, are not effective stimuli in the long term. While tax cuts might provide some stimulus, they must be weighed against growing budgetary pressures. Indeed, tax increases are more likely than tax cuts in coming years as Japan tackles its growing public debt and fiscal deficit. Consensus is growing that the only way to avoid economic stagnation is to free up the economy through reform, deregulation, restructuring and innovation. (See Chapter 4 - *Macroeconomics*.)

Economic and Structural Reform

While recognising that Japan's policies were effective in developing internationally competitive industries, many Japanese now criticise the system for overly protecting inefficient sectors. High cost structures and inefficient practices and regulations, particularly in services such as finance, transport, communications and distribution, burden all economic activity and give Japan the highest consumer prices among member countries of the Organisation for Economic Cooperation and Development (OECD). Deregulation is proceeding; however, the extent to which the government will protect emerging industries remains to be seen. (See Chapters 6 - *Internationalisation*, 8 - *Market Access*, 9 - *Distribution*, 10 - *Regions*, 12 - *Energy*, 13 - *Transport* and 14 - *Services*.)

Financial Reform

Financial sector reform is underway, but the extent and time for completion remain uncertain. Reform is crucial and urgent, as the sector is central to improving economic performance and meeting the growing needs of a rapidly ageing population. A key objective of reform is to increase efficiency, flexibility and innovation in financial institutions, so as to provide Japanese borrowers with internationally competititve services, and investors, including retirees, with reasonable returns. With mature sectors likely to decline, reforms also aim to ensure sufficient capital flows to prospective new sectors and enterprises. This will require a less tightly controlled, more efficient, accountable and transparent financial system. Despite their high priority, these reforms will take years.

Fear of risks, such as unemployment resulting from rationalisation, mergers, bankruptcies and other restructuring, has held back deregulation in a number of sectors, including finance. New holding company legislation may assist deregulation, for example, by enabling companies to form subsidiaries to absorb surplus employees or to allow talented workers to try out new ideas under venture capital programs. At the same time, however, establishing holding companies could allow firms to delay hard decisions, which in the long term would not be good for employees or for efficiency. (See Chapter 7 - *Finance*.)

Distribution System Reform

Foreign companies traditionally viewed the distribution system, with its complex, multitiered maze of relationships and financial arrangements, as a major barrier to the Japanese market. However, commercial imperatives arising from the recession and the appreciating yen of the early to mid-1990s are driving liberalisation. Intense competitive pressures have forced efficiencies, innovation and ‘price destruction’, and to a certain extent have eroded the network of loyalties among producers, suppliers, wholesalers and retailers. In addition, sustained foreign pressure has raised domestic awareness of the world’s most complex and costly distribution system.

While some official deregulation has occurred, more is needed. The main beneficiaries to date are consumers, who enjoy improved choice, variety, price and quality. Many companies also have benefitted from lower costs and greater sourcing and marketing flexibility. However, with the weaker yen, pressure for further efficiencies and reform is easing. (See Chapters 9 - *Distribution* and 13 - *Transport*.)

Demographics and Social Security Pressures

The growing aged population has become an urgent issue, making broad change and reform imperative. People over 65 years of age will make up more than 20 per cent of Japan’s population by 2010, compared with just 12 per cent in 1990. Moreover, recent forecasts indicate that Japan’s population will peak at 128 million in ten years, then decline to a mere 70 million by the end of the twenty-first century (Ministry of Health and Welfare, 1997). This has major implications for health care, social welfare, tax revenue, the workforce, families, technology, savings, investment, trade and growth. (See Chapters 2 - *Socioeconomic Evolution*, 3 - *Politics*, 4 - *Macroeconomics*, 7 - *Finance* and 14 - *Services*.)

From around 2000, a declining labour force could reduce output growth unless Japan steps up the pace of structural reform, vigorously adopts new technologies, makes better use of the female workforce and perhaps employs more immigrants. Japanese employment practices are undergoing experimental changes, and larger companies may slowly alter lifetime employment and seniority-based promotion and salary systems. The younger generation entering the workforce over the next decade should enjoy a more mobile and flexible system, with more rapid advancement opportunities for bright, ambitious and innovative employees. (See Chapter 2 - *Socioeconomic Evolution*.)

Education System Reform

Education remains a major issue, as many Japanese recognise that the current system is not providing the analytical, technical and creative skills that young people will need in the future, or even at present. Persistent problems include resistance to technological advances, and pressure to conform to the status quo in schools. Learning by rote rather than learning to find and apply information is still common, and many teachers discourage questions. Experts concur that a strong champion is needed to push through the necessary changes, which would aim to maintain high education standards while promoting greater creativity in the classroom and in extracurriculur activities. (See Chapters 2 - *Socioeconomic Evolution* and 14 - *Services*.)

POLITICAL EVOLUTION

In many ways, Japan's postwar political system is at a crossroads. The old Cold War divisions along conservative and socialist/communist lines are fading rapidly, as is public tolerance for a certain amount of corruption and deal-making in the system in exchange for stability and economic growth. The Japanese voters of the 1990s are uncertain about the future and concerned about economic and social security. They desire a competent, fair and reliable government and political system.

While the October 1996 Lower House elections effectively returned the Liberal Democratic Party (LDP)[7] to government, reflecting the electorate's continuing conservatism, the record-low turnout highlighted the extent of voter apathy and cynicism. Electoral reform has yet to take hold fully, and many doubt it will. Some analysts predict a return to control by a single party with numerous personality-dominated factions. Others are more optimistic, expecting politics to become more policy focused and less personality oriented.

A stronger policy focus may be occurring already. Prime Minister Hashimoto has strengthened his position by making himself acceptable to both sides of a party in which the traditional division along factional lines is becoming a split between

7 The LDP held government for an uninterrupted period from 1955 to 1993.

conservatives and moderates. He has enhanced his credibility by effectively handling numerous difficult policy issues, including the *jusen* housing loans debacle, the US-Japan alliance, and economic and administrative reform. At present, the opposition is in disarray and the LDP is strengthening as conservative independents return to the fold. To regain a strong hold on power, however, the LDP Government will have to deliver workable solutions to Japan's economic and social problems and navigate wisely on security issues. (See Chapter 4 - *Politics*.)

JAPAN INC

A common perception exists that Japan has been run for much of the postwar period by the government-business-bureaucracy 'iron triangle' and networks of business relationships referred to as 'Japan Inc'. This was viewed as a closed circle which planned industrial and economic development and restricted the scope for foreign competition. While of diminishing relevance, this 'circle' is unlikely to disappear altogether. Rather, the relationships are evolving in different ways. For example, corporate self-interest is gaining importance, as Japanese business faces increasing cost and competitive pressures at home and abroad. In addition, growing exposure to liberalisation trends worldwide and ever-faster technological change has raised questions about the effectiveness of the traditional system which allowed the government to pick winners (and protect losers), but which also produced severe rigidities and structural inefficiencies in sectors not exposed fully to international competition.

Technology could reduce the effectiveness of government-business-bureaucracy links. Business relationships in Japan increasingly depend on advanced technology, such as computerised distribution and point-of-sale links, or networked financial services. This could ostensibly reinforce exclusive business relationships (including cartel behaviour) and weaken competition. However, technological advances more probably will force companies to establish flexible rather than exclusive relationships, because the pressures to constantly innovate will drive companies to seek the most appropriate suppliers and partners available, inside or outside the group. Fast-growing mail order and Internet sales pose additional competitive challenges. (See Chapters 8 - *Market Access*, 9 - *Distribution* and 13 - *Transport*.)

STRUCTURAL CHANGE

Globalisation, competition from East Asia, demographics and economic factors (such as the fluctuating yen) will continue to drive structural change in Japan. The manufacturing sector will continue to rely on technological innovation to produce higher-value-added goods, and will move offshore lower-value-added operations. The services sector will evolve rapidly, absorbing workers displaced from manufacturing. Reforms, if sustained, will improve communications, transport and financial services, enhancing the business environment, cutting costs and streamlining transactions, distribution and the supplier-customer interface.

Competition may eliminate many smaller companies in traditional sectors, such as distribution, retailing and locally oriented manufacturing. Creative and flexible medium-sized firms (many of which would be classified as 'large' in most countries) are emerging, especially in the tertiary sector, but also in manufacturing. At the same time, many larger enterprises are consolidating their positions. (See Chapters 4 - *Macroeconomics*, 5 - *Trade*, 6 - *Internationalisation*, 9 - *Distribution*, 13 - *Transport* and 14 - *Services*.)

Should Hollowing Out Be a Concern?

'Hollowing out', in essence the transfer of domestic production offshore, has underpinned Japan's move into higher-value-added exports in recent decades. Given the very rapid rise in US dollar-based wage rates in Japan over the last decade, the hollowing out of labour-intensive processes is a natural phenomenon which should be encouraged to improve efficiency in the economy. However, it has become a concern since the pressures of structural rigidities and yen appreciation from 1985 to 1995 made many companies uncompetitive, leading them to move to lower-cost production sites in Asia. In addition, firms remaining in Japan increasingly source inputs from abroad.

However, Japan still has a comparatively low ratio of offshore production to total manufacturing. In 1995, just 10 per cent of Japan's manufacturing took place overseas, compared with 25 per cent of the USA's and 21 per cent of Germany's. Hollowing out is only a concern if otherwise viable firms are forced by slow domestic reform and an unrealistic exchange rate to relocate overseas.

The trend toward moving offshore slowed in 1996 and 1997 as the economy improved and the yen strengthened to well above the ¥104:US$1 rate that many firms considered their breakeven point (Economic Planning Agency, 1996). However, large cost disparities remain between Japan and its trading partners. Continued liberalisation should help prevent inappropriate hollowing out in future. Ongoing structural adjustment will see greater specialisation in higher-value-added industries, leading to the development of new high-technology and services-based sectors. In addition, the solid, albeit slow, liberalisation moves in the financial sector may forestall any significant hollowing out of the Tokyo money market. (See Chapters 4 - *Macroeconomics*, 5 - *Trade*, 6 - *Internationalisation*, 7 - *Finance* and 8 - *Market Access*.)

CAN THE YEN BE MANAGED?

Managing the yen to prevent excessive fluctuations and appreciation will remain difficult. Many Japanese manufacturers are comfortable with the currency in the ¥110 to ¥120:US$1 range, where it is cheap enough to sustain exports but not so weak as to overprice the increasing volumes of imported inputs. A return to levels of ¥80 to ¥90:US$1 would cause great concern.

A number of reforms underway should reduce, over the medium term, the likelihood of extreme currency fluctuations. Financial system reform aims to make Japan an 'advanced international financial market (that) would promote access to and use of the yen across national borders, … allowing smoother fundraising by foreigners in Japan as well as freer use of the yen abroad' (Prime Minister Hashimoto, 1997). This could smooth capital flows and ease exchange rate fluctuations, ensuring that currency movements more appropriately reflect Japan's economic fundamentals. Macroeconomic management and continuing trade and investment liberalisation also may reduce the yen's volatility. (See Chapters 4 - *Macroeconomics*, *6 - Internationalisation* and 7 - *Finance*.)

CAN JAPAN ACHIEVE A TECHNOLOGICAL EDGE?

Japan's research and development intensity is among the highest in the OECD: 2.8 per cent of GDP between 1990 and 1994 (OECD, 1996).[8] Despite Japan's success, the government is concerned about the economy's long-term innovative capacity, given continued weaknesses in basic research.[9] Companies' focus on advancing their comparative advantages in applied technology has led to a further decline in basic research in the 1990s, igniting concerns about 'hollowing out' of R&D in a number of industries, including information technology, biotechnology and new materials. Analysts have begun to question whether Japan may not be falling irretrievably behind the US in terms of technological innovation (*Nikkei Weekly*, 14 April 1997, p. 7).

To address these issues, Japan made a new commitment to basic R&D in 1996, with legislation establishing a five-year science and technology development program and encouraging venture capital investments. Fully implemented - and it will take considerable political will to do so given fiscal constraints - the program would see government science and technology spending rise to 1 per cent of GDP by 2001, comparable to that of the USA and Europe. However, increasing the science and technology budget may not be enough to give Japan a technological edge. The country also may need to refocus its educational and training system to foster greater creativity, and encourage an entrepreneurial system which advocates inventiveness with its inherent element of risk.

Hollowing Out - or Best Practice?

Faced with domestic technical and human resource constraints, many Japanese companies are commissioning R&D or establishing R&D activities overseas. Some are joining the round-the-clock R&D trend by setting up R&D centres or commissioning R&D in strategic locations such as the USA, Australia and Europe. Under such programs, teams work on the same project around the clock, thus progressing faster than a single one-time-zone research team. Companies then can combine the world-class research with Japan's strengths in designing innovative processes and applications to develop winning products. This phenomenon is likely to continue, hastening product development, further shortening product life cycles and intensifying competition. The Japanese companies that can effectively develop and use such links will maintain a technological edge. (See Chapters 2 - *Socioeconomic Evolution*, 6 - *Internationalisation* and 14 - *Services*.)

....

8 The private sector finances and conducts more than two thirds of Japan's research, while the government funds about 20 per cent and other national sources about 10 per cent. The government's main role is to promote the exchange of research personnel between industry, academia and the public sector and to disseminate information on R&D (OECD, 1996, pp. 134).

9 Weaknesses in basic research and the potential hollowing out of R&D were major concerns discussed in the *1996 White Paper on Science and Technology*, issued by the Prime Minister's Office in May 1996 (OECD, 1996, p. 190).

MANAGING CHANGE

Japan, in most ways, has achieved its goal of catching up with the West in terms of economic power and international status. The challenge now is to form a new national consensus around goals appropriate to take Japan into the twenty-first century. Broad objectives are to remain competitive and enhance the quality of life by coping successfully with intensifying international competition and the challenges of an ageing and contracting population.

Reactive, piecemeal reform could place the Japanese system under major stress, or even force it into long-term cyclical decline. Many Japanese are urging the government to develop well thought-out, farsighted and far-reaching measures that will resolve critical problems, enable Japan to regain its growth momentum, and better position it to manage future challenges.

Much will depend on the Government's continuing reform zeal. Achieving the right pace and scope of reform to satisfy the majority while placating entrenched public and private sector interests, and at the same time endeavouring to achieve a majority in the Diet, will not be easy.

While the Hashimoto Government's reform policy statements have been lauded, they also have been criticised by pro-reformists as insufficient and by anti-reformists as excessive. The pro-reformists point out that many measures are not new, but have simply been repackaged, and that many are too gradual to meet pressing needs. The anti-reformists say that Japan cannot cope with major deregulatory shocks on top of the traumas experienced in the past few years. They claim that people want stability. However, consumers and businesses that have benefitted from the liberalisation, especially those still facing high costs and international competitive pressures, are urging the government to persevere.

Balancing these conflicting elements and proceeding in the nation's best interest will require great persistence, acumen and statesmanship.

THE CHALLENGES OF THE TWENTY-FIRST CENTURY

Japan's objectives for the twenty-first century go beyond the goal of economic growth ('catching up with the West') which dominated much of the twentieth century. A maturing economy, it must meet high expectations for quality of life and stability and solve the social challenges an ageing society and increasing internationalisation pose.

The challenges ahead include:

- determining an appropriate domestic and international role for government
- attaining sufficient growth to support a large aged population with a shrinking workforce and a declining population overall. This is a major incentive for removing excess regulation and government intervention, freeing up the economy and nurturing innovation
- embracing technological advances and providing the younger generation with the tools to take advantage of them

- improving the quality of life of individual Japanese
- determining new comparative advantages and building on them
- defining a broader national interest and the appropriate bilateral, regional and multilateral mechanisms to promote it.

The choices Japan makes in coming years will determine its capacity to meet the challenges ahead. The choices will need to be timely to ensure that living standards and growth continue to improve even as demographic change reduces the fiscal options. The general consensus is that Japan will weather the current period of political, economic and social uncertainty, achieving sufficient liberalisation and innovation to sustain domestic and international competitiveness.

Overall, Australia-Japan relations are strong and multifaceted, and should continue to strengthen and diversify into new areas of trade, investment and international cooperation. While the pace of reform in both countries will determine to a certain extent how ties mature, the potential benefits for Australia of Japan's liberalisation are substantial. Australia must remain well informed about the changing dynamics of the Japanese market and the relationship, if it is to grasp successfully the opportunities that emerge.

REFERENCES

East Asia Analytical Unit, 1996, *Asia's Global Powers: China-Japan Relations in the Twenty-First Century*, Department of Foreign Affairs and Trade, Canberra.

Economic Planning Agency, 1996, Economic Survey of Japan 1995-1996, Economic Planning Agency, Tokyo.

Hashimoto, R., 1997, 'Reforms for the New Era of Japan and ASEAN - for a Broader and Deeper Partnership', policy speech for The Singapore Lecture, 14 January 1997 (provisional translation).

Kishi, N. and Russell, D., 1996, *Successful Gaijin in Japan: How Companies are Making it in Japan*, NTC Business Books, Chicago.

Ministry of Health and Welfare, 1997, *Long-Term Forecasts of the National Institute of Population and Social Security Research*, Ministry of Health and Welfare, Tokyo.

Nikkei Weekly, 14 April 1997, 'In Technology Race, Japan is Keeping Pace', p. 7.

Organisation for Economic Cooperation and Development (OECD), 1996, *OECD Economic Surveys: Japan 1996*, OECD, Paris, December.

World Bank, 1997, *World Development Indicators*, CD-ROM, Washington DC, February.

Chapter 2

SOCIOECONOMIC EVOLUTION — OR REVOLUTION?

Japan is undergoing extensive societal introspection and change, driven primarily by:

- unprecedented affluence
- rising quality of life expectations, especially by youth and women
- a dramatic ageing of the population
- an urgent need to revitalise the economy, following the worst recession for decades.

Traditional Japanese institutions and practices are being challenged. Extended families are increasingly the exception rather than the norm; families are getting smaller; young and old people are living alone; women are participating more in the economy, although not realising their potential; and the younger generation is becoming more individualistic. Companies are restructuring and adjusting employment practices, rewarding merit and performance alongside the traditional seniority and loyalty; this in turn is producing a more fluid labour market. At the same time, Japan may face labour shortages in the first half of the twenty-first century. Some options are to use more efficiently existing labour resources, particularly women, make greater use of foreign workers and free up the labour market by continuing the deregulation process.

Consumer purchasing patterns also are changing, reflecting evolving tastes, wider choice and greater price consciousness. Rising affluence has increased expenditure on services and travel, and as the economy recovers from the recent recession, shopping is less constrained.

In short, important changes are occurring that will affect doing business in Japan in coming years. This chapter examines these trends and their implications for companies. It first looks at the key demographic developments such as the ageing population, changing household structures, generational differences and the status of women. It then assesses the challenges to traditional labour market practices and the education system. Finally, it examines how consumers are changing their spending patterns.

TODAY'S SOCIETY

The 1996 annual *White Paper on The National Lifestyle* (Economic Planning Agency, 1996) claims that societal flux has eroded Japan's self-confidence with people tired of crisis and confused by change. The main reasons are that:

- the Japanese economic miracle ended abruptly with the collapse of the bubble economy and the deepest and most prolonged recession in Japan's modern history, provoking much uncertainty about the future

- structural change, especially of households, birthrates, the labour market and enterprises, has caused Japanese people to reassess the way they live and their expectations for the future. Indeed, the central role of loyalty, which has traditionally underpinned Japanese society, began to be re-examined in the business environment as longstanding relationships, including those between employer and employee, came under strain during the prolonged recession
- a spate of natural crises hit Japan: the 1993 drought and rice crop failure necessitated the first-ever substantial rice imports; and the 1995 Great Hanshin Earthquake caused major loss of life and drew criticism of Japan's ability to construct safe infrastructure and manage natural disasters
- Japan's international corporate image was damaged by scandals exposing inadequate internal management practices, such as the negative impact on world copper markets of Sumitomo's secret copper trading, Daiwa's failure to report US losses as required by US law and the US sexual harassment class action suit against Mitsubishi
- scandals involving government and bureaucracy damaged the traditional respect for the bureaucracy and faith in political leadership, such as the Ministry of Finance's failure to avert the collapse of the housing loan companies, the 1996 scandal implicating the Health and Welfare Ministry in the use of blood products tainted with AIDS virus and corruption charges implicating politicians and bureaucrats
- Japan's image as a harmonious, crime-free society was damaged following the 1995 poison gas attacks on Tokyo subways by Japanese cult members and increases in violent and drug-related crimes.

It is not surprising, therefore, that longstanding institutions, role models and ideals are no longer sacrosanct. Although more people feel their quality of life has improved, they also are more pessimistic about the future than they were a decade ago (*Nikkei Weekly*, 25 November 1996, p. 1, based on the *White Paper on National Lifestyle*).

Ageing, Urbanised, Middle-Class Society

Japan's population is expected to peak at 130 million between 2010 and 2015, declining to 103 million by 2065 (Management and Coordination Agency, 1996, p. 33). In 1996, of a population of 126 million, 16 per cent was aged under 15, the next 70 per cent was aged between 15 and 64, and the remaining 14 per cent was aged 65 and over. Between 65 and 70 per cent of Japanese live in urban areas and surrounding residential districts; more than 50 per cent live in Tokyo, Osaka and Nagoya. People aged under 30 comprise more of urban than rural populations. Although income disparity gradually is increasing, one thing unchanged in recent decades is that, like most Western countries, most Japanese still consider themselves to be middle class (Figure 2.1).

The proportion of elderly in Japan's population is rising dramatically, and life expectancy, already among the longest in the world, is still increasing.[1] The

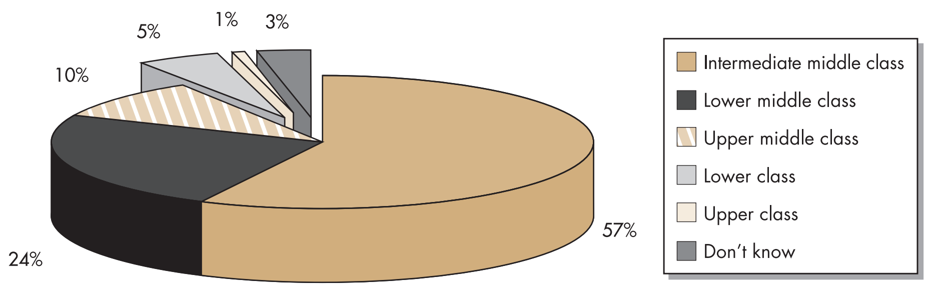
[1] For example, average life expectancy in 1995 was 77 years for men and 83 years for women. Australia also has relatively high life expectancy: 74 years for men and over 80 years for women.

proportion of elderly in the population will grow most rapidly over the next two decades; by 2015, 25 per cent of the population will be aged over 65 (Figure 2.2). By 2040, almost 30 per cent of the population will be aged over 65, compared to 14 per cent aged under 15. By 2040 then, 43 per cent of the population will be outside the labour force (compared to 30 per cent at present), leaving just 57 per cent of the population to support the children and the retired.[2]

Figure 2.1

Most Japanese Consider Themselves Middle Class

Self-Perception of Living Standards in Japan (1995)



Note: Based on a Prime Minister's Office survey in May 1995 of 10 000 people (with an effective response rate of 73.5 per cent).

Source: Japan External Trade Organisation, 1996a, p. 146.

Of all socioeconomic developments, the ageing of the population has the most profound implications for Japan. These include:

- a smaller workforce paying taxes to support social services
- a larger proportion of older employees in the workforce
- a shrinking economically active population with greater incentive to save for retirement, thereby altering consumption patterns (See Chapter 4 - *Macroeconomics*)
- a growing economically unproductive population drawing on savings and pensions, reducing funds available for investment
- more retired people seeking paid or unpaid postretirement occupations
- increased demand for aged-care goods and services, straining the medical and welfare budget
- business opportunities emerging in the 'silver' (aged-related) industries (see Chapter 14 - *Services*)
- a society more influenced by the aged, and therefore more conservative.

....

2 However, a large proportion of Japanese retirees continue to work after retirement.

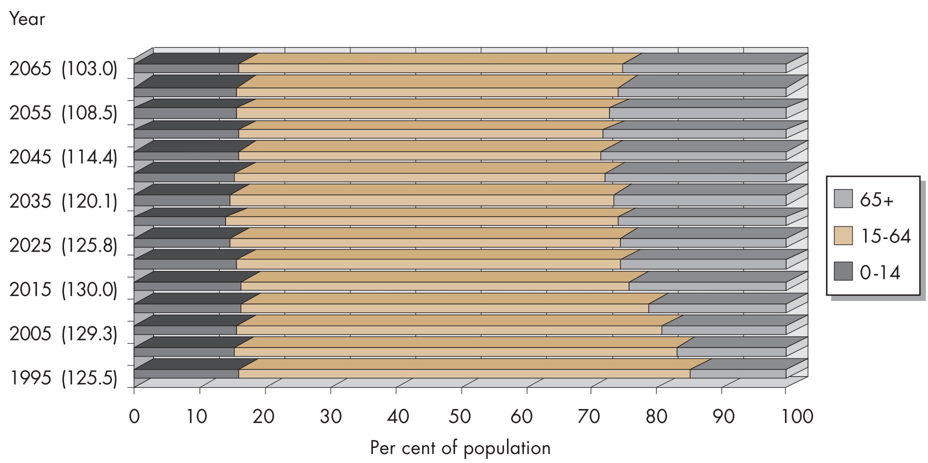
Japan's ageing population is explained mainly by the declining birthrate, which at 1.4 children for each woman in 1995, was the lowest in the world and far below the 2.1 rate needed to maintain a constant population size. This rate is projected to decline further to 1.38 in 2000 and then climb slowly to hover around 1.6 from 2025.[3] The birth rate is declining because:

- while more women work outside the home, work practices do not accommodate working mothers
- the economic cost of having children, especially of education, is relatively high
- government and societal support for working mothers generally is lacking
- more women are marrying later, or never marrying[4]
- more married couples are having fewer children or refraining from having children at all.

Figure 2.2

Japan's Population Set to Age Dramatically

Ageing of Japan's Population: 1995 to 2065



Note: Figures in parentheses next to the year indicate the total population (millions of people) projected for that year.

Source: Management and Coordination Agency, 1996, p. 33.

....

3 Based on a study by the National Institute of Population and Social Security Research using 1995 census data, reported in the *Nikkei Weekly*, 27 January 1997, p. 3. However, Professor Noriyuki Takayama, Hitotsubashi University, anticipates that the birth rate could fall to 1.1, the current rate for Tokyo, because child rearing is so unrewarding for women and expensive (*Far Eastern Economic Review*, 3 April 1997, p. 36).

4 Many women do not expect marriage will improve their quality of life yet most adhere to societal norms and marry. In many cases, marriage places a heavy burden on women who become working mothers. In 1996, nearly 50 per cent of women in their late twenties and 20 per cent of women in their thirties were single. It is forecast that 14 per cent of women born in 1980 will never marry, and the rate for future generations will be similar (*Nikkei Weekly* 27 January 1997, p. 3, p. 6; *Japan Times*, 13 February 1997).

Increasing pressure is on government and business to address the declining birth rate and future labour shortages by easing the burden on working mothers; using and rewarding more effectively available labour, regardless of age, sex and nationality; and accelerating economic deregulation, allowing a more efficient use of labour resources.

HOUSEHOLDS AND FAMILIES

While marriage is relatively stable by Western standards, in 1996 divorce reached a record high in Japan at 1.7 divorces per 1 000 people,[5] compared to 2.8 divorces per 1 000 people in Australia. The number of single-parent families has risen up to 50 per cent since 1970 (*The Economist,* 21 December 1996, p. 28). By the mid-1990s nuclear (two-generation) families comprised just over 60 per cent of households. Single-member households comprised 25 per cent of households and three-generation households comprised 13 per cent. Unlike in the past, most newly married couples now live apart from their parents, because:

- 'they will lose independence if living with parents'
- 'they dislike having to yield to the wishes of the older generation'
- 'the house is too small, so two or three generations cannot live together' (Japan External Trade Organisation, 1996b, p. 20, based on the 1993 Basic Survey of National Life).

The number of single-member households is rising, as affluence, education and increased adaptability enable more young and old people to lead independent, self-reliant lifestyles. When grandparents live in an extended family it is often at the request of their children who benefit from pooling family assets and having live-in housekeepers and baby-sitters. Increasingly, grandparents object to this role being thrust on them (Fujiwara, 1995).

Most married women with grown children or with no children work, mostly in part-time positions. Of all women working full time, 41 per cent are married; whereas, of those working part time, 78 per cent are married. These women spend some of their extra income on travel, eating out, cultural pursuits, and high-quality personal effects such as clothing and accessories. They also save for children's education or use money for mortgage repayments. Although the employment situation for women deteriorated during the recession, the number of double income families is expected to increase. In addition to increasing household purchasing power, this phenomenon is changing consumption patterns. More time at work leaves less time for the home, boosting demand for convenience foods, home services, education, child care and flexible shopping hours. It also leaves fewer family carers for elderly relatives, increasing demand for aged-care services.

5 As reported in the *Nikkei Weekly,* 9 September 1996 and 13 January 1997, based on data from the Ministry of Health and Welfare. Most divorce occurs among couples married less than five years.

Generational Differences

The first baby boomer generation, born immediately after World War II into a life of scarcity and intense competition, was also the first to experience the affluence Japan's economic prosperity generated. They sacrificed much to enable Japan to achieve rapid economic growth and catch up with the West, obeying requirements to conform. They tend to be very status conscious, buying fashionable products that provide prestige and excitement, and spent lavishly during the bubble economy period.

The second baby boomer generation, born in the early 1970s, are very different. Typically, they are:

- very concerned with their individual identity
- less competitive than preceding generations
- less committed to work, changing jobs at a higher rate than preceding generations and focusing more on family and personal fulfillment
- governed less by sexually prescribed roles than previous generations
- very aware of and burdened by the ageing population
- extremely fashionable and style-literate, knowing what they want and dismissive of anything that does not suit their taste.

The younger generation's increased focus on individualism and quality of life has led the older generation to label them as lazy and lacking the capacity to maintain Japan's place as a leading world economy.

WOMEN'S STATUS CHANGING, SLOWLY

In the 1990s, over half of working-age women are employed and more women than men enter tertiary education often with higher grades than males, but still Japanese women lag behind women in other industrialised nations. Increasingly, they are aware of this but tend to be risk adverse when assessing the impact of change against the security of traditional values.

While more women than men now turn out to vote, they have little influence in the political system. In 1996, women comprised only 7.6 per cent of national politicians, well below many other countries.[6] In December, 1996 of 500 seats in the lower house, women held only 23 or 4.6 per cent; of 250 upper house seats, women held 34 or 13.5 per cent.

The one area where Japanese women express themselves freely is in consumption; they are by far the most active consumers in the world (Fujiwara, 1995). Traditionally, Japanese women managed the family budget, controlling regular expenditure on food and household items, but also strongly influencing spending decisions on consumer durables, education and leisure activities. This role now is expanding with increased affluence. For example, in 1996 the Japanese (mainly women) accounted for 70 per cent of worldwide sales of designer-label clothes (*Nikkei Weekly*, 22 April 1996).

6 Comparable figures are 21 per cent in Australia, 11.4 per cent in Indonesia, and 38 per cent in Sweden.

Young women in their 20s and 30s who live with their parents and commute to work have very high purchasing power, are extremely fashion conscious and enjoy shopping. These 'single aristocrats' spend more on clothing, accessories and cosmetics than any other age group; they save for expensive sports, domestic and international travel, weddings and their own homes; and they list friends, travel and good health as their main interests. These women also work for longer, although they can be pressured if they are not engaged or married by 26, the average age for first marriage.

Japanese women were once stereotyped as 'meek and patient'. Whilst Japanese women had power within the home, their influence outside the home was very limited. However this is changing, albeit slowly. Younger Japanese women are losing their fear of being thought 'unfeminine' if they speak their minds, and teenage girls increasingly adopt the curt 'male' speech patterns. Older women, too, are more assertive. For example, in March 1996, hundreds of housewives in Hiroshima Prefecture forced a referendum which deposed the local mayor because he would not build a new hospital for the aged, whose main carers are housewives (*The Economist*, 1 June 1996, p. 91).

However, in politics, public administration and business, women have yet to achieve the influence of their counterparts in other industrialised countries. According to Shizue Kato, the 100-year-old 'grandmother' of Japanese feminism and the first woman elected to parliament, Japanese women now are among the best educated and richest in the world, but need to be more assertive and take on decision-making positions (*The Economist*, 1 June 1996, p. 91).

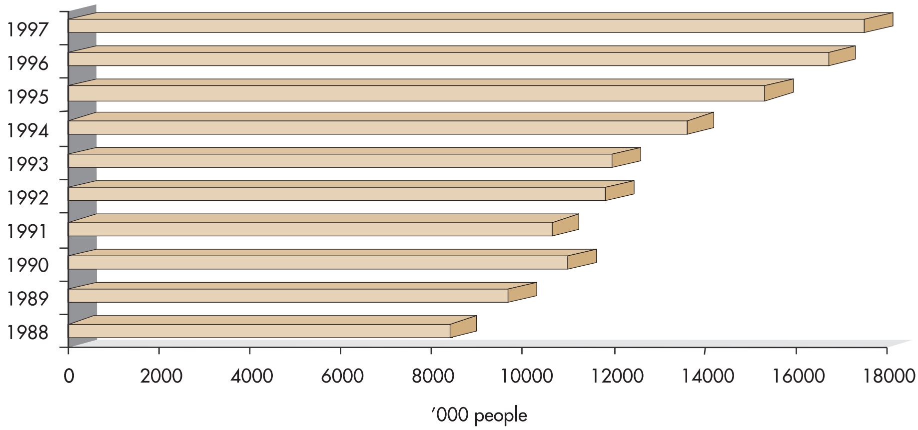
OVERSEAS TRAVEL

Japanese overseas travellers have almost doubled in less than a decade (Figure 2.3 and Chapter 14 - *Services*). Even during the post-bubble recession, the strong yen encouraged overseas travel, which declined only in 1991. The two most travelled groups are young female tourists and older businessmen (Table 2.1). Significantly, in 1995 the Japan Travel Bureau reported a marked increase in families travelling together. Exposure to overseas living standards through travel and living abroad has encouraged the Japanese to improve the quality of their lives. They seek better housing, more leisure hours, various leisure activities and more high-quality, reasonably priced goods and services, including imports.

Figure 2.3

More Japanese See the World

Overseas Travellers



Note: 1997 figure is a Japan Travel Bureau projection.

Source: Japan External Trade Organisation, 1996a, p. 158 (based on the Ministry of Justice's *Annual Report of Statistics on Legal Migrants*, 1995).

Table 2.1

Young Women and Senior Businessmen Travel Frequently

Profile of the Japanese Traveller (1994)

Travellers, Most-travelled by age	**millions of people**
Total Population — 20-29 years old	3.8
Male — 40-49 years old	1.8
Female — 20-29 years old	2.4
Most common reasons for travel	**per cent of travellers**
First — Tourism	83.0
Second — Business	13.0
Third — Scientific study and research	9.0
Strongest growing reasons for travel	**per cent change from 1993**
First — Business	18.0
Second — Tourism	13.0
Third — Study and acquisition of technical skills	11.0
Most popular destinations	**per cent of travellers**
First — USA	32.0
Second — Republic of Korea	11.0
Third — Hong Kong	7.0

Source: Japan External Trade Organisation, 1996, pp. 158-59 (based on the Ministry of Justice's *Annual Report of Statistics on Legal Migrants*).

THE JAPANESE AT WORK

Japan's labour market is facing major structural change in the wake of recession, financial crisis, increased import penetration, heightened competition and an ageing population. Employers are confronting complex management issues as they seek to improve competitiveness. The production of many low-value-added products already has moved overseas, especially to Asia, to benefit from lower costs and to service local, as well as Japanese, markets. At home, employers must balance an immediate need to restructure enterprises and reduce workforces with the longer-term prospect of labour shortages.[7] It will be critical to the control costs associated with more older workers, given the seniority based remuneration system.

Employees are experiencing unprecedented job insecurity as a result of the restructuring. This shocks those who have been devoted to one company. People of all age groups, but especially those just beginning their careers, are reassessing the balance between their private and working lives. The result is traditional attitudes to corporate loyalty are eroding.

Japan's record unemployment of 3.5 per cent in 1996, although low by world standards, reflects a turbulence unusual to the Japanese labour market. Furthermore, if hidden unemployment[8] were included, the rate would be 8 to 10 per cent, similar to many other industrialised countries.[9]

Unemployment has hit younger people and women. The unemployment rate for people aged 16 to 25 is more than double the official national average mainly because companies cut recruitment instead of dismissing existing employees during the recession. Also younger workers are more inclined to leave jobs they find unsatisfying, making them relatively mobile (Figure 2.4). Thus, at any given point they are more likely to be between jobs and recorded as unemployed.

While firms have been reluctant to retrench permanent male staff, they have retrenched part-time employees, a category almost entirely female. Moreover, in 1996, for every male Japanese graduate seeking work, 1.3 jobs were available; for every female, fewer than 0.5 jobs were available (*The Economist*, 1 June 1996, p. 91). Female graduates call the present employment situation the 'super ice age', and consequently complain more about discrimination. While statistics do not yet show large numbers of unemployed people in their mid- to late careers, company restructuring efforts focus on this age group and it faces an unprecedented rate of early retirement or transfers to subsidiaries or other companies.

7 Government forecasts show the young workforce (aged 20 to 29) declining from its current level of around 19 million to about 12.5 million over the next two decades. The size of the total Japanese workforce is expected to start to decline even earlier, probably before the turn of the century.

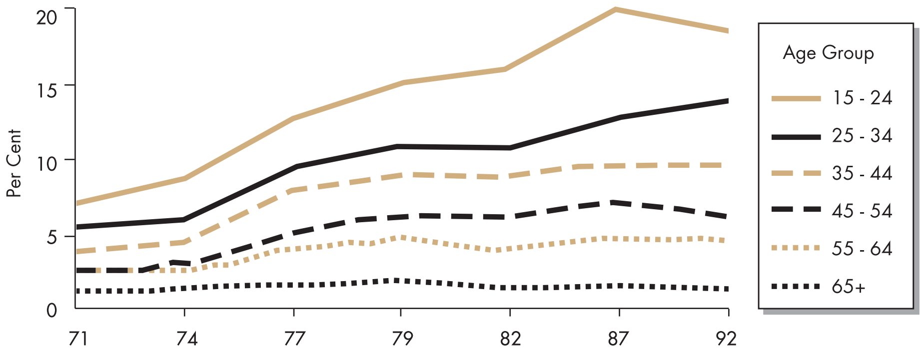
8 That is, counting people who are so discouraged by employment prospects that they drop out of the labour market and others who are not included in official statistics, such as part timers who would like to work full time.

9 A senior economist at Sakura Institute of Research expects that the recent 3 per cent unemployment rate may be the natural unemployment rate of a more mature Japanese economy (*Nikkei Weekly*, 3 February 1997, p. 3). If this is the case, it will entail a major change in employment policies and attitudes.

Figure 2.4

Young People Keen to Change Jobs

Trends in Workers Wishing to Change Jobs
Per Cent



Source: Ministry of Labour, 1996.

Nevertheless, actual employment cutbacks are tempered by expectations of a labour shortage in the next century due to the ageing population. This, combined with a traditional reluctance to dismiss workers outright, means that the level of underemployment remains significant.

LABOUR MARKET RIGIDITIES

Lifetime employment and seniority-based labour management practices are only the norm for male workers in larger enterprises, estimated to cover between 20 to 40 per cent of the labour force. However, all employees in Japan tend to stay with the same company for relatively long periods; in 1996 the average length of continuous employment for men was 12.7 years and 7.4 years for women, higher than for any other country (*Nikkei Weekly*, 25 November 1996, p. 2).[10] These and other institutional arrangements have led to labour immobility, thereby impeding enterprises' ability to adjust quickly to change - a reason often used to explain the length and depth of the recent recession. For example:

- an important part of the government's unemployment relief program assists firms to maintain labour rather than redeploy workers to more profitable activities
- retirement pension systems are not portable
- the size of the retirement lump sum tax exemption is a function of the length of continuous service with one firm, rather than a function of total working life.

....

[10] For example, the corresponding figure for men in the USA was 7.5 years, and in the UK was 9.2 years.

As well as impeding the movement of labour from declining to emerging industries, labour market rigidities affect Japan's performance at the micro level, both domestically and overseas. Management practices and protectionist policies insulate many domestically oriented businesses from global competition. Restrictions on competition enable companies to maintain inflexible and outdated business practices and to pay higher input costs. These burdens are passed on to consumers as higher prices. The key issues include:[11]

- *risk-averse behaviour*: employees are reluctant to make bold decisions which might derail a lifetime career; this conservatism stifles firms' progress
- *barriers to women*: as attitudinal and structural impediments to the effective use of women's qualifications and abilities abound, Japan underuses half its potential labour supply
- *individual fulfilment*: the lack of alternative employment opportunities means that employees are often subject to the whims of management in job assignment, regardless of individual abilities and preferences
- *personal lives*: companies often instil a culture whereby willingness to accept any transfer, work excessive hours and take few holidays are criteria for promotion to management positions; this seriously affects family life
- *workplace concerns*: firms' incentive to respond to concerns about work conditions is weakened as they know employees are unlikely to leave
- *conformity*: workplace practices encourage corporate cultures emphasising conformity; this reduces their ability to integrate diverse viewpoints and negatively affects creative decision making and the flexibility required for global operations.

In the past, some of these characteristics were advanced as aspects of Japan's traditional values system that assisted the economy to rapidly achieve Western income levels. That so many basic workplace features now are seen as barriers to change indicates the challenge management faces in reassessing core values and realigning priorities. For this reason, change is unlikely to be rapid.

CHANGES IN THE WORKPLACE

Nevertheless, the changes occurring in the workplace include encouraging staff to take holidays, offering early retirement programs, basing pay and promotion more on merit and less on seniority, refusing to guarantee lifetime employment and practising more flexible recruitment. For example, almost 60 per cent of the 251 companies listed on the Tokyo Stock Exchange reported that they gave preferential treatment to employees prepared to take early retirement, compared with only 20 per cent in 1980 (Institute of Labour Administration's annual 1995 survey). One-third offered early retirement benefits to employees aged under 50, and 6 per cent to employees aged under 40 (*Look Japan*, December 1995, p. 5).

....

11 These are according to Rochelle Kopp, Managing Principal of Japan International Consulting in Chicago and author of *The Rice Paper Ceiling* (*Nikkei Weekly*, 29 April 1996, p. 7).

More companies are recruiting throughout the year according to need rather than relying on an annual graduate intake. Daiei, for example, has even ended the traditional celebrations for new graduates entering the company to discourage expectations of lifetime employment. Although not a mainstream trend, some progressive companies appoint foreign executives to introduce change. A more positive attitude towards foreign employees, especially in their promotion to management positions, could eventually help deal with labour shortages. Even opportunities available to foreigners in local and prefectural governments are reported to be increasing (*Nikkei Weekly*, 3 February 1997, p. 1). Similarly, working for foreign companies is becoming more acceptable among Japanese, giving foreign investors better access to high-quality employees. Indeed, more ambitious young graduates, especially women, see working for foreign companies as more rewarding than working for traditional Japanese enterprises.

Part-time employment[12] has grown rapidly in the 1990s due to its flexibility in controlling labour costs in a flat and increasingly services-oriented economy. In 1995, part-time employment grew eight times faster than full-time employment (2.5 per cent versus 0.3 per cent), and relatively strong growth should continue. Because more women work part time and for less pay, part-time workers' earnings as a proportion of full-time earnings have fallen.

CHANGING LABOUR PRACTICES

Nippon Steel's three-year restructuring plan, which started in 1994, will abolish 4 000 white-collar positions and 3 000 blue-collar jobs. Half of the white-collar reduction will be through attrition and the remaining 2 000 employees will be transferred to affiliate companies.

Fujitsu introduced a merit-based salary system for its professional staff to give management some discretion in rewarding employee ability and performance. Between 1994 and 1997, 7 000 managers and 6 000 senior professionals from a workforce of 54 000 were moved to this system.

Nihon Unisys, in 1994, transferred employees aged 50 to 55 to subsidiary companies, in theory extending their employment to the age of 63. These employees also were given the chance to start new careers in related firms. For example, Nihon Unisys assisted employees aged 48 to 58 find new jobs with subcontractors or, alternatively, guaranteed business to any employee aged under 55 with 20 years' service who started a business in a relevant field.

East Japan Railway Company introduced the 'New Life Plan with Paid Time Off', which more than 600 employees accepted. Under this plan, employees aged 55 and over were given retirement options ranging from extended paid leave and transfer to an affiliated company, to early retirement.

Source: *Australia-Japan Economic Institute*, 1996, p. 14.

[12] Less than 35 hours work per week.

While demand is mostly for unskilled part-time workers, outsourcing has increased the need for skilled workers. This development has placed pressure on the 1986 Manpower Dispatching Business Law, under which the Ministry of Labour retains control over private temporary employment agencies and restricts the employment categories they can cover. In 1997, the Ministry increased the number of categories from 16 to 28 but pressure remains on the Government to remove more restrictions to improve labour market flexibility. In the meantime, temporary placement agencies are branching out into career counselling and retraining.

While companies practise early retirement policies, after many years' debate the Government is extending the retirement age. From 1998, the official retirement age will be increased from 55 to 60, and it may be further extended to 65. However, large companies oppose moves in this direction due to the cost of maintaining expensive elderly labour. Despite the official retirement age, in 1994, 75 per cent of men aged 60 to 64 years, and 50 per cent aged 65 to 69 still worked (Japan External Trade Organisation, 1996b, p. 29). At the same time, the Government gradually has shortened the working week for large companies, with small and medium-sized companies to follow within two years.

FEMALE EMPLOYMENT

According to the Ministry of Labour, in 1995, 20.5 million women comprised nearly 40 per cent of the workforce (Japan External Trade Organisation, 1996a, p. 125) - a proportion only slightly lower than Australia's 43 per cent. The female labour force is being redistributed from factories and primary industries into white-collar occupations (Figure 2.5). In 1994, more than one third of working women were in clerical positions, up almost 10 percentage points from 1960. More than one quarter were in professional, technical and sales occupations, the fastest-growing segments.[13] However, the proportion of women employed as officials and managers remained relatively unchanged, at a minuscule 1 per cent (Table 2.2).[14]

Table 2.2

Japanese Women Managers Lag Behind Their Western Counterparts

Working Women - Per Cent Who Are Managers

	Japan (1995)	USA (1993)	Canada (1993)	Germany (1991)
Female employees who are managers	1.0	11.4	13.1	1.6

Source: Japan External Trade Organisation, 1996a, p. 125.

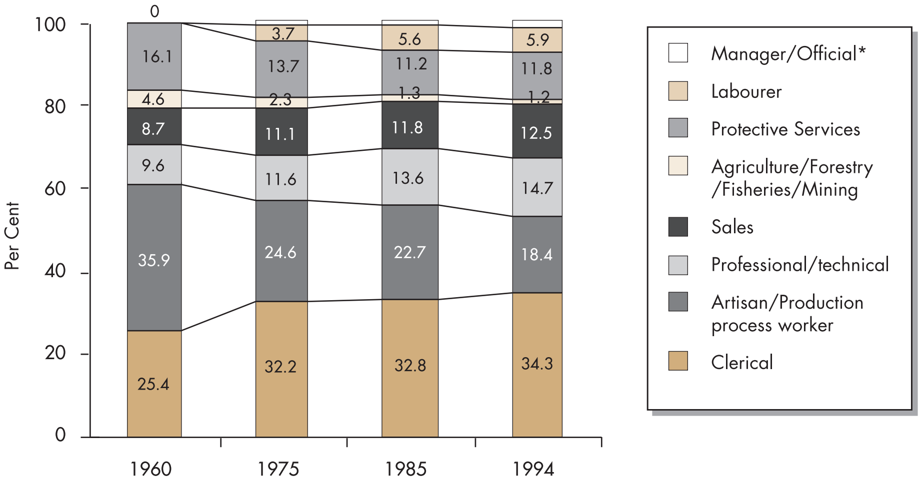
13 The one exception to these trends has been the dramatic growth in women classified as labourers.

14 By comparison, in Australia, women comprise 22 per cent of managers and administrators, 41 per cent of professionals, 36 per cent of paraprofessionals, 6 per cent of tradespeople, 71 per cent of clerks, 51 per cent of sales and personal service workers, 9 per cent of plant and machinery operators and 24 per cent of labourers and related workers (Australian Bureau of Statistics, 1994).

Figure 2.5

Women's White-Collar Employment Increasing

Changing Female Employment Structure



Note: * Figures for this category are: 1960: 0.3 per cent; 1975: 0.9 per cent; 1985: 0.9 per cent; 1994: 1 per cent.
Source: Australia-Japan Economic Institute, 1996, p. 11.

While Japan adopted Equal Employment Opportunities legislation in 1985, the law contains no punitive measures, so it is relatively ineffective. In 1984, before the Equal Employment Opportunities law was enacted, 66 per cent of companies admitted to hiring men for skilled and managerial jobs and women for clerical tasks. By 1992, although some progress had been made, the figure was still a high 40 per cent (*The Economist*, 1 June 1996, p. 91). Japan compares poorly with international levels in that:

- only 4 per cent of managers are women (Table 2.3)
- only 0.3 per cent of board members in large Japanese corporations are women
- women earn only 62 per cent of men's earnings on average (compared to 65.5 per cent in Australia)
- the 1947 Labour Standards Law restricts women's working hours, thereby limiting their career opportunities[15]
- the first workplace sexual harassment case was only won in 1995.

Many women seeking professional careers opt to join international companies or organisations, or to start their own businesses. For example, between 1975 and 1995, the number of Japanese women employed in specialist or higher positions in the United Nations grew from 19 to 190 (*Nikkei Weekly*, 6 May 1996, p. 14). In most

[15] This law prohibits women from working more than six overtime hours per week and a total of 150 overtime hours per year; working on public holidays; and working between 10 p.m. and 5 a.m. All manufacturing and most services jobs are covered by the law. In July 1996, a council established by the Ministry of Labour proposed eliminating this law (*Nikkei Weekly*, 9 September 1996, p. 1).

cases, however, Japanese women still have to choose between a family and a career. With the workforce shrinking, Japan can ill afford to ignore the skills of its highly educated and talented women.

Table 2.3

Very Few Female Managers

Women As a Per Cent of Managers in Japan Pre- and Post-EEO Law

	1984				1994			
	Total	Department head	Section head	Chief clerk	Total	Department head	Section head	Chief clerk
Per cent of managerial positions at this level	**100.0**	7.1	25.0	67.9	**100.0**	6.9	28.4	64.8
Women as per cent of managers at this level	**2.5**	1.1	1.5	4.0	**3.9**	1.4	2.6	6.4

Note: Based on data from companies with 100 or more employees.

Source: Japan External Trade Organisation, 1996a, p. 124 (based on Ministry of Labour data).

EDUCATION

Japan's education system, long hailed as one of Japan's fundamental strengths, now is subject to increasingly trenchant criticism (Table 2.4). The system, by perpetuating loyalty to the status quo, focusing on rote learning and failing to foster inquisitive minds, is hindering attempts to revitalise the economy. Education tends to be highly structured and inflexible, disadvantaging students who attend schools that do not prepare them for entrance examinations in Japan. After exposure to Western schooling, Japanese parents often despair that their children are discouraged from even asking questions in class. According to Professor Hideo Aiso[16] 'it is not enough just to acquire knowledge; students must also be able to organise and use it' (*The Australian*, 23 October 1996, p. 28). Improved education is essential to keep Japan internationally competitive, yet in some key areas (for example, foreign languages and computers) Japan has fallen behind other developed countries. Consequently, Prime Minister Hashimoto included education reform as one of his 'six pillars of reform'.

[16] Professor Hideo Aiso is Keio University's Chair of the Graduate School of Media and Governance.

Table 2.4

More Studying Now

Participation Rates in Japanese Education
Per Cent, 1986 and 1995

	1986 Total	1986 Males	1986 Females	1995 Total	1995 Males	1995 Females
Advancement to high school	94.2	93.1	95.3	96.7	95.8	97.6
Advancement to universities and junior colleges within two years of high school graduation	34.7	35.9	33.5	45.2	42.9	47.6

Note: Japan has an average 99.99 per cent participation rate in compulsory education.

Source: Japan External Trade Organisation, 1996a, p. 152 (based on Ministry of Education data).

The education system shows some preliminary signs of change. Inagakuen High School is one example (see box). The innovative 4 000-place Shonan Fujisawa Campus of Keio University is another. It aims to nurture individuality, originality and internationalisation and has ten applicants for every available place (*The Australian*, 23 October 1996, p. 28).

THE NEW-LOOK JAPANESE SCHOOL?

Inagakuen High School, north of Tokyo enrolls 3 000 students, and is the largest upper-secondary school in Japan. It is a comprehensive school that aims to foster individuality and creativity, offer educational freedom and choice, and emphasise internationalisation. The school's motto is: think for yourself and be creative in society.

Entry is competitive: only one in three applicants is accepted. Some students travel 2.5 hours per day to attend the school. Each year, 90 per cent of Inagakuen students apply for university places and about half are successful, above the national average.

Source: *The Australian*, 23 October 1996, p. 28.

However, the tight hold of the Ministry of Education, or *Monbusho*, over the formal education system may impede reform. While freedom to determine courses and curricula in universities has increased, the Ministry continues to control student intake to protect small regional universities. It apparently took US intervention before the Ministry of Education allowed publicly funded universities to subscribe to the Internet.

Forces Driving Change

As education broadens in Japan, demand for more nontraditional educational services will increase. Education is being reassessed and its lifetime value strengthened.[17] Universities gradually are offering more evening classes, opening their doors to mature-age students and playing a larger role in retraining an increasingly mobile labour force. Demand for vocational education is increasing as more people seek postretirement pursuits. (See Chapter 14 - *Services*.)

Another force driving change in the education system is the transformation of Japanese employment practices. As university degrees no longer guarantee secure long-term employment, many students seek alternative qualifications for working in smaller enterprises and starting their own business. Universities and business colleges have responded by offering more courses in entrepreneurship, for example at Toyohashi Sozo College near the city of Nagoya. One third of its students are accepted on their high school credentials; the rest complete a special entrance exam. In 1996, applicants exceeded places ten-fold. The story is similar with the three-year-old University of Aizu, Fukushima Prefecture. Students also are increasingly keen participants in Japan-wide seminars on entrepreneurship by the MITI-affiliated Venture Enterprise Centre (*Nikkei Weekly*, 3 October 1996).

CONSUMER VALUES

In the late 1980s when the economy was booming and incomes were rising, the Japanese became well known for extravagant spending. During the recession of the early 1990s, consumers became preoccupied with low prices and frugality, and consumption expenditure plummeted. However, in late 1995, as expectations of economic recovery strengthened, consumers began to move towards 'smart shopping',[18] and since then, value for money has become the primary concern. This section explores how consumption patterns are evolving in Japan.

In recent years, exporters to Japan have benefitted enormously from consumers' more positive attitude towards imported goods. Whereas expensive brand-name imports were always fashionable and popular, consumers were less receptive to other imported products. Imports are increasingly acceptable because:

- consumers are less tolerant of the large price discrepancies between domestic and foreign products
- import prices are lower due to the strong yen of the early 1990s and distribution system reforms
- quality, after-sales service and marketing have improved as more exporters become familiar with market requirements

[17] According to Katsuhide Kusahara, Director General of the Monbusho's Lifetime Learning Bureau, Japan is entering 'a new stage of social evolution where education is valued throughout an individual's lifetime' (*Look Japan*, January 1996, p. 9).

[18] 'Smart shopping' refers to the trend of spreading purchases across a variety of price ranges, from cheap insignificant brands to expensive famous brands, but always with the overriding objective of seeking sound quality and good value.

- market-opening measures and deregulation facilitate import access
- consumers are better informed through personal travel, TV, mail order shopping and the Internet.

However, just as brand-name consciousness is deeply embedded in consumer behaviour, so too is strong loyalty to Japanese products. Thus, although import penetration has increased significantly and should continue to do so, this does not mean that Japan has suddenly become an 'easy' export destination. However, it is more accessible than previously. (See Chapters 5 - *Trade*, 8 - *Market Access* and 9 - *Distribution*.)

Social and economic change, especially increasing real incomes, also have affected consumers' purchasing decisions (Tables 2.5 and 2.6). The distribution of household disposable income has changed since the early 1980s, as:

- expenditure on services generally increased more than expenditure on goods
- relative expenditure on food declined
- expenditure on education and housing increased strongly.

A breakdown of food expenditure also demonstrates the effects of increased affluence and changing lifestyles on consumer preferences (Table 2.7). For example, while expenditure on rice fell, spending on prepared foods, fruit juice and bread increased. (See Chapter 11 - *Agrifood*.)

Table 2.5

Strong Growth in Expenditure on Housing and Education

Monthly Household Budget in Real Terms

	1983		1994		Per cent change: 1983 to 1994
	Yen	Per cent of disposable income	Yen	Per cent of disposable income	
Total disposable income	344 133	100	481 178	100	40
Total living expenses	272 199	79	353 116	73	30
of which					
Food	72 099	21	81 513	17	13
Housing	12 929	4	22 446	5	74
Water and utilities	15 774	5	19 150	4	21
Furniture and household utensils	11 216	3	13 239	2	18
Clothing and Footwear	18 910	6	21 963	5	16
Medical care	6 436	2	9 474	2	47
Transportation and Communication	25 729	8	37 301	8	45
Education	10 414	3	18 988	4	82
Reading and recreation	23 462	7	34 549	7	47
Other living expenses	75 230	22	94 491	20	26

Note: Percentages rounded to nearest whole number.
Source: Japan External Trade Organisation, 1996b, p. 24 (based on data from the Office of the Prime Minister's *Report on the Household Budget Survey*, 1994).

Table 2.6

Evolving Purchasing Decisions

Changes Taking Place in Consumer Purchasing Patterns

Quality

Japanese consumers seek quality, reasonably priced products. Minor faults, for example, in presentation, unimportant in other markets, can make products unacceptable in Japan.

Recent developments

Packaging: While quality packaging is important, excessive packaging is being reduced to avoid waste and lower costs.

Price

During the post-bubble recession, less expensive products became popular. Retailers responded with cheap imports, both foreign-branded and private-brand merchandise.

Recent developments

Daily shopping: Purchasing fresh food daily is still common. Daily price fluctuations are monitored and supermarket and department store specials are watched carefully.

Brand consciousness: For items such as sporting goods, cosmetics, shoes, and bags, brand-names remains important. Good quality, wellknown brands at reasonable prices are most popular.

Fashions

Consumption in Japan has long been characterised by short-lived ‘fads’ often started by new products featured in the media, magazine articles and advertising campaigns.

Recent developments

Individualism: Individual rather than group-oriented expression now is more socially accepted, influencing the purchasing of personal consumer items.

Brand consciousness: Young adults are fashion conscious and influenced by popular brands. Value for money is important.

Colour preferences

Popular colours show both traditional and Western influence. Traditional colours are more subdued. Dress is influenced by age; older people choose more conservative colours.

Recent developments

Clothing: Greater colour variety is popular across all age groups.

Variety: Similarly, more colourful products are popular.

Environment

Environmental consciousness has risen steadily in recent years.

Recent developments

Recycling: Businesses are reducing excess packaging; disposable products are being revised; and recyclable goods are increasing.

‘Friendly’ products: Organically grown and other ‘environmentally friendly’ products are attracting attention, indicating good opportunities for ‘clean and green’ goods.

Source: Japan External Trade Organisation, 1996b, pp. 31-34.

Table 2.7

Prepared Foods Are Very Popular

Annual Food Expenditure by Household
'000 Yen

	1985	1988	1991	1994	Per cent change 1985-1994
Rice	75.3 (8)	64.4 (7)	61.8 (6)	63.4 (6)	-16
Bread	23.5 (3)	24.2 (3)	27.6 (3)	28.8 (3)	22
Fish and shellfish	130.1 (14)	128.9 (13)	140.0 (13)	128.2 (12)	-2
Meat	96.8 (10)	93.1 (10)	98.5 (9)	88.9 (8)	-8
Vegetables and seaweed	114.8 (12)	117.9 (12)	135.5 (13)	128.2 (12)	12
Milk products and eggs	44.0 (5)	40.9 (4)	47.9 (4)	46.6 (4)	6
Prepared foods	60.0 (6)	68.3 (7)	85.0 (8)	89.4 (9)	50
Green teas	6.6 (1)	6.4 (1)	6.6 (1)	6.7 (1)	2
Black teas	1.3 (<1)	1.6 (<1)	1.0 (<1)	0.8 (<1)	-41
Coffee and cocoa	7.1 (1)	7.0 (1)	7.3 (1)	7.6 (1)	7
Fruit juice	7.9 (1)	9.3 (10)	11.8 (1)	12.5 (1)	58

Note: Parentheses indicate percentage of total food expenditure, rounded to nearest whole number.

Source: Japan External Trade Organisation, 1996b, p. 25 (based on data from the Office of the Prime Minister's *Report on the Household Budget Survey*, 1994).

REGIONAL SIMILARITIES AND DIFFERENCES

The postwar trend towards greater homogeneity throughout Japan continues. Consumers receive the same education, read common newspapers and watch nationally broadcast television programs. Ownership of commonplace consumer durables (Table 2.8), except heating and cooling devices, varies little between regions. Clothing expenditure also is fairly constant across the country. However, regional differences remain, especially in industrial infrastructure, specialisation and scale, and local traditions and culture, all of which affect lifestyles and market opportunities. The cost of living is higher in urbanised areas. Spending on leisure and education activities is also higher, reflecting the greater range and choice. (See Chapter 10 - *Regions*.)

Table 2.8

Most Have Washing Machines - Only Half Have Cars

Proliferation of Main Consumer Durables, December 1995

	Per cent of households nationwide	Average years of use[1]
Refrigerator	97.8	11.6
Washing machine	99.0	8.9
Vacuum cleaner	98.3	7.7
Air conditioner	77.2	10.4
Colour TV	98.9	9.3
VCR	73.7	7.5
Video Camera	31.3	6.6
Computer	39.4	5.9
Car (new)	47.0	6.3

Note: 1. Denotes the average period that households which brought new items during October to December 1995, had previously owned comparable items.

Source: Japan External Trade Organisation, 1996a, p. 146 (based on Economic Planning Agency data).

NEW OPPORTUNITIES FROM SOCIAL CHANGE

An ageing population, greater import penetration, increased affluence and exposure to foreign ideas through travel, and economic restructuring have coincided to produce extensive change in Japan. Traditional practices in the market, the workplace and the home are giving way to new approaches. Many institutions and practices being challenged served Japan well in the past, but now are outdated.

Most families are nuclear, and one-child families are increasingly the norm. Single-member households also have increased significantly. Jobs are less secure, and younger people's career structures are unlikely to follow the same paths as their parents. As firms restructure to improve competitiveness and prepare for forecast labour shortages and an older workforce, labour is becoming more mobile. Increasingly, merit and performance will determine success. A key issue in coming years will be how to best use scarcer human resources, for example, attracting more women to the labour market. In turn, the education system is under scrutiny, with some changes occurring as the need for reform becomes more urgent.

Consumer spending patterns have changed significantly. Expenditure has increased on services and decreased on goods, and imported products are much more acceptable. Following a period where frugality was shoppers' major concern, economic recovery has made shoppers more aware of value for money regardless of the price category. Compared with a decade ago, after accounting for inflation, the typical household spends nearly twice as much on housing and education and 50 per cent more on health, transport, communication and leisure activities. Some of the opportunities arising from this shift in expenditure are covered in Chapters 9 - *Distribution* and 14 - *Services*.

Virtually all the changes explored in this chapter give rise to business opportunities in Japan, ranging from servicing the needs of the aged and dual-income families to introducing innovative new ideas in leisure, tourism and education. These changes also are reducing gradually the insularity of the Japanese market and increasing the acceptance of things foreign, making it easier to do business in Japan. However, being successful in Japan still requires thorough research, a professional approach to marketing, a quality product, long-term commitment and plain hard work.

REFERENCES

The Australian, various issues.

Australian Bureau of Statistics, 1994, Canberra.

Australia-Japan Economic Institute (AJEI), 1996, *Economic Bulletin*, Vol. 4, No. 10, Sydney, October, p. 11.

Economic Planning Agency, 1996, White Paper on the National Lifestyle, Economic Planning Agency, Tokyo.

Far Eastern Economic Review, various issues.

Fujiwara, M., 1995, 'The changing nature of Japanese society - family expectations and gender equality', summary of speech at the Asialink Evening Seminar Series, University of Melbourne, November.

Japan External Trade Organisation (JETRO), 1996a, *Business Facts and Figures - Nippon 1996*, Japan External Trade Organisation, Tokyo.

____ 1996b, *The Japanese Market - A Compendium of Information for the Prospective Exporter*, JETRO, Tokyo.

Japan Times, various issues.

Look Japan, various issues.

Management and Coordination Agency, 1996, *Japan Statistical Yearbook 1996*, Statistics Bureau, Tokyo.

Nikkei Weekly, various issues.

The Economist, various issues.

Sanwa Bank Limited, 1997, *Economic Newsletter*, Tokyo, January.

Chapter 3

THE FRAMEWORK OF GOVERNANCE

Following four years of political uncertainty, Japan appears to be heading back into a somewhat more stable period of conservative rule, although the situation will remain fluid in the short term. The survival of the current Liberal Democratic Party (LDP) Government headed by Prime Minister Ryutaro Hashimoto will depend largely on its success in delivering economic and governmental reforms that set Japan on a healthy course for the coming decades.

The Japanese Government will confront a number of difficult and controversial issues over the next few years, including:

- determining the appropriate role for government, choosing between extensive intervention in the economy, and continued administrative reform and economic deregulation, which would lead eventually to comparatively minor intervention
- reassessing foreign policy alignments as Japan's economic interests in Asia grow and as its international role broadens
- establishing a new security policy that will be broadly acceptable to the electorate and meet Japan's national interest.

Japan's choices on these and other issues will be crucial for its future, although as in other democracies, the different groups probably will compromise. With conservative values and politics expected to predominate in coming years, voters will be looking for a pragmatic and flexible approach that delivers results.

This chapter explores the evolution of the Japanese system of government and politics from the postwar period to the present day, with a focus on economic and social policy. It analyses how the LDP stayed in power for nearly four decades, how it responded to change and the need for reform over that period, why it lost government in 1993, and how the current LDP Government is addressing reform. Finally it looks at how the political framework may evolve.

THREE POSTWAR PHASES OF GOVERNMENT

Japan's postwar political and governmental system has evolved in three main phases:

1. The 1945 to 1952 US Occupation. This imposed fundamental changes on the Meiji and militarist governmental structures, including enacting a new Constitution (see box). Japan was firmly incorporated into the US Pacific security alliance, setting the external parameters for Japan's postwar foreign and defence policies. The alliance of conservative parties which was to become the LDP pragmatically accepted these changes, and developed a two-pronged policy platform giving priority to economic growth and limited rearmament within the US alliance. This won broad electoral support and formed the foundation for the LDP's domination of government for the next four decades.

2. **The 1955 to 1993 period of one-party LDP government.** The LDP realised its chief policy goal of economic growth and 'catching up with the West', the main element in maintaining its popular mandate. The strategies and processes of government of this period became known as the '1955 system'. By the 1990s, however, Japan faced new global and domestic circumstances and challenges, and the conservatives failed to agree on policies to address them. This produced a party split and in July 1993, the LDP lost government.

3. **The 1993-to-present period of political uncertainty.** Between mid-1993 and 1996, Japan had four prime ministers, heading first a short-lived coalition of reform-conservatives and socialists, then an uneasy two-year LDP-socialist coalition. Following elections in October 1996, Ryutaro Hashimoto formed a minority LDP government with policy support from the socialists and some former LDP members, including independents. Defections from the breakaway parties since have raised LDP numbers in the 500-seat Lower House of the Diet (Parliament) from 239 to 244 seats.

US OCCUPATION: 1945 TO 1952

The US Occupation imposed changes that constituted a major watershed for the Japanese system of government. It established political, economic and security settings which were radically different from the conservative parties' initial preferences. However, the conservative parties pragmatically accepted and effectively used these changes to secure a prolonged hold on government.

The USA's initial priority was to transform Japan into a demilitarised, Western-style democratic state. One of the first actions of the Supreme Commander for the Allied Powers (SCAP[1]), General Douglas MacArthur, was to draft a new Constitution introducing a dramatically more open political system under civilian control and guaranteeing a full range of political freedoms.[2]

The New Postwar Conservatism

Three conservative groups (Liberal Party, Progressive/Democratic Party and Japan Cooperative Party), the Japan Socialist Party (JSP) and the Japan Communist Party (JCP) contested the first postwar elections in April 1946. The conservatives won over half the seats and combined to form a coalition government. Although the JSP and the JCP won a sizeable number of seats in following elections, they remained disadvantaged by funding shortages, lack of administrative experience and unconvincing policies. The JSP was part of the Katayama and Ashida Coalition Governments in 1947 and 1948 (Appendix Table 3.1), but then had to wait almost half a century to again join government. The JCP never did.

....

1 The abbreviation SCAP was used to refer to both the SCAP Commander and the SCAP Headquarters in Tokyo.

2 This contrasted with the partial democracy of the Meiji and Taisho periods and the repressive military-controlled society of the 1930s and war years. The Meiji (1868 to 1912) and Taisho (1912 to 1926) periods produced the beginnings of democratic government in Japan, with the formation of the first modern political parties from the 1870s, the promulgation of a Constitution in 1889, the establishment of a national bicameral legislature (the Diet) in 1890, the introduction of universal male suffrage in 1925, and almost two decades of political party-dominated governments (Taisho period).

JAPAN'S POSTWAR CONSTITUTION: TO REVISE OR NOT TO REVISE - THE CONTINUING QUESTION

On the fiftieth anniversary of Japan's postwar Constitution, debate continues on whether to revise it to better reflect Japan's present-day realities. One of the US Occupation's earliest reforms was to substantially revise the 1889 Meiji Constitution.[3] The first postwar national elections were held in March 1946 in accordance with the SCAP-proposed Constitution, which the newly elected National Diet adopted with only minor alterations and formally promulgated in November 1946; it came into effect on 3 May 1947.

The new Constitution was based on Western democratic principles tailored to Japanese traditions and the postwar circumstances.

- Sovereignty was to reside in the people rather than the Emperor, with the Emperor declared no longer divine but rather a symbol of the state and the unity of the people.
- The predominant power of government was vested in an elected bicameral legislature representative of and responsible to the people, based on universal adult franchise.
- An executive was formed based on the majority party of the Lower House of the legislature and was answerable to it.
- An independent judiciary was established.
- The military was excluded from any part in government.
- The full range of Western liberties was established: freedom of religion, speech, association, assembly and creed, and universal adult franchise.

The new Constitution's most remarkable element was the renouncement of armed forces and the so-called 'No War' clause of Article 9. Most Japanese support Article 9, which politically limits the scope and level of rearmament but has been interpreted to allow the development of self-defence forces (SDF).

Debate over constitutional revision has continued throughout the postwar period but has recently become more open and broader in scope. According to media polls on the fiftieth anniversary of the postwar Constitution, while nearly 70 per cent of most poll respondents said that Article 9 (now referred to as the Peace Clause) should not be changed, the public *would* like the Constitution to better reflect contemporary issues such as the environment, freedom of information and the electoral system. Half of respondents in one poll said that 'new issues have arisen to which we cannot make an effective contribution internationally under the current Constitution'. A cross-party group of senior Diet members will study the Constitution and propose possible revisions.

....

3 In September 1945, following the SCAP's directive, the Shidehara Government appointed a committee 'to remove the undemocratic principles' from the Meiji Constitution' (Storry, 1968). The SCAP, however, found the committee's revisions insufficient and in February-March 1946 drafted in effect an entirely new Constitution (though technically still a revision of the 1889 Meiji Constitution), though also accepting some changes by the Shidehara Government (Livingston et al, 1973).

By 1947, the external parameters of the US Occupation had changed dramatically. The deterioration in US-USSR relations and growing communist power in China shifted US policy toward securing Japan as a buffer state and ally against communism. Japanese political stability and economic recovery replaced reform in the order of priorities, and initial US plans to purge the economic leadership, dismantle the *zaibatsu* (financial and industrial conglomerates), strengthen unionism, and force Japan to pay large reparations to Asia, were modified or reversed. The purges were stopped, with most of those purged returning to normal life.[4] Many of the old conservative elite reestablished their power bases. Finally, General MacArthur's successor, General Matthew Ridgeway, announced in April 1951 that the Japanese Government could reconsider Occupation-sponsored laws and institutions. It promptly acted upon this and recentralised the system of government, among other measures.

The reversal of US policies set major political parameters which favoured the conservatives over the socialists and communists. At the same time, the USA's superpower status and postwar generosity, including economic assistance for reconstruction, contributed to Japanese acceptance of the historic changes to the system of government.

THE YOSHIDA DOCTRINE

Shigeru Yoshida (1878 to 1967), five times Prime Minister between 1946 and 1955, played a crucial role in adapting the conservatives to the radical postwar reforms and in formulating Japan's postwar objectives. He developed a conservatism quite distinct from the prewar emphasis on traditional values and loyalty to the Imperial system. Blaming the military for Japan's defeat and economic devastation, he welcomed the initial US Occupation policies of demilitarisation and resisted post-1947 pressures to rearm (Welfield, 1988). Yoshida's flexible and pragmatic conservatism, his strong prioritisation of economic growth, and his adherence to limited rearmament within the US-Japan security alliance have had a lasting influence on Japanese conservative policies and politics.[5] This approach became known as the Yoshida Doctrine.

A number of US policy measures during this period contributed to economic development and political stability over the next half century, including:

- the 1946 to 1950 land reforms, which revived agricultural production and benefitted six million rural households. The land reforms raised the proportion of owner-cultivators from around 30 per cent to 75 per cent of total landholders, reduced tenanted land from 50 per cent to 10 per cent of

....

4 The early Occupation purges covered prewar and wartime leaders including military leaders, politicians, business people, and bureaucrats. From 1950, SCAP redirected the purge to force 21 000 communists and other perceived radicals out of jobs in government, the media and the private sector (Livingston et al, 1973).

5 As the leading conservative figure of 1945 to 1955, and influential until his death in 1967, Yoshida was also patron to several future conservative leaders including: Hayato Ikeda, Eisaku Sato, Masayoshi Ohira and Kiichi Miyazawa.

cultivable land, helped diminish rural poverty and linked most farmers into the postwar economic renewal (Livingston et al, 1973)

- partial deconcentration of the *zaibatsu*, delinking them from single-family ownership and control, and allowing new types of conglomerates to be formed under more modern management and ownership structures (Livingston et al, 1973)
- entrenchment of the power of the bureaucracy from the US Occupation's operation through it, which continued much of the prewar bureaucratic structure, policies and personnel (Johnson, 1982)
- removal of the military's influence on government and economic management freed up both policy making and fund allocation in favour of nonmilitary economic development.

Japan's current defence parameters were also set in this period.[6] A strong general preference for strict limitations on rearmament was an important element in the eventual majority acceptance of the US-Japan security alliance. This security framework, a fundamental parameter of postwar politics and economic development, allowed the Japanese Government to concentrate on economic issues.

THE LDP IN GOVERNMENT: 1955 TO 1993

While the old conservative political parties had resumed their traditional rivalries during the Occupation, they and business became concerned about the JSP's reunification in 1954 and its growing electoral support. This motivated the two main conservative groups, the Liberal Party and the Democratic Party, to merge as the Liberal Democratic Party (LDP) at the end of 1955.

The LDP sustained its hold on government for the next 38 years (Figure 3.1) by:

- making economic growth, good economic management and higher incomes and living standards, its main policy platform
- adapting to change in electoral priorities, modifying its 'conservative' policies and broadening its support base to represent a large number of interest groups
- allying itself with the bureaucracy for effective policy development and delivery
- maintaining strong backing from business which saw the LDP as the best party to deliver political stability and a capitalist economic system

....

6 By the outbreak of the Korean War in 1950, a Maritime Safety Force and armed National Police Reserve (NPR) were established which later formed the nucleus of a new army and navy. The 1951 Peace Treaty was accompanied by the US-Japan Security Treaty and the indefinite continuation of US forces in Japan (including continued US occupation of Okinawa and the Ryukyu Islands, operation of the US Seventh Fleet out of Japanese ports, and maintenance of around 260 000 US troops in Japan (Welfield, 1988)). In 1954, the US-Japan Mutual Assistance Agreement was signed, under which the Japan Defence Agency and the Self-Defence Forces (Ground, Maritime and Air) were established by legislation.

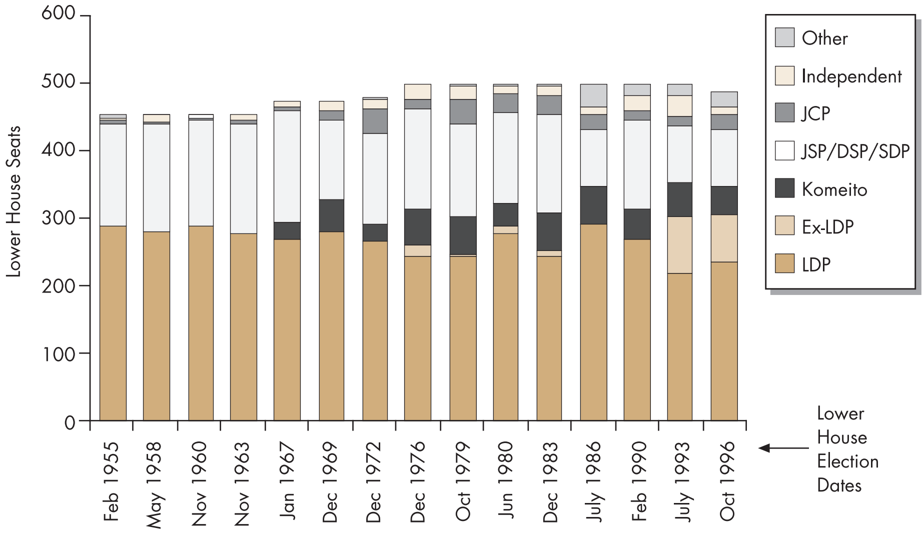
- securing the support of farmers freed from tenant farming and debts by the land reforms,[7] by firstly, subsidising agricultural incomes with price support policies, and secondly, as the rural population declined, maintaining a disproportionate number of rural constituencies through unequal weighting of rural and urban votes
- benefitting from the opposition's policy weaknesses and political divisions
- developing strong funding mechanisms and electoral organisations
- attempting to avoid controversial foreign policy initiatives
- maintaining a security policy for the Cold War period which the electorate considered realistic and acceptable.

Figure 3.1

Conservatives Remain Dominant

Japanese Lower House Elections 1955 to 1996

Party[a] Votes by Number of Seats[b]



Notes: a. Some parties changed over the period, but have been grouped as follows: 1. LDP: for 1955 election, votes of still separate Liberal and Democratic Parties combined. 2. Non-LDP: all conservative parties formed by LDP defectors: New Liberal Club/NLC, 1976 to 1983 elections; *Shinseito*/Japan Renewal Party, *Nihon Shinto*/Japan New Party, and *Sakigake*/ Harbinger Party for 1993 election; *Shinshinto*/New Frontier Party, *Minshuto*/ Democratic Party, and *Sakigake* for 1996 election. For the 1993 and 1996 election results, as far as possible, non-ex-LDP members of these parties have been subtracted from the ex-LDP count and added to the relevant party of former membership. 3. JSP vote includes Democratic Socialist Party/DSP, and for 1996 election, the Social Democratic Party of Japan (*Shakaiminshuto*)/SDPJ, the new name of the JSP from January 1996. 4. *Komeito* first contested elections in 1967 and joined *Shinshinto* for 1996 election, though Komeito seats for October 1996 are shown separately here for the purpose of the graph.

b. Lower House seats were: 467 in 1955 to 1963, 486 in 1967 to 1969, 491 in 1972, 511-512 in 1976 to 1993, and 500 in 1996.

Source: Statistics Bureau (Prime Minister's Office), *Japan Statistical Yearbook*, various years.

....

7 In the early 1950s, Japan's population was about 40 per cent rural (in contrast to less than 10 per cent by the 1990s), so the rural vote was a significant proportion of the electorate.

Factions Play Key but Controversial Role in LDP

Much of the real power in the LDP was held by factions which formed around preeminent leaders who could be regarded as potential prime ministers.[8] The factions were 'formal political entities with a headquarters, regular meetings, a known membership, an established structure and firm discipline', and were regarded as 'parties within a party' (Thayer, 1973).[9] Their key functions were to:

- supply candidates for party leadership contests (usually the faction leaders)
- participate in party decision-making to choose the LDP leader and allocate cabinet positions and other posts in government and the party
- raise and distribute most party funds
- assist and back faction members in election campaigns (with the multimember constituency system institutionalising factional rivalry).

The leaders who recruited the most members to their factions had the best chance of winning party leadership contests and thereby becoming prime minister. After Eisaku Sato was Prime Minister (1964 to1972), the leaders of the five main factions (Tanaka, Miki, Fukuda, Ohira and Nakasone) in effect took turns at holding the office over the next 15 years.[10] When faction leaders died, some factions split; others continued under a new faction head; and a small number continued under collective leadership.

Effective fundraising gave factions their power. With the postwar land reforms removing social and other services provided by the prewar landlords, rural areas supported the politicians who did most for them (Thayer, 1973). Local politicians competed to be each electoral district's most prominent purveyor of largesse. Their extensive funding needs were provided primarily by the faction, although personal funds, business contributions and money from other supporters were also important.[11] Interfactional competition and the system of 'money politics' were heavily criticised for harming the LDP's cohesion and attention to policy making, and became a major focus of political reform by the 1990s.

In 1972, Kakuei Tanaka assumed leadership of the Sato faction and developed it into the most powerful in the LDP's history. It became the archetype of factional 'money-power politics', discrediting the factional system and leading to the undoing of the LDP itself (Johnson, 1995). The Tanaka faction ended the previous balance of

....

8 The LDP's formal structure comprises a president (elected biannually, usually by LDP Diet members and representatives from each party prefectural organisation), vice-president, secretary-general, executive council, Policy Affairs Research Council and other bodies. The party president becomes prime minister when the LDP is in government.

9 The LDP's factions were primarily centred around the Lower House members, with House of Councillors members operating less significant Upper House factions, while simultaneously belonging to Lower House factions.

10 The death of Ohira in office resulted in Suzuki's unexpectedly becoming prime minister to complete the Ohira faction's turn, and Nakasone's becoming prime minister earlier than expected.

11 Thayer (1973) gives the example of a typical young Dietman in the mid-1960s receiving US$700 in monthly salary, having to expend an absolute minimum of US$2 000 per month to 'cultivate' his electorate. In addition, election campaigns required an enormous expenditure of US$40 000 to $80 000 (in mid-1960s US dollars).

factional power and verged on taking over the party. Its huge funding and disbursements machine allowed it to exert influence across all spheres of government. Despite being implicated in a number of corruption scandals, Tanaka's mastery of the political system allowed him to remain Japan's most influential politician, with all prime ministers needing his support to hold office, until he suffered a cerebral haemorrhage in 1985.[12] His faction under Noboru Takeshita continued to be the most powerful until it - and the LDP - split in 1993.

LDP Policy Making

LDP policies for most of the 1955 to 1993 era were essentially based on the Yoshida doctrine. However, considerable change in the Japanese electorate between 1955 and 1993 led the LDP to adjust and broaden its policies to meet new concerns.

The economic expansion of the 1950s and 1960s raised incomes and living standards, expanded educational opportunities and created a predominantly urban middle-class society. The concerns of the 1970s reflected society's higher expectations, including managing the transition from industrial to postindustrial society, developing social services, improving the quality of life, and examining the adverse effects of rapid growth, including environmental pollution. As opposition parties responded to these concerns, the LDP's vote declined to a postwar low in the 1970s, forcing the party to review its policy stance. By passing several landmark antipollution laws, giving greater policy and budget priority to social welfare, and doing more to address rural areas' development needs, the LDP rebuilt its electoral support by the 1980s.

As the LDP broadened its original support base of mainly business, agriculture and the bureaucracy, to embrace a wide range of interest groups articulating new concerns,[13] some observers suggest that it transformed itself into a 'catch-almost-all' pragmatic centrist party. The only difference from a fully pluralist democracy was that interest groups had to express their views through a few specified channels, such as LDP party organs and specific ministries (Muramatsu and Krauss, 1987).

Who Played the Major Role in Policy Making?

Some analysts contend that the bureaucracy provided the main leadership in Japanese policy making in the 1955 to 1993 period (see box). Others attribute the primary role to an 'iron triangle' of LDP leaders, big business and the bureaucracy who in effect combined to form 'Japan Inc' (Kosai, 1987). (See Chapters 1 - *Overview* and 8 - *Market Access*.)

12 Despite his haemorrhage, Tanaka continued to be reelected as a Diet member by the Niigata Third District until the July 1993 elections, when his daughter Makiko succeeded him. (It is common in Japan for a relative to succeed a politician in a seat.)

13 A survey among interest group leaders conducted in 1980 found that the LDP had the highest support among all types of interest groups, including welfare bodies, and only excepting labour and citizen/political entities (Muramatsu and Krauss, 1987).

Business was central to economic policy formulation during 1955 to 1993. Four main groups of business organisations[14] developed and articulated the private sector's views through a range of channels, including regular personal contact; position papers; the industry-specific *shingikai* ('deliberation councils') run by ministries with mainly business participants; presentations to LDP organs and committees; special groups and clubs formed around leading LDP figures;[15] groups of politicians and businessmen who came together around a common issue; and marriage, family, social and educational ties.

A major development in LDP politicians' contributions to policy making was the emergence of the crossfactional *zoku* ('tribe' or 'group') of Diet members who shared an interest in a particular area of public policy, and which became increasingly specialised and important (Muramatsu and Krauss, 1987).

DEBATE OVER THE BUREAUCRACY'S ROLE IN JAPAN'S ECONOMIC SUCCESS

The source of Japan's economic success is debated widely. Johnson (1982) argues that the postwar bureaucrats were the central influence; they opted for a system of public-private cooperation in development, after considering Japan's experience with total state control (early Meiji period) and a completely free private sector (1880s to 1920s).

Johnson describes the key government policy tools as:

- the Ministry of International Trade and Industry (MITI), which evolved from the Meiji period to become the 'pilot agency' of postwar economic guidance
- a two-tiered banking system of government-guaranteed 'city banks' and government created and owned financial institutions which allowed overlending to strategic industries
- control of the primary budget by the bureaucracy, rather than the Diet
- the so-called 'second', or 'investment', budget for strategic industries controlled by MITI and the Ministry of Finance - financed by pooling postal savings into the Fiscal and Investment Loan Plan
- extensive control of foreign exchange and foreign trade by MITI under the Foreign Exchange and Foreign Trade Control Law of 1949, which remained in use until the 1970s

....

14 These were: leaders of basic industries and large financial institutions; representatives of the four main formal business organisations (*Keidanren*/Federation of Economic Organisations; *Nihon Shoko Kaigisho*/Japan Chamber of Commerce and Industry; *Keizai Doyukai*/Japan Association of Corporate Executives; *Nikkeiren*/Federation of Employers' Organisations); private company owners; and representatives of industry federations, such as the Japan Coal Association and Japan Steel League (Thayer, 1973).

15 For example, the *Choei* Society of about 40 company and bank presidents was just one of about 20 groups which formed around Prime Minister Sato in the 1960s (Thayer, 1973).

- an elaborate trade promotion apparatus set up in the 1950s (MITI's Japan External Trade Organisation, JETRO)
- a tax system which encouraged exports, allowed rapid depreciation on investments in 'industrial rationalisation', excluded strategic machinery from import duties, made deductible royalties paid for foreign technology, *inter alia*.

Johnson points out that many other special institutions and characteristics also were relevant to the success of Japan's guided industrial development.[16] Critics of Johnson's thesis that the bureaucrats were the chief architects of Japan's postwar success, while admitting its merit in explaining aspects of Japan's early postwar development, strongly qualify it by pointing to other contributory elements, such as:

- the important role of other ministries in economic policy, especially the Ministry of Finance, which became at least as powerful as MITI
- the consistency of Japan's macroeconomic management with other OECD countries' policies
- the increasing internationalisation of the Japanese economy from the 1970s
- LDP leaders' key role in identifying and pursuing overall national goals
- the decline in the bureaucrats' relative influence from the 1970s
- the declining willingness of the private sector to follow bureaucratic direction from the 1980s.

Delivering on Policy Goals

The dominance of economic objectives in LDP policy goals effectively required LDP presidents and prime ministers to have some expertise in the field (Kosai, 1987). Most of the 15 LDP Prime Ministers during 1955 to 1993 had been Minister of International Trade and Industry or Minister of Finance.[17]

An important policy development was the attempt to clearly emphasise the benefits of economic growth to *all* citizens. In contrast to the 1955 and 1957 LDP plans emphasising higher production capacity and heavy industry development, Prime Minister Ikeda's (1960 to 1964) 10-year 'National Income Doubling Plan' incorporated improved living standards and social development as a central

....

[16] These included: inducements to high personal savings; the distribution system; the 'descent from heaven' (*amakudari*) whereby retired bureaucrats assumed senior management positions in companies they previously regulated; the structure of major industrial groupings (*keiretsu*); the 'dual economy' featuring vertical linkages between major corporations and numerous small and medium-sized subcontractors and suppliers; enterprise unions; the lifetime employment system in large corporations; the seniority wage system; the low level of equity in companies (due to the government-supported system of bank 'overlending'); and the system of cross-shareholding among *keiretsu* companies which gave ordinary shareholders a low degree of influence.

[17] This was a major change from the predominantly diplomatic or military backgrounds of conservative prime ministers in the 1880s to 1920s.

objective of economic growth (Kosai, 1987). Achieving this income growth target strengthened the LDP's mandate.

Most importantly, the LDP delivered economic growth and 'caught up with the West' in terms of national wealth. Japan's impressive growth rates from the 1950s through to the late 1980s allowed its gross domestic product (GDP) and per capita GDP to overtake those of the UK by 1970 and those of the USA and Germany by 1990 (Table 3.1).

Table 3.1

Japan Catches Up with the West

Real GDP, GDP per Capita: Japan, USA, Germany, UK 1950 to 1995, in 1990 US dollar terms

	Japan Real GDP US$ bn	Real GDP per capita US$	*USA* Real GDP US$ bn	Real GDP per capita US$	*Germany* Real GDP US$ bn	Real GDP per capita US$	*UK* Real GDP US$ bn	Real GDP per capita US$
1950	268	3 210	1 606	10 547	226	4 520	357	7 058
1960	479	5 089	2 234	12 365	527	9 513	470	8 970
1970	1 236	12 105	3 256	15 879	932	15 357	621	11 207
1980	1 960	16 778	4 276	18 772	1 204	19 562	752	13 349
1990	2 932	23 734	5 522	22 097	1 504	23 780	979	17 000
1995	3 128	24 984	6 066	23 061	1 803	22 089	1 037	17 794

Note: The figures for Germany before 1995 are for the former FRG only.
Source: International Monetary Fund, 1997.

Breakdown of the 1955 to 1993 System

In the 1980s and early 1990s, several postwar policy parameters fundamental to the LDP's political strategies altered or disappeared. Many of the issues that emerged as a result remain pertinent today and are described below.

Economic Factors

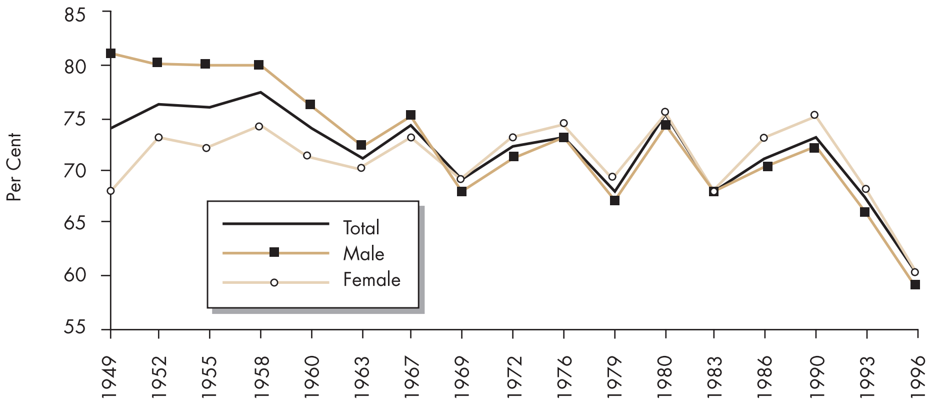
- Achieving economic equality with the West left the LDP without a central policy goal.
- Without a common central policy goal, policy differences on other issues and difficulty prioritising objectives weakened LDP cohesion, increasing the party's vulnerability to fissures and splits.
- US-Japan trade friction intensified as Japan accounted for the main share of the growing US merchandise trade deficit, which nearly trebled between 1980 and 1990. Similar frictions arose between Japan and Western Europe.
- The end of the Cold War raised questions about continuing the US-Japan security alliance and redefining national security, and removed a major check on US-Japan trade friction.

- External and internal pressures grew to correct Japan's imbalance between strong export-oriented output and below-OECD-average domestic consumption.
- The LDP attempted to address issues such as rising budget deficits and fiscal reform at the same time as it faced electoral pressures to increase public spending.
- The doubling of the yen's value against the US dollar (from ¥238:US$1 to ¥108:US$1) between 1985 and 1993 significantly reduced Japan's international competitiveness, forcing major cost-cutting across Japanese industry and pushing numerous export-oriented manufacturers and their suppliers offshore. (See Chapter 6 - *Internationalisation*.)
- The bursting of the 1987 to 1991 'bubble economy' resulted in massive asset deflation, bad loans, a prolonged recession and fast-growing imports, arousing fears in the electorate that Japan's economic superpower status would be shortlived. Furthermore, attaining such status had not necessarily improved quality of life to the extent expected.
- Traditional backers of the LDP, including big business under strong competitive pressure in domestic and international markets, began to press for policies and a vision that would facilitate the structural reforms and revitalisation Japan needed to survive in the new global economic climate.[18]

Figure 3.2

Falling Voter Turnout

Voter Turnout in Japanese Lower House Elections 1949 to 1996



Source: Statistics Bureau (Prime Minister's Office), *Japan Statistical Yearbook*, various years.

....

18 For example, see Makihara, Minoru 1993, pp. 70-76.

Political Factors

- Public disapproval grew over 'money-power politics', structural corruption and the institutionalised 'sale of access' to LDP decision makers (Johnson, 1995). Citizens were particularly dissatisfied with the Tanaka faction's overwhelming domination of the LDP, which reduced public accountability.
- Dissension grew between old-style and younger more reform-oriented LDP politicians, causing growing factional cleavage.
- Once highly respected bureaucrats were tarnished by bribery and corruption scandals, policy uncertainty and growing infighting.
- The emergence of an overwhelmingly urban electorate by the 1980s created new voter concerns and expectations, and highlighted the unequal weighting given to rural voters.
- Falling voter turnout and rising votes for other parties in prefectural and gubernatorial elections reflected increasing disillusion with LDP party politics.[19]
- The LDP's focus on meeting the demands of individual interest groups and increasing corruption in the 'sale of access' process, stultified the party's economic policy-making ability.

1993 TO 1997: DIVISION AND REGROUPING

The LDP lost government after 38 years, following the general elections of July 1993. The electorate did not reject the LDP; the party destroyed itself by splitting in early 1993.[20] The Tanaka/Takeshita faction split was the key element, with 48 members breaking away to form *Shinseito* (Japan Renewal Party) under Ichiro Ozawa and Tsutomu Hata, and *Sakigake* (Harbinger Party) under Masayoshi Takemura, leaving the LDP with 227 members.[21]

Four Prime Ministers in Three Years

The main achievement of the eight-party coalition which came into government under Prime Minister Morihiro Hosokawa[22] in August 1993 was a major reform of the Lower House electoral system in 1994.[23] This included:

- abandoning the postwar system of multimember constituencies of three to five members which led to intraparty competition, factional politics and campaigns more focused on personality than policy

....

19 By 1995, more than 50 per cent of voters said they had no party allegiance (Stockwin, 1995).

20 Figure 3.1 shows that in the July 1993 elections, the LDP plus recent LDP defectors (223 plus around 88) still won more than enough seats for a majority in the Lower House.

21 The other half of the Tanaka/Takeshita faction remained in the LDP under the leadership of Keizo Obuchi.

22 Morihiro Hosokawa, a former LDP governor of Kumamoto prefecture, was elected as an LDP member to the Upper House in 1992, but broke away to form the *Nihon Shinto*/Japan New Party in the same year, which won four seats in the mid-1992 half Upper House election, and 35 seats in the July 1993 Lower House election.

23 Japan passed its first electoral law in 1890, and has tried various electoral arrangements over the past 100 years. The middle-sized electoral district with three to five elected members was first introduced in 1925, and after a single postwar election in 1946 based on large electoral districts, was renewed in 1947.

- introducing a combined system of:
  - 300 single-member constituencies; and
  - 200 seats based on proportional representation, for which the country was divided into 11 large blocs. This combination produced 500 Lower House seats (replacing the former 512)
- tightening rules for political funding aimed at eliminating 'money-power politics'.

Apart from introducing electoral reform, the coalition, first under Hosokawa, then briefly under Prime Minister Hata, failed to thrive. It lacked a united vision for change and sought to introduce reform too quickly. Also, organisational weakness prevented it from forging broad support for its policies from business, interest groups and the bureaucracy. Similar problems hindered the subsequently reconstructed coalition of opposition parties (*Shinshinto*, or New Frontier Party) dominated by Ichiro Ozawa, whose policy agenda represented too bold and abrupt a change from the postwar pattern; even within his own party it was unacceptable. Furthermore, his reputation as a political fixer cast doubt on his reform credentials.

After the reformist coalition government collapsed within a year, the remaining bulwark of the LDP, led by Yohei Kono, formed a coalition government with the JSP in August 1994, under Socialist Prime Minister, Tomiichi Murayama. The small mainly LDP-breakaway party, *Sakigake*, also took part. However, it could only be a temporary partnership. The JSP, abandoning its 50-year policy platform based on socialist economic principles, neutrality and nonalignment, for a new platform based on market economy principles and acceptance of the Self-Defence Forces and the US-Japan Security Treaty, effectively abandoned its identity as a distinct party. Some argue that the JSP, now the Social Democratic Party of Japan (SDPJ), at this point virtually became a faction of the LDP (Stockwin, 1996).

In the meantime, the LDP was working through the shock of the 1993 defeat and bitterness toward leading defectors like Ozawa, trying to reinvent itself and recover electoral support. Ryutaro Hashimoto, who became LDP leader from September 1995, is considered a flexible and pragmatic conservative who reads the electorate and the political situation skillfully.[24] Hashimoto recognised the range of challenges Japan faced. After Prime Minister Murayama resigned in January 1996, coalition members agreed that Hashimoto should head the government until the next Lower House election. Hashimoto's image was enhanced when he achieved broad agreement to reaffirm the US-Japan security alliance in April 1996.[25]

....

24 A major boost to Hashimoto's standing was his successful handling as MITI Minister of the acrimonious 1995 auto dispute with the USA. Many Japanese were impressed by Hashimoto's bold and self-confident style in dealing with the US Government.

25 This reaffirmation had originally been timed for a scheduled November 1995 visit by President Clinton to coincide with the Osaka APEC Meeting. So due to the rescheduling of the visit, it was Hashimoto rather than Murayama who enjoyed the limelight from hosting it. Nonetheless, Hashimoto achieved an agreed approach on the reaffirmation across the government and thus made the visit a success.

The LDP Returns and Offers Reforms

In the October 1996 Lower House elections under the new electoral system, the LDP increased its preelection position from 211 (out of 511 seats) to 239 seats in the 500-seat Lower House. Despite the lowest voter turnout in the postwar period (Figure 3.2),[26] it was clear the electorate wanted stability and 'known quantities' after four coalition governments in three years, sharp currency fluctuations, a prolonged recession, the January 1995 Kobe earthquake, the Aum Shinrikyo sarin gas attacks, and business and bureaucratic scandals. Securing 'policy support' for the LDP's reform agenda in both the Lower and Upper Houses[27] from former coalition partners, the Social Democratic Party of Japan (SDPJ) and *Sakigake*, Prime Minister Hashimoto was able to form a minority LDP government in November 1996.

Prime Minister Hashimoto understood the issues and offered solutions. His November 1996 'Big Bang' Statement on financial deregulation (see Chapter 7 - *Finance*) was followed by a major policy package in January 1997, centring on:

- fiscal reconstruction to cut central and local government budget deficits to a maximum of 3 per cent of GDP by JFY2005 (later revised to JFY2003)
- reform and revitalisation of the education system to encourage diversity and creativity
- reform of the social security system to address issues related to the ageing population
- economic restructuring focusing on bold deregulation, corporate tax reform and repeal of the ban on holding companies
- financial system reform, including liberalising foreign currency transactions, improving market access and strengthening the independence of the Bank of Japan
- administrative reform, including raising ministries' and agencies' ethical standards and eradicating improper practices.

26 The low voter turnout was partly attributed to voter uncertainty about the new electoral procedures.

27 The 252-seat House of Councillors or Upper House comprises 100 seats elected by the national constituency, and 152 seats elected from prefectural constituencies, with each of the 47 prefectures having a minimum of 2 seats in its prefectural constituency, and the more populous prefectures having more (for example, Tokyo has 8). Half of the Upper House seats come up for election every three years for a six-year term. The powers of the Upper House are subordinated to those of the Lower House, but except for passage of the budget and ratification of treaties, a two thirds majority in the Lower House is required to override a negative vote by the Upper House on all other legislation (including any amendment to the Constitution). (Appendix 3.3.)

ADMINISTRATIVE REFORM TO STREAMLINE GOVERNMENT

Administrative reform has been an active issue since the 1960s, when growing budget deficits raised concerns. For example, Prime Minister Nakasone (1982 to 1987) linked fiscal reconstruction to administrative reform as his government's principal goal. In recent years, the Hosokawa and Murayama Governments both adopted administrative reform as a key policy goal. Overall, however, progress has been limited: budget deficits continue to rise and bureaucracy remains extensive.

In the October 1996 election campaign, Prime Minister Hashimoto announced his 'Kasumigaseki Reform Initiative',[28] a plan to reduce radically over the next decade the number of central government ministries and agencies from the current 22 to between 11 and 14, to reduce regulation, improve efficiency and lower the cost of government.[29] The proposal involves splitting MITI along international and domestic lines, and splitting MOF along budget and regulatory lines. The three main criteria for change will be :

1. whether government regulations on private sector activities could be abolished
2. whether the private sector could better perform public sector services
3. whether local authorities could take over some central government functions.

Business has long supported administrative reform, partly to reduce corporate taxes but also to reduce government intervention in business. The Keidanren supports structural changes to strengthen the Prime Minister's authority and create an Economic Cooperation Ministry and a new Trade Representative's Office (as in the US system).

So far, the Hashimoto Government has encountered inertia and resistance from bureaucrats. Some political observers see administrative reform as a high-risk political strategy with little chance of success. Others consider that the electorate will support Hashimoto's attempts to tackle such an important reform issue. Most importantly, Hashimoto has recognised that administrative reform is essential for Japan's future and is determined to progress it. However the reforms which *do* eventuate are unlikely to be as major or clear cut as planned.

Pacing Deregulation

Achieving the right balance on the pace and depth of reform will be vital. Prime Minister Hashimoto appears to be steering the reform agenda at medium speed, appealing to a broad middle ground between the no-change and progressive conservatives. In the past, this approach has unified most conservatives.

....

28 Kasumigaseki is where the main central government ministries and agencies are located in Tokyo and is a commonly used term to refer to the government and bureaucracy.

29 Relocating government functions out of Tokyo, and even establishing a new administrative capital, is an option.

The Hashimoto Government is making progress on key objectives, including:

- implementing some financial deregulation measures
- gaining passage of the JFY1997 budget
- raising the consumption tax as planned from 3 per cent to 5 per cent in April 1997
- passing legislation to override Okinawan refusal to renew land leases for US bases in time to meet the expiry date of the old leases
- obtaining widespread support to repeal the postwar ban on holding companies, in line with general OECD practice.

However, the business community clearly wants to see more results before giving the LDP full support.[30]

Survival of the Hashimoto Government

Despite initial predictions of a short life span, in 1997 the Hashimoto Government appears increasingly likely to stay in office until the next Lower House elections (due by September-October 2000). Continued defections from opposition LDP-breakaway parties have bolstered its Lower House numbers, indicating it may secure a majority in coming months. In the meantime, support from ex-LDP independents gives the LDP an effective Lower House majority. Importantly, the opposition is in disarray, providing little threat.

The LDP's recent resurgence does not necessarily imply that the process of political reshaping and realignment has run its course, or that it is simply a case of 'back to the LDP'. Changes over the past four years have shaken up both the LDP's policy framework and its traditional factional alignments. Strategic alliances, both between groups still within the LDP, and with groups and individuals in breakaway-LDP and other parties, will continue to form. By early 1997, emerging groups within the LDP suggested some possible directions:

- *Kayukai*, led by older party members, principally Seiroku Kajiyama, favours a larger conservative alliance (*Ho-ho rengo*), embracing parts of *Shinshinto*
- *Shinseiki* (New Century), led by Koichi Kato, comprising generally younger politicians, advocates closer links with the more progressive non-LDP parties.

Other groups are forming as well, partly along traditional factional lines, suggesting that the LDP's factional problems remain to be resolved.[31]

30 Following the post-1993 political uncertainty, scandals and electoral reform, the business community stepped back from its traditional support for the LDP. For example, in 1993 the Keidanren suspended its annual political funding contributions (mostly to the LDP) of around ¥13 billion.

31 The former factional affiliation of the 356-member LDP (244 Lower House and 112 Upper House members) at mid-1997 stood as follows: former Mitsuzaka faction (83 members); former Miyazawa faction (72); former Obuchi faction (88); former Watanabe faction (68); former Komoto faction (24); and no factional alignment (21).

CONSERVATIVE GOVERNMENT LIKELY TO PREVAIL

Although Japan's political system has featured a long period of single-party rule without the familiar Western pattern of power alternating between a 'conservative' and a 'progressive/reformist' party, it is democratic and will continue to evolve in accordance with Japanese choices.

Given the fluidity among conservative parties and factions and disarray in the opposition, the situation will remain uncertain in the short to medium term. However, because the Japanese electorate is predominantly conservative, the longer-term outlook for Japanese politics would appear to centre around three possibilities:

1. a return to a single large conservative party (such as the LDP) if a key leader like Hashimoto can maintain strong leadership and secure agreement on key reforms
2. temporary alliances of conservative parties to form government or support key issues
3. the emergence of two fairly large conservative parties, one strongly conservative and the other reform-conservative.

AN UNDERLYING CONSERVATIVISM?

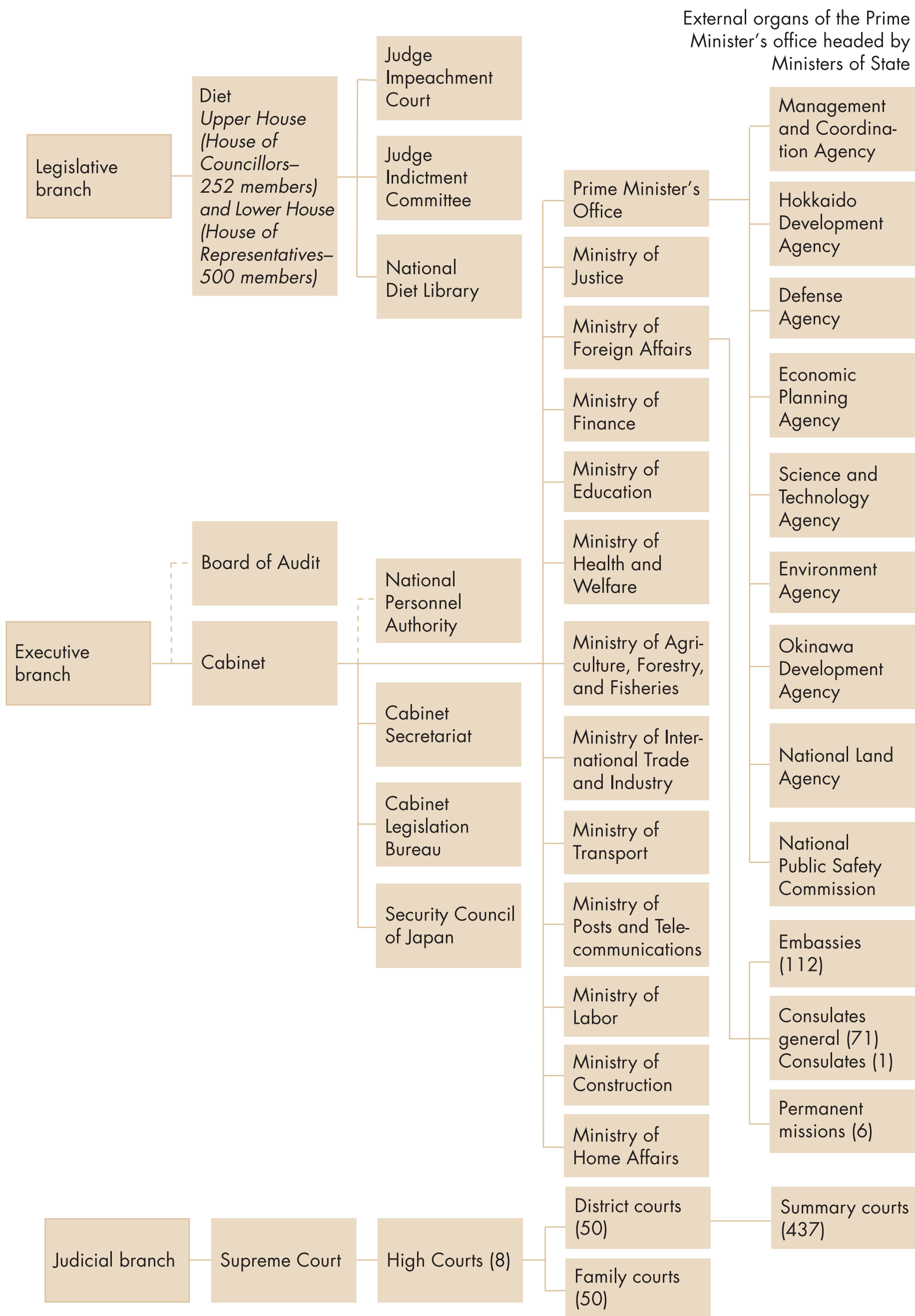
A number of factors make the Japanese electorate and political culture largely conservative.

- The vast majority of the population has become middle class.
- The proportion of older voters, who have little propensity for radical change, is increasing.
- Concern is increasing about a loss of social harmony and stability following the numerous 'shocks' of the 1990s.
- The continuing sluggish economy is giving rise to anxiety over economic revitalisation.
- Japan, like many other democracies, is experiencing a trend towards more centrist policies, and less electoral support for left-wing parties.
- Voters want parties which present - and are likely to implement - pragmatic policies.
- The external security environment is a source of concern, with predominant issues including China's future intentions in the region, instability on the Korean peninsula and future US-Japan defence arrangements.

Until a clear trend emerges, policy-making and implementation will reflect the fluidity of the political situation and uncertainties in the administrative system. However, the LDP now has had considerable time to reflect on its failure to produce appropriate new policies from the mid-1980s to respond to Japan's new issues and challenges. Also, conservative government in Japan has had a strong track record of recognising the need for change and delivering economic reform.

Appendix 3.1

ORGANISATION OF JAPANESE GOVERNMENT 1997



Note: Figures in parentheses indicate number of institutions.

Source: Reproduced from Foreign Press Centre, 1995.

Appendix 3.2

JAPANESE GOVERNMENTS 1945 TO 1997

Prime Ministers and Parties: 1945 to 1954

Period	Prime Minister	Political Parties in Government
Aug 1945 - Oct 1945	**Prince Higashikuni**	Appointed by Emperor after surrender
Oct 1945 - May 1946	**Kijuro Shidehara**	Appointed by SCAP as interim government
May 1946 - May 1947	**Shigeru Yoshida** (LP)[a]	Coalition of three conservative parties
May 1947 - Mar 1948	**Tetsu Katayama** (JSP)[b]	Coalition of JSP and Ashida's Progressive / Democratic Party
Mar 1948 - Oct 1948	**Hitoshi Ashida** (DP)[c]	Conservative-socialist coalition government
Oct 1948 - Jan 1949	**Shigeru Yoshida**	Coalition of three conservative parties
Jan 1949 - Oct 1952	**Shigeru Yoshida**	Conservative coalition
Oct 1952 - Apr 1953	**Shigeru Yoshida**	Conservative coalition
Apr 1953 - Dec 1954	**Shigeru Yoshida**	Conservative coalition

Note: a. LP: Liberal Party; b. JSP: Japan Socialist Party; c. DP: Progressive Party, renamed Democratic Party.

LDP Governments, Main Policy Goals: 1955 to 1993

Period	Prime Minister	Key Policy Goals and Features[a]
Dec 1954 - Dec 1956	**Ichiro Hatoyama**	Priority to modernising production facilities and expanding exports
Dec 1956 - Feb 1957	**Tanzan Ishibashi**	Goal set of achieving full employment
Feb 1957 - Jun 1958	**Nobusuke Kishi**	Priority to improving infrastructure, more heavy industry, expanding exports
Jun 1958 - Jul 1960	**Nobusuke Kishi**	New US-Japan Security Treaty pushed through despite mass protests; leads to Kishi's resignation
Jul 1960 - Dec 1960	**Hayato Ikeda**	National 'Income Doubling' Plan
Dec 1960 - Nov 1963	**Hayato Ikeda**	Emphasis on economic growth to improve quality of life
Nov 1963 - Nov 1964	**Hayato Ikeda**	
Nov 1964 - Jan 1967	**Eisaku Sato**	Emphasis on moderate growth and controlling inflation
Jan 1967 - Dec 1969	**Eisaku Sato**	Declaration of the three non-nuclear principles and four nuclear policies
Dec 1969 - Jul 1972	**Eisaku Sato**	Return of Okinawa to Japanese sovereignty achieved
Jul 1972 - Dec 1972	**Kakuei Tanaka**	Normalisation of Japan-China relations
Dec 1972 - Dec 1974	**Kakuei Tanaka**	'Plan for Remodelling the Japanese Archipelago'; large increases in domestic infrastructure spending
Dec 1974 - Dec 1976	**Takeo Miki**	Focus on Japan's role in international economy
Dec 1976 - Dec 1978	**Takeo Fukuda**	Dealing with stagflation, price stabilisation

LDP Governments, Main Policy Goals: 1955 to 1993 (cont.)

Period	Prime Minister	Key Policy Goals and Features[a]
Dec 1978 - Oct 1979	**Masayoshi Ohira**	Pursuit of stable growth path; efforts for fiscal reconstruction to deal with budget deficits
Oct 1979 - Jun 1980	**Masayoshi Ohira**	Dealing with second oil shock ; electoral rejection of general consumption tax
Jul 1980 - Nov 1982	**Zenko Suzuki**	Efforts for fiscal reform without tax increase
Nov 1982 - Dec 1983	**Yasuhiro Nakasone**	Major emphasis on administrative reform
Dec 1983 - Jul 1986	**Yasuhiro Nakasone**	Abolition of 1 per cent of GNP ceiling on defence expenditure, and increase in share carried by Japan of costs of US defence forces in Japan
Jul 1986 - Oct 1987	**Yasuhiro Nakasone**	
Oct 1987 - Apr 1989	**Noboru Takeshita**	Introduction of 3 per cent general consumption tax
Apr 1989 - Jul 1989	**Sosuke Uno**	
Jul 1989 - Feb 1990	**Toshiki Kaifu**	Electoral reform proposals (failed)
Feb 1990 - Apr 1990	**Toshiki Kaifu**	
Apr 1990 - Nov 1991	**Kiichi Miyazawa**	Legislation passed to allow limited Japanese SDF participation in UN Peace-Keeping operations
Nov 1991 - Jul 1993	**Kiichi Miyazawa**	Electoral reform proposals (failed)

Note: a. Information on main policy goals mainly drawn from Kosai, 1987.

Governments: 1993 to 1997

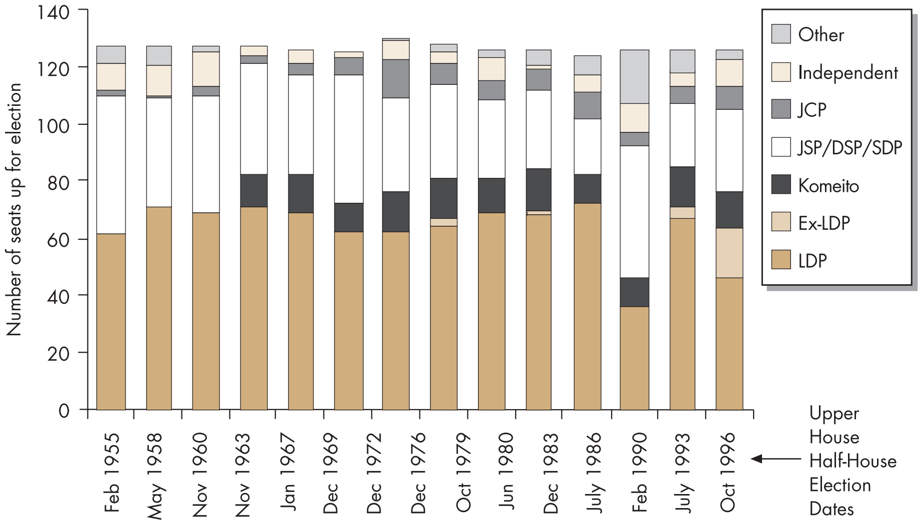
Period	Prime Minister	Participating Parties
Aug 1993 - Apr 1994	**Morihiro Hosokawa**	8-party coalition led by Shinseito, JSP, Komeito
Apr 1994 - Jun 1994	**Tsutomu Hata**	8-party coalition led by Shinseito, JSP, Komeito
Jun 1994 - Jan 1996	**Tomiichi Murayama**	3-party coalition of LDP, JSP, Sakigake
Jan 1996 - Oct 1996	**Ryutaro Hashimoto**	3-party coalition of LDP, JSP, Sakigake
Nov 1996 -	**Ryutaro Hashimoto**	LDP (at first with policy support from SDPJ and Sakigake, but by mid-1997 near majority in own right due to defections from other parties)

Appendix 3.3

THE UPPER HOUSE

Japanese Upper House[a] Half-House Elections 1956 to 1995:

Party[b] Votes by Number of Seats



Notes: a. The total number of Upper House (House of Councillors) seats was originally 250, and increased to 252 in 1972 with the reversion of Okinawa; 100 seats are elected from the national constituency, and 152 elected directly from prefectural electoral districts. The term of office for the Upper House is six years, with approximately half the members up for election every three years. The next half-House election is due in mid-1998.

b. Some parties changed over the period, and have been grouped as follows:

1. Non-LDP represents all conservative parties formed by LDP defectors: New Liberal Club / NLC, 1977 to 1983 elections; *Nihon Shinto* / Japan New Party for 1992 to 1995 elections; *Shinshinto* / Japan Renewal Party and *Sakigake* / Harbinger Party for 1995 elections. For the 1995 election, as far as possible, non-ex-LDP members of these parties have been subtracted from the ex-LDP count and added to the relevant party of former membership. 2. JSP vote includes Democratic Socialist Party / DSP votes, and for 1995 election, those for the Social Democratic Party of Japan / SDPJ, the new name of the JSP from January 1996. 3. Komeito first contested Upper House elections in 1965, and joined *Shinshinto* for 1995 elections, though Komeito seats for 1995 election are shown separately here for the purpose of the graph.

Source: Statistics Bureau (Prime Minister's Office), *Japan Statistical Yearbook*, various years.

Appendix 3.4

BRIEF CHRONOLOGY OF JAPAN'S POSTWAR GOVERNMENT AND POLITICS: 1945 TO 1997

15 Aug 1945	Emperor Hirohito announces Japanese surrender, and appoints first postwar government
Aug 1945	President Truman's Initial Post-Surrender Policy Directive for Japan issued outlining Occupation policies and tasks; Allied Occupation forces arrive
2 Sept 1945	Formal Japanese surrender to General MacArthur on USS Missouri in Tokyo Bay; Occupation commences; Japanese demobilisation and disarmament
1945-49	Severe shortages of food and goods cause periods of major inflation (up to 300 per cent per year)
Oct-Nov 1945	SCAP installs new interim Japanese government, with Kijuro Shidehara (a prewar liberal) as Prime Minister; SCAP dissolves Japanese Imperial Army and Navy, releases wartime political prisoners
Dec 1945	SCAP has Shidehara government legislate Trade Union Law, with rights to organise, bargain collectively and strike; rebirth of Japanese labour movement
Jan 1946	Emperor Hirohito issues rescript renouncing any claims to divine status
1946-50	SCAP's Land Reform program to boost agriculture increases farmers' land ownership
Mar-Apr 1946	SCAP presents proposed new Constitution; first postwar central government elections held in accordance with proposed Constitution; three conservative parties win 248 of 464 Lower House seats
May 1946	SCAP purges Hatoyama Ichiro, head of largest conservative party (Liberal Party - *Jiyuto*); conservative-led government formed under PM Shigeru Yoshida (Liberal Party)
Sept 1946	Labour Relations Adjustment Law imposes some restrictions on trade union activity (such as limited right to strike by government and public utility employees)
Nov 1946	After passage through National Diet, new Constitution formally promulgated
1947-48	Change in external security parameters together with change of economic views in USA causes gradual reversal (*gyaku kosu*) of overall US policies towards Japan, away from reprisals and reform towards expediting recovery and rebuilding
Feb 1947	SCAP bans general strike planned by new labour movement
Mar 1947	Diet passes Fundamental Law of Education, replacing Meiji Imperial Rescript on Education, and laying down new principles for postwar education system
April 1947	Local Autonomy Law passed, introducing new system of popular elections, instead of appointments, for prefectural governors and elected prefectural legislatures
Apr/May 1947	Second postwar elections; socialist-conservative coalition government formed under PM Tetsu Katayama (Japan Socialist Party -JSP - *Nihon Shakaito*)
3 May 1947	New postwar Constitution comes into legal effect
Feb/Mar 1948	Third postwar elections; conservative-socialist coalition government formed under conservative PM Hitoshi Ashida (Democratic Party- *Minshuto*)
Mar 1948	US Army Undersecretary Draper leads business mission; recommends reversal of Occupation economic policies towards rebuilding Japanese capitalism; establishment of 10 000-strong Maritime Safety Force (*Kaijo Hoan Tai*)
June 1948	US economic mission led by Federal Reserve Board member Ralph Young recommends measures to control inflation including fixed exchange rate, but rejected by SCAP
Oct 1948	Fourth postwar elections; conservatives regain government under PM Yoshida
Dec 1948	US National Security Council's 'Nine-Point Program' on new direction for economic policies for Japan; curtails SCAP authority in economic policy
1949	Chinese communists defeat Kuomintang and declare People's Republic of China (PRC)

Jan 1949	Fifth postwar elections; conservatives retain government under PM Yoshida; Japan Communist Party (JCP - *Kyosanto*) wins 35 Lower House seats, a postwar peak
Feb-April 1949	US banker Joseph Dodge (as delegate of President Truman) leads economic policy review mission; his recommendations for reduced US subsidies to Japan, balanced budget, and fixed Yen-US$ exchange rate at ¥360:US$1 (rate retained for next 22 years) all implemented
Jan 1950	JCP embarks on campaign of strikes, industrial sabotage, and non-cooperation with Occupation; SCAP and conservatives fear domestic communist revolution
Mid-1950	PM Yoshida establishes Cabinet Research Office (*Naikaku Chosa Shitsu*) within PM's Office to strengthen independent advice to PM
June-July 1950	Outbreak of Korean War; US military intervention, with US forces from Japan; major stimulus to Japan's economic recovery; SCAP establishes 75 000-strong National Police Reserve Force (*Keisatsu Yobitai*), doubles size of Maritime Safety Force
April 1951	President Truman dismisses General MacArthur; succeeded by General Matthew Ridgeway
8 Sept 1951	Treaty of Peace for Japan signed at San Francisco by United States, Japan, and 47 other nations, but not China or USSR; US-Japan Security Treaty also signed
1950-51	Release of purged prewar politicians who return en masse to political scene, with most disruptive effect on conservative parties; JSP splits into Left/ Right JSP
28 April 1952	Formal end of the Occupation and resumption of Japanese sovereignty; entry into force of US-Japan Security Treaty (with no time limit)
1952	Due to US pressure on Japan, agreement on Japan-Taiwan Peace Treaty
April 1952	Maritime Safety Force transformed into new navy under name of Maritime Patrol Force
Aug 1952	Yoshida government sets up a National Security Agency (*Hoan Cho*), as outer bureau of PM's Office, to be in charge of an enlarged and transformed Police Reserve (renamed National Security Force - *Hoantai*) and expanded Maritime Safety Force
Oct 1952	Conservatives retain government at general elections with reduced majority; two socialist parties increase Lower House seats from 46 to 111 seats
1953-60	Reports of disease (mercury poisoning) among inhabitants of Minamata, Kumamoto prefecture
April 1953	Fall in conservative support at general elections though retain government, but socialists win 138 Lower House seats; depurged former leader of Liberal party, Ichiro Hatoyama, splits from party with 35 followers, leaving PM Yoshida with minority government
Aug 1953- March 1954	Three conservative parties (Liberal and Democratic parties, and Hatoyama's group) begin to discuss unification; negotiate to reach a common defence policy
Mar-June 1954	US-Japan Mutual Security Assistance (MSA) Agreement; Defence Agency (*Boeicho)* set up under Defence Agency Establishment Law; Self-Defence Forces (SDF-*Jieitai*) established by law
1954	Reunification of right and left socialist parties into JSP
Dec 1954	Yoshida forced to resign as PM over petty scandal; Ichiro Hatoyama becomes PM
Nov 1955	Main conservative parties merge to form Liberal Democratic Party (LDP-*Jiyuminshuto*)
Dec 1955	Economic Counsel Board renamed Economic Planning Agency (EPA-*Keizai Kikaku Cho*); PM Hatoyama announces first Five-year Plan for Economic Self Support
1956	Japan admitted to membership of the United Nations; official diplomatic relations restored with USSR; Law Concerning the Structure of the National Defence Council (*Kokubo Kaigi*) passsed
1956-62	First postwar period of rapidly rising urban land prices
Dec 1957	Kishi government introduces New Long-Range Economic Plan (1958-62) 'to serve as guideposts for economic cooperation within the basic framework of free enterprise and a free market'
1959	Reported bronchial ailments among citizens of Yokkaichi, Mie prefecture (traced to petrochemical industry); JSP splits again, into JSP and Democratic Socialist Party (DSP - *Minshushakaito*)

Jan 1960	Kishi government announces agreement on new US-Japan Security Treaty, to remain in force for ten years; considerable domestic opposition mounts to new pact
May 1960	Kishi government achieves Diet ratification of new security treaty using unconventional tactics; mass demonstrations against treaty
June 1960	Anti-treaty demonstrations continue; Kishi resigns, succeeded by Hayato Ikeda (follower of Shigeru Yoshida's views)
Oct 1960	JSP Secretary-General, Inejiro Asanuma, assassinated by right-wing extremist
Nov-Dec 1960	Prime Minister Ikeda announces his National Income Doubling Plan; LDP wins 297 seats in Lower House election
1963	Japan becomes a signatory to the GATT
1964	Japan admitted to membership of the OECD, an economic milestone; also joins the IMF
Oct 1964	Japan hosts 18th Olympic Games; China tests first atomic bomb
1964-65	Minamata disease (mercury poisoning) reported in Niigata prefecture
Nov 1964	PM Ikeda dies in office; succeeded by Eisaku Sato; new opposition party, *Komeito* (Clean Government Party) established by Buddhist organisation *Soka Gakkai*
1966	Beginning of budget deficits and use of national bonds to fund expansionary fiscal policy
July 1967	Basic Law for Environmental Pollution Control passed
Oct 1967	Shigeru Yoshida dies at age of 90
Dec 1967	PM Sato announces 'three non-nuclear principles' and 'four nuclear policies'
1970	Commonly called *Kogai Gannen*, the inaugural year of era of environmental challenges; LDP sponsors several landmark antipollution laws, including strengthening of the 1967 Basic Environmental Law US-Japan Security Treaty extended, with either signatory able to annul with one year's notice
1971	'Nixon shocks' - US decision to shift to normalisation of relations with PRC without advising Japan, and US imposition of 10 per cent surcharge onto all imports into US market
1971-73	Environment Agency established; four major environmental pollution cases (involving mercury, cadmium and petrochemical poisoning) won by victims/ plaintiffs
Dec 1971	USA pushes Japan to accept Smithsonian Agreement for first revaluation of the yen since 1949, by 17 per cent up to Y307:US$1
1972	Okinawa reverts from US to Japanese administration and sovereignty
Sept 1972	PM Kakuei Tanaka restores official diplomatic relations with PRC
1972	PM Tanaka announces his 'Plan for Remodelling the Japanese Archipelago'
1972-73	Second postwar period of rapidly rising urban land prices
May 1973	Japan agrees with OECD conventions to fully liberalise capital inflows, with some exceptions
Oct 1973- Jan 74	First oil shock (price of Arabian light crude rises fourfold to US$11.65 per barrel); subsequent recession and severe inflation; reassessment of long-term energy plans to reduce oil dependency, and increase nuclear power and natural gas use
Mar 1973	Japan conforms with international replacement of fixed exchange rates with floating rates; yen floats upward to ¥265:US$1
1974	Press exposure of extent of Tanaka's 'money-power politics' forces his resignation as PM, and out of LDP, but remains Diet member; succeeded by Takeo Miki as PM
1976	PM Miki reaffirms moderate national defence posture, puts a ceiling on defence expenditure of 1 per cent of GNP, with strong public support
1976	Lockheed bribery scandal breaks, leading to arrest of Tanaka and others over bribery allegations; but Tanaka remains most powerful LDP figure
1976	8 LDP Diet members resign from party to protest against Tanaka's 'money-power politics' and form New Liberal Club (NLC)
1978	Japan-China Treaty of Peace and Friendship
1979	Second oil shock; electorate rejects Ohira proposal for consumption tax
June 1980	Death in office of Prime Minister Ohira; succeeded by Zenko Suzuki
Oct 1983	Kakuei Tanaka found guilty of receiving Lockheed bribes, and appeals
Dec 1983	LDP loses 36 seats in Lower House elections; coalition with NLC to retain government; Tanaka reelected with record majority; Tanaka faction loses only 2 seats

Feb 1985	Kakuei Tanaka paralysed by stroke, his personal influence declines, but Tanaka/Takeshita faction remains most powerful
1985	Maekawa Report recommends restructuring of Japanese economy
Sept 1985	Plaza Accord agreed by G5 Finance Ministers, contributing to significant appreciation of the yen against the US$
1985-88	Yen appreciates from ¥238:US$1 to ¥128:US$1
1986	US trade deficit with Japan reaches peak of US$60 billion, exacerbating US ire about Japanese market access and economic structure
1986-90	Third postwar period of rapidly rising urban land prices
Aug 1986	New Liberal Club (NLC) disbands
Jan 1986-Feb 1987	Bank of Japan lowers official discount rate from 5 to 2.5 per cent, its lowest level since 1945, giving birth to period of supereasy credit that leads to bubble economy (*baburu keizai*)
Jan 1987	PM Nakasone formally abolishes 1 per cent of GNP ceiling on defence expenditure, but defence spending remains around this level
Jan 1989	Showa Emperor (Hirohito) dies after 63 years on throne; his son Akihito succeeds and the new Heisei (Peaceful Life) era begins
1989	Takeshita government introduces consumption tax of 3 per cent
April 1989	PM Takeshita resigns over Recruit scandal; Sosuke Uno briefly succeeds him
May 1989	LDP announces major program of political reform but too late to prevent big fall in electoral support; PM Uno soon caught up in scandal
July 1989	Upper House half election sees big loss in LDP vote and JSP gain, mainly due to public disgust at corruption scandals; LDP makes Toshiki Kaifu PM in effort to project new clean image
1989-90	Bank of Japan raises official discount rate from 2.5 to 6 per cent and introduces tougher credit controls; Tokyo Stock Exchange Nikkei Stock average falls by almost half after 12 years of continuous rise; bursting of the bubble economy (*baburu hokai)*
April 1990	Electoral System Council report recommends major electoral reform
Aug 1990	Shin Kanemaru resigns as Deputy PM and head of Tanaka/Takeshita faction over Sagawa Kyubin scandal
1989-92	Structural Impediment Initiative (SII) Talks initiated by Bush Administration to address market access issues and US trade deficit
1992	Morihiro Hosokawa, LDP Upper House member, breaks away from party to form *Nihon Shinto* (Japan New Party), which wins four seats in mid-1992 half-Upper House election
Oct 1992	First visit to China by a Japanese Emperor (Akihito) and Empress
1992	Landmark legislation passed to allow limited Japanese SDF participation in UN Peace-Keeping Operations (PKO) in Cambodia
May/June 1993	Split from LDP of 48 members to form two new parties: *Shinseito* (Japan Renewal Party) led by Ichiro Ozawa and Tsutomu Hata; and *Sakigake* (Harbinger) Party led by Masayoshi Takemura; LDP left with 227 members, and No-confidence motion in Diet passed; brings down LDP government and precipitates elections
July 1993	US-Japan Economic Framework Agreement; Clinton Administration aims at reducing Japan's trade surplus on sector-by-sector basis
July 1993	Lower House elections; the split LDP loses government after 38 years, though old LDP still wins largest number of seats (223), and LDP defectors in Shinseito 55 seats, Sakigake 13 seats and some of Japan New Party's 35 seats; thus in effect still a conservative majority; Yohei Kono becomes LDP leader in opposition
Aug 1993	Formation of 8-party coalition government under PM Morihiro Hosokawa comprising Shinseito, JSP, Komeito, and others
Dec 1993	Hosokawa Government agrees to end ban on rice imports under UR agreement
Nov 1993-Jan 1994	Hosokawa government gets electoral reform laws passed for new Lower House electoral system, after initial rejection in Upper House, and considerable compromise
Dec 1993	Death of Kakuei Tanaka, the 1972-85 godfather of Japanese politics
March 1994	Hosokawa government announces major deregulation program

April 1994	PM Hosokawa resigns over financial impropriety allegations and stalling of 1994 budget; Tsutomu Hata becomes PM, but JSP withdraws from government over exclusion from Ozawa's scheme for new reform coalition; Hata left with minority government
1994	US merchandise trade deficit with Japan reaches new record of US$67 billion
June 1994	Hata Government presents deregulation package; end of coalition government under PM Hata, in face of imminent no-confidence motion by LDP; formation of coalition government comprising LDP, JSP and Sakigake, under socialist PM Tomiichi Murayama
Sept 1994	JSP makes major changes to its long-standing postwar policy platform, in particular abandoning neutrality and non-alignment, recognising SDF as Constitutional, and accepting US-Japan Security Treaty
Dec 1994	Formation of *Shinshinto* (New Frontier Party)from Shinseito, plus some of Komeito, and seven other parties; former PM Toshiki Kaifu wins leadership over Hosokawa and Hata
Dec 1994-Apr 1995	Rapid yen appreciation which peaks at ¥79:US$1; widespread business alarm, especially among manufacturers, and calls for government action
17 Jan 1995	Great Hanshin (Kobe) Awaji Earthquake kills over 6 500 people and does extensive damage to housing and infrastructure, including Kobe port; severe national psychological shock; strong public criticism over goverment's bungled disaster relief efforts
March 1995	Major sarin gas attack on Tokyo subway by *Aum Shinrikyo* (Aum Supreme Truth) religious sect; 11 people killed
July 1995	US-Japan auto accord reached after difficult confrontation
Aug 1995	50th anniversary of end of Asia-Pacific War; Diet's Resolution on apology for Japan's role passed after great difficulty, and not satisfying most countries affected
Aug-Sept 1995	MOF and US Treasury reach understanding over limit to yen appreciation; yen begins to fall against US$
Sept 1995	LDP biannual Presidential elections; Ryutaro Hashimoto elected leader
Dec 1995	Ichiro Ozawa wins leadership of Shinshinto replacing former PM Kaifu
Jan 1996	Murayama resigns as PM of coalition government; Hashimoto becomes PM; JSP reconstitutes itself as Social Democratic Party of Japan (SDPJ - *Shakaiminshuto*)
April 1996	US-Japan Leaders Summit in Tokyo; President Clinton and Prime Minister Hashimoto reaffirm commitment to US-Japan security alliance for Asia-Pacific regional security
Oct 1996	Democratic Party of Japan (DPJ-*Minshuto*) formed from parts of SDPJ, Sakigake and other parties, led by Yukio Hatoyama (ex-LDP/Sakigake) and Naoto Kan (ex-LDP/Sakigake)
Oct 1996	First general elections held under new electoral system; LDP improves from pre-election 211 seats to win near majority of Lower House (239 seats)
Nov 1996	LDP forms minority government under PM Ryutaro Hashimoto, with policy support agreement from SDPJ (15 seats) and Sakigake (2 seats)
1996	Ex-PM Murayama resigns as SDPJ leader; succeeded by Takako Doi
Dec 1996	Hashimoto government announces 'Big Bang' financial reform and deregulation package; former PM Hata with supporters split from Shinshinto to form the Sun Party (*Taiyoto)*
Jan/Feb 1997	More defections from opposition parties to LDP, now with 241 Lower House seats; Shinshinto rocked by arrest of ex-member Tomobe in Orange Kyosai Kumiai scandal
March 1997	Hashimoto Government announces its plan to reduce central and local government budget deficits to no more than 3 per cent of GDP by 2005 (later revised to by 2003)
April 1997	Hashimoto government raises consumption tax, as previously announced, from 3 to 5 per cent; LDP Lower House numbers reach 244 from more returning defectors; yen reaches ¥127:US$1, its lowest level in four years

REFERENCES

International Monetary Fund, 1997, *International Financial Statistics*, International Monetary Fund, Washington DC.

Johnson, C., 1982, *MITI and Japan's Economic Miracle*, Stanford University Press, place.

____ 1995, *Japan: Who Governs? The Rise of the Developmental State*, W.W. Norton and Co, New York.

Kosai, Y., 1987, 'The Politics of Economic Management', in Yamamura, K., and Yasuba, Y. (eds), 1987, *The Political Economy of Japan*, *Volume 1: The Domestic Transformation*, Stanford University Press, Palo Alto.

Livingston, J., Moore, J. and Oldfather, F., 1973, *Postwar Japan: 1945 to the Present*, Random House, New York.

Makihara, M., 1993, 'Japan in Transition', *Journal of Northeast Asian Studies*, Vol. XII, No. 2, Summer, pp.70-76.

Muramatsu, M. and Krauss, E., 1987, 'The Development of Patterned Pluralism', in Yamamura, K., and Yasuba, Y. (eds), 1987, *The Political Economy of Japan*, *Volume 1: The Domestic Transformation*, Stanford University Press, Palo Alto.

Statistics Bureau (Prime Minister's Office), 1996 and previous years, *Japan Statistical Yearbook*, Tokyo.

Stockwin, Arthur, 1996, 'Reforming Japanese politics: highway of change or road to nowhere? Part II', Seminar, Australia-Japan Research Centre, ANU, Canberra.

____ 1995, 'Reforming Japanese politics: highway of change or road to nowhere? Part I', Seminar, Australia-Japan Research Centre, ANU, Canberra.

Storry, R., 1968, *A History of Japan*, Pelican, London.

Thayer, N.B., 1973, *How the Conservatives Rule Japan*, Princeton University Press, New Jersey.

Welfield, J., 1988, *An Empire in Eclipse: Japan in the Postwar American Alliance System*, The Athlone Press, London.

Chapter 4

MACROECONOMIC ISSUES

Japan's macroeconomic management will be an important determinant of economic performance in coming years. Much depends on how the authorities manage fiscal and monetary policy, including developing strategies to deal with the declining savings rate and the budgetary pressures emerging from an ageing population. Low or zero growth is a major problem with the Japanese economy facing the challenge of achieving sufficient growth rates to allow solid and sustainable improvements in living standards. Stop-gap solutions, such as regular minibudgets to provide a midyear boost, have proved ineffective in the long run. Cutting interest rates to below their current record low of 0.5 per cent is not viable. Cutting taxes might provide some stimulus, but must be weighed against growing budgetary pressures. A weaker yen would stimulate growth, but Japan is reluctant to encourage further depreciation, given international opposition. The main requirement to generate sustainable growth, therefore, appears to be faster deregulation and reform. This and subsequent chapters assess Japan's options for sustaining economic growth and the likely policy developments over the next five to ten years.

The analysis in this chapter follows two interwoven themes. The first theme is the existing macroeconomic environment in Japan, the main forces that shaped it, short-term trends in key variables such as growth, inflation and the current account, and the likely role of macroeconomic policy. Compared to the period between 1992 and 1995, Japan's growth prospects are reasonably robust in 1997 and 1998. As this growth is increasingly driven by the private sector, it should boost import demand.

The second theme is the longer-term outlook for the Japanese economy, which faces major challenges: longer-term structural adjustment, continuing reform and the ageing population. Japan's potential growth rate could decline due to the contracting workforce. Ageing is also likely to reduce the savings rate and the current account surplus. In addition, the yen could strengthen as retirees repatriate funds currently invested overseas.

Addressing these longer-term challenges will require bold action to promote productivity growth, check threats to potential expansion of new sectors, and encourage more efficient allocation of potentially scarce savings.

SHOCKS TO THE SYSTEM

The Japanese economy has been shaken by a series of 'shocks' in recent years, including:

- dramatic appreciation of the yen
- the collapse in asset prices known as the 'bursting of the bubble economy'
- the crisis in the financial system
- the Kobe earthquake
- the unsettled political climate.

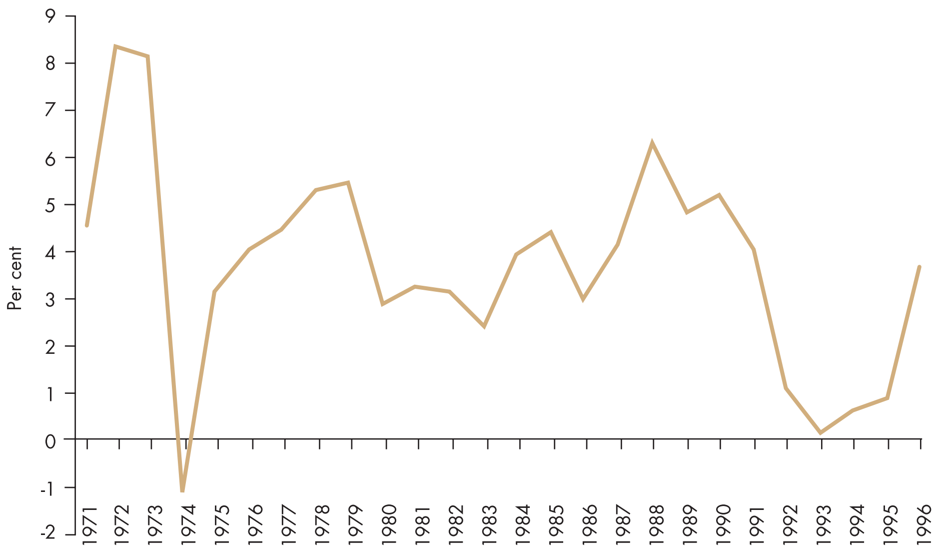
Difficulties in dealing with these shocks, together with major structural problems such as low productivity in nonexport-oriented sectors, have undermined economic recovery in recent years (Figure 4.1). Recovery from the oil shock in 1973 was much faster than recovery from the recession of the early 1990s.

Figure 4.1

Unprecedented Weakness in Early 1990s

Japanese Real GDP Growth

1971 to 1996



Source: Organisation for Economic Cooperation and Development, 1997a and previous years.

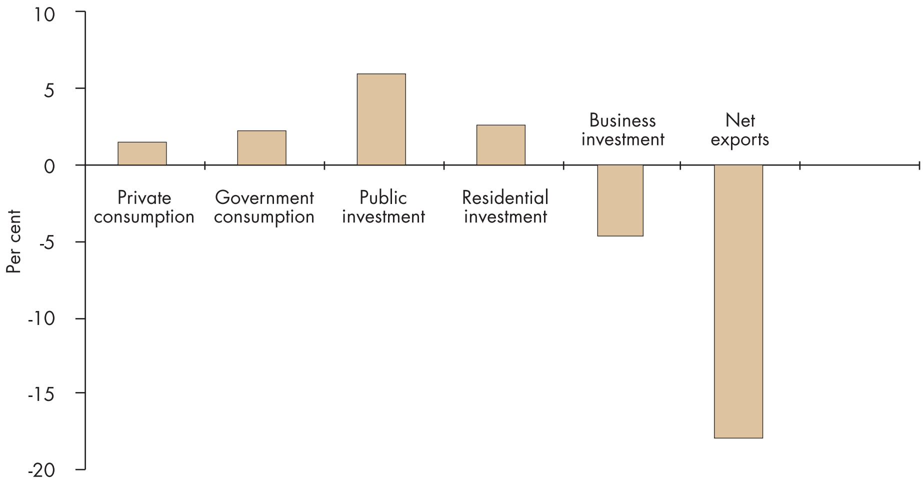
RECENT MACROECONOMIC EXPERIENCE

Between 1992 and 1995, the weakest components of economic activity were business investment and net exports (Figure 4.2). Business investment was weak because of low profitability, low capacity utilisation and the appreciating yen. The fastest growth came from public investment, reflecting Japan's expansionary fiscal policy, though this adversely affected the government's budget balance (Figure 4.3). While private consumption growth averaged only 1.5 per cent per year, it contributed more to growth than public investment, reflecting its 60 per cent share of GDP.

Figure 4.2

Weak Private Sector Activity from 1992 to 1995

Average Growth by Type of Expenditure

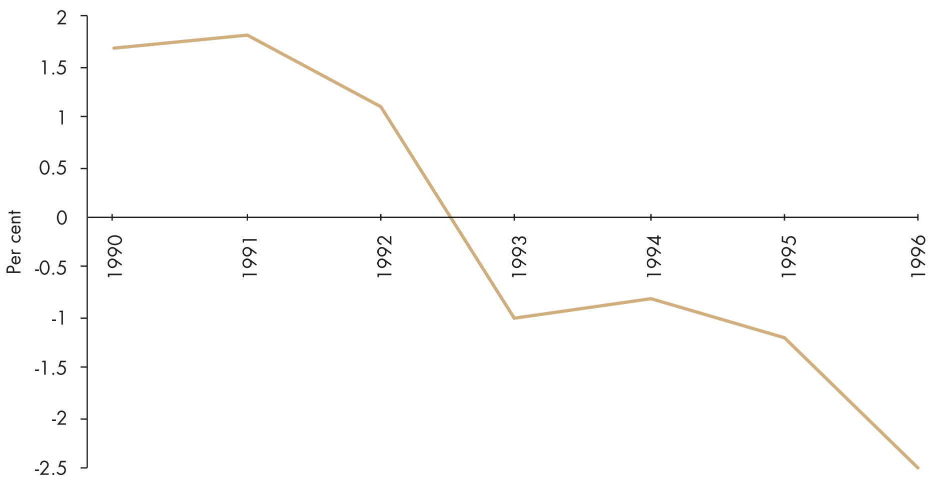


Source: Organisation for Economic Cooperation and Development, 1997a and previous years.

Figure 4.3

Japan's Fiscal Position Deteriorating

General Government Structural Budget Balance as a Percentage of GDP



Note: The structural budget balance discounts cyclical influences by subtracting the effects of cyclical deviations (for example, higher deficits in recessions) from the actual budget position.

Source: International Monetary Fund, 1996.

In 1996, growth rose to 3.6 per cent, its highest level since 1991. In the first half of the year, public investment grew 26.8 per cent while net exports continued to detract from growth. Private domestic activity strengthened over the year. Business and residential investment were the fastest growing components. Private consumption grew 2.7 per cent in 1996, up from 1.7 per cent in 1995, due mainly to real disposable income growing 2 per cent in 1996, the highest increase since 1992.[1] Net exports inhibited growth, with losses similar to those recorded in 1995.

Two important changes occurred in the second half of 1996:

1. Following the substantial depreciation of the yen in late 1995 and early 1996,[2] net exports increased, contributing positively to growth in both the September and December quarters.

2. Fiscal policy exerted a contractionary influence on economic activity, with public investment declining sharply as expenditure from the September 1995 stimulus package ceased.

Monetary Policy

In contrast to fiscal policy, monetary policy continues to stimulate private sector demand. Short-term interest rates have fallen since mid-1991, and the official Bank of Japan discount rate has been 0.5 per cent since September 1995. Market call rates have been at or below the official discount rate since this time (Figure 4.4). Long-term rates also have fallen, dropping to below 2.5 per cent in late 1996 and early 1997.

SHORT-TERM POLICY INFLUENCES AND PROSPECTS

Since the impact of the September 1995 minibudget has largely run its course, fiscal policy will be essentially contractionary due to:

1. the consumption tax rise from 3 per cent to 5 per cent in April 1997

2. higher income tax rates from 1997 following cessation of temporary tax cuts introduced in 1994.

Furthermore, in line with legislative requirements, contributions to the National Pension Scheme will rise 5 per cent in real terms in 1997 and 1998 (Organisation for Economic Cooperation and Development, 1996b). The Ministry of Finance argued successfully for these measures to address the growing fiscal deficit.

....

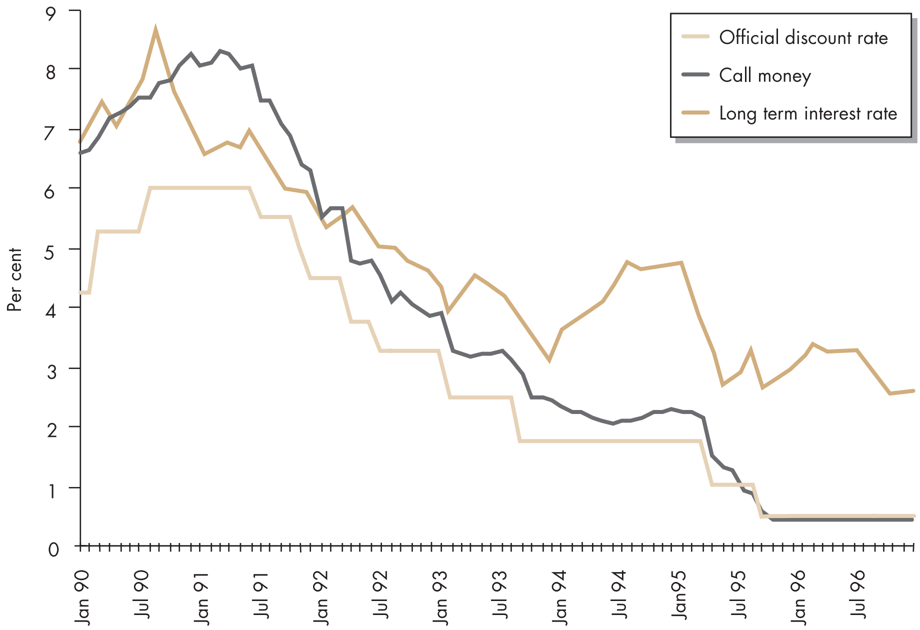
1 Real disposable income was estimated to have grown 2 per cent in 1996 (Organisation for Economic Cooperation and Development, 1996a). Negative factors affecting consumption expenditure in 1996 include the public health scare in the Japanese summer and the statistical impact of the leap year which detracted from June quarter growth. By the December quarter, these factors acted to boost growth as they had created a lower base.

2 Between April 1995 and June 1996 the yen depreciated 30 per cent against the US dollar.

Figure 4.4

Interest Rates at Record Lows

Japanese Interest Rates



Source: Organisation for Economic Cooperation and Development, 1997b and previous years.

In coming years, the adoption of the fiscal policy target proposed by the Fiscal System Reform Council to lower the combined deficits of the central and local governments to 3 per cent of GDP by 2005 (from 7.4 per cent currently) will require additional fiscal tightening.[3] Monetary policy will remain expansionary, with any increase in official interest rates likely to be delayed until late in the year when the effects of tax increases can be more clearly assessed.

Short-Term Prospects

For the recovery to continue, private sector demand must accelerate sufficiently to offset ongoing fiscal policy contraction. Provided the yen does not appreciate sharply, business investment is likely to continue growing solidly in 1997 and 1998,[4] driven by the substantial progress made in restructuring, low capital costs and wage restraint. The major uncertainty is whether private consumption will fall as taxes and income deductions rise. The more households run down their savings to finance this

[3] This figure differs from that in Figure 4.3 as it is not adjusted for the economy's recent cyclical weakness.

[4] In its December 1996 *Economic Outlook*, the OECD forecast real growth of business investment of 7.7 per cent in 1997 and 8.7 per cent in 1998.

decrease in disposable income, the smaller will be the impact on consumption.[5] The consensus among forecasters is for growth to dip in 1997 and pick up again in 1998 (Table 4.1).[6]

Table 4.1

Growth Dipping in 1997 and Rising Steadily in 1998

Forecasts of Real GDP Growth in 1997 and 1998

Organisation	Forecast real GDP growth (per cent) 1997	1998
OECD	1.6	3.7
International Monetary Fund	2.7	n.a.
Consensus Forecasts	1.4	2.4
The Economist survey average	1.8	2.7
JP Morgan-Japan	2.4	2.8
Daiwa Institute of Research	1.5	2.7
Official[a]	1.9	n.a.

Note: a. For Japanese fiscal year.

Source: Organisation for Economic Cooperation and Development, 1996b; International Monetary Fund, 1996; *The Economist*, 29 March 1997; Consensus Economics, 1997.

LONG-TERM GROWTH POTENTIAL

Notwithstanding the forecast for accelerated economic activity in 1998, in the longer term Japan faces a decline in its potential growth rate, driven by the growing proportion of elderly in its population. (See Chapter 2 - *Socioeconomic Evolution*.) The International Monetary Fund (IMF) estimates Japan's potential growth will be around 2.5 per cent per year in CY1995-2000, dropping gradually to around 1 per cent per year by 2015 as growth in the working-age population slows (Meredith, 1995a, p. 47).[7] The steady decline in potential growth post-2000 highlights the need for bold action to hasten structural reform and thus boost productivity growth.

5 The impact of the consumption tax increase on consumption will also depend on whether business absorbs any of the increase, but in net terms this may be less important because absorbing this increase will depress profitability.

6 Assumptions differ on the impact of new taxes on consumption and on variables such as the exchange rate.

7 This projection is based on the assumption that total factor productivity growth will continue at the rate expected for the 1990s; that the capital-output ratio will increase in line with the declining relative price of capital goods; and that the participation rate of the working age population will be roughly constant beyond 2000 (Meredith, 1995a, p.47).

Japan's New Economic Plan to Fiscal Year 2000, adopted by Cabinet in December 1995, recognises the link between structural reform and potential growth. It argues that real GDP growth of 3 per cent per year is achievable in JFY1996-2000 by continuing broad structural reforms. Without ongoing reform, it anticipates growth would be only 1.75 per cent per year.

EMPLOYMENT

Weak output growth caused employment to expand only 0.2 per cent or less per year between 1993 and 1995 (Figure 4.5). In 1996, employment growth rose slightly to 0.5 per cent. This weakness caused the unemployment rate to rise steadily to a record high of 3.6 per cent in May 1996, though it fell back to 3.3 per cent by December 1996.[8]

Figure 4.5

Low Output Growth, Low Employment Growth

Employment Growth and the Unemployment Rate
1971 to 1996

Source: Organisation for Economic Cooperation and Development, 1997a and 1997b.

8 Though the labour force grew at around 0.5 per cent per year between 1993 to 1995, the participation rate fell by 0.3 percentage point to 63.4 per cent. However, in 1996 participation increased by 0.1 percentage point from its level in 1995.

While the weak labour market has a strong cyclical element, structural influences are also important. For instance, slow structural reform in the Japanese economy reduces the extent to which expanding areas, particularly the services sector, can create new employment. Moreover, lifetime employment contracts[9] make forced redundancies largely unacceptable. This makes employers reluctant to take on new workers and hinders the creation of new jobs. While this was not a significant constraint in Japan's high growth era, it is now. Some companies, recognising this, are discouraging expectations of lifetime employment. (See Chapter 2 - *Socioeconomic Evolution*.)

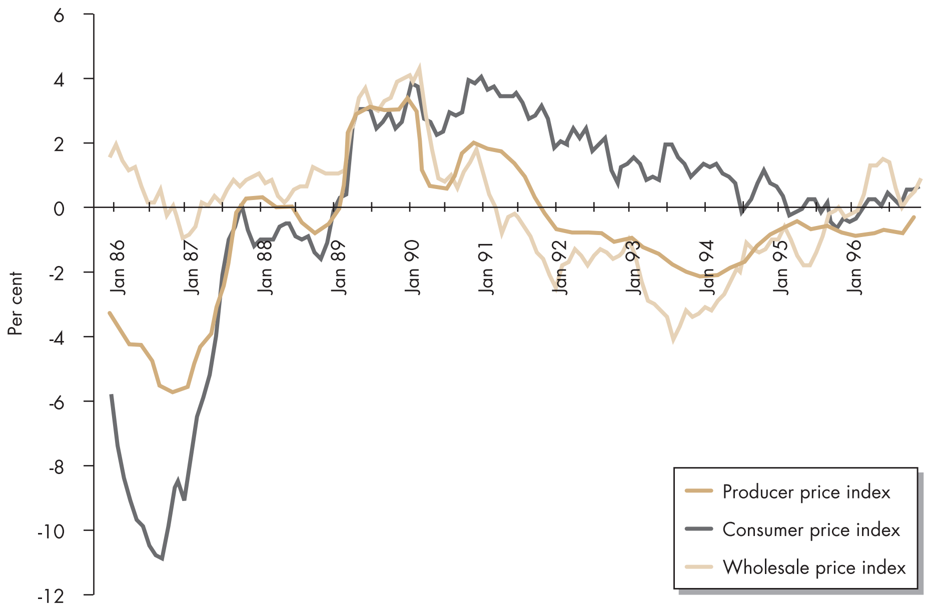
INFLATION

Between 1991 and 1995, concerns about deflation increased as yen appreciation and flat economic activity contributed to substantial and sustained declines in wholesale, producer and land prices, falls in the consumer price index and falls in the GDP deflator, the most general indicator of price pressures (Figures 4.6 and 4.7). In 1996, with the exception of land prices, a depreciating yen and strengthening economic activity caused price trends to turn around or at least stabilise, and concerns about deflation faded. However, with continued spare capacity, ongoing deregulation, tariff reform and globalisation, inflationary pressures are likely to remain subdued.

Figure 4.6

Prices Have Stopped Falling ...

Wholesale, Producer and Consumer Inflation



Source: Organisation for Economic Cooperation and Development, 1997b.

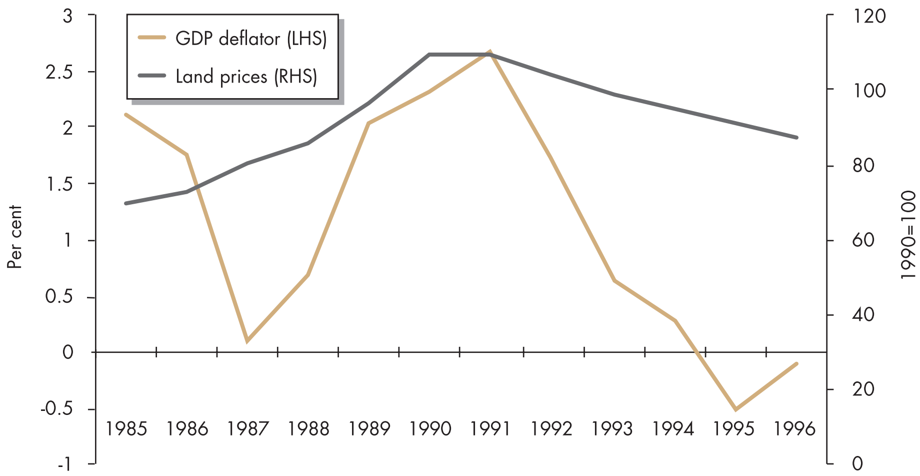
....

9 These predominate primarily in large companies.

Figure 4.7

... Except in Land Markets

Land Prices and the GDP Deflator



Source: Organisation for Economic Cooperation and Development, 1996b; Nikkei data base.

JAPANESE SAVINGS

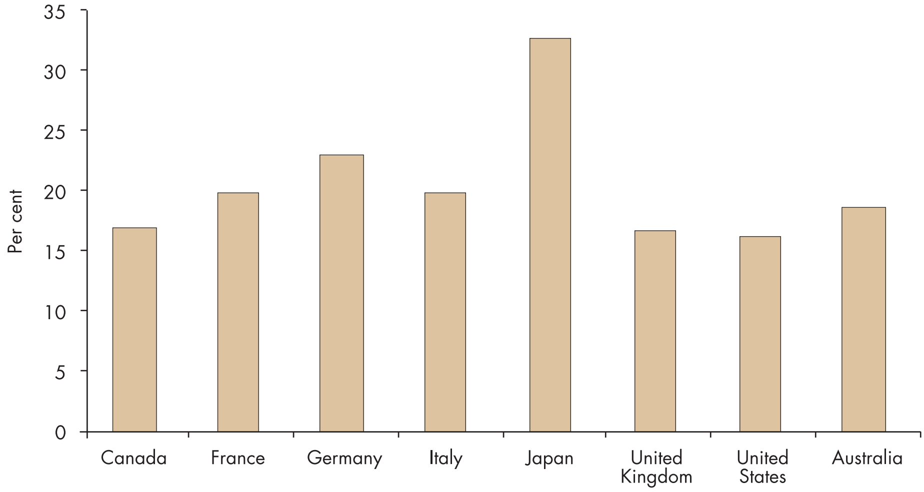
Strong savings performance since World War II has been critical to the Japanese economy's phenomenal success, promoting high growth rates and rapid accumulation of physical and financial assets with minimal dependence on international capital. Unlike many other developed nations, Japan's solid savings record continued even after it became fully industrialised, and its average ratio of gross savings to GDP remains well above that of other major industrialised countries, including Australia (Figure 4.8).

However, this is changing. Between 1991 and 1995, Japan's savings rate dropped by 3.5 percentage points to 30.8 per cent of GDP, mostly due to steeply falling government savings (Figure 4.9). Private savings, which are dominated by household savings, declined steadily in the 1980s. They recovered partly in the first half of the 1990s but remain 2 percentage points below their peak of the mid-1980s.

Figure 4.8

Savings Still Strong ...

Average Gross Savings Rates as a Percentage of GDP, 1985 to 1995

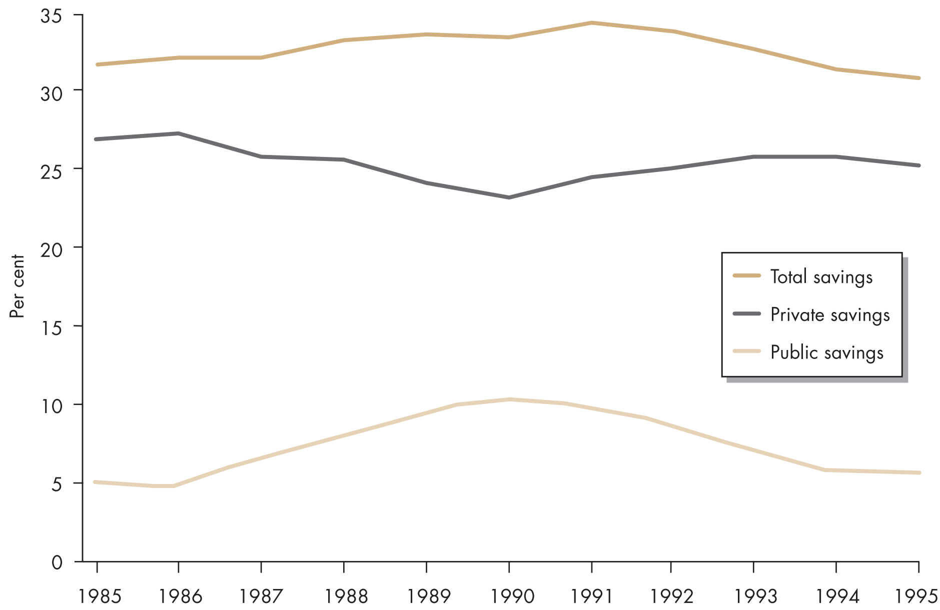


Source: International Monetary Fund, 1996; Australian Bureau of Statistics, 1996a and 1996b.

Figure 4.9

... But Performance Is Slipping ...

Japanese Savings by Sector as a Percentage of GDP, 1985 to 1995



Source: International Monetary Fund, 1996.

Future Savings Prospects

Fiscal consolidation should stop the decline in general government savings in the late 1990s and lift overall savings. Over the long term, the dominant influence on savings is likely to be demographic, as the ratio of elderly to working age households increases. (See Chapter 2 - *Socioeconomic Evolution*.) The ratio of the elderly to the working age population is projected to rise more than 28 percentage points to 46 per cent between 1990 and 2030 (Meredith, 1995b).[10] On its own, this will decrease substantially the aggregate savings rate, as elderly households run down savings while working age households accumulate them.[11] In 1990 elderly people's household savings as a percentage of disposable income were -3.5 per cent, versus 25 per cent for working households (Meredith, 1995b, p. 39).

Moreover, current Japanese social security tax rates are unlikely to be able to support the projected ratio of elderly to working age households.[12] Failure to act will see general government debt increase rapidly after 2010 to above 50 per cent of GDP in 2025, thus reducing government savings (Meredith, 1995a, p. 49). To avert this, additional revenue or expenditure measures equalling around 2 per cent of GDP in 1995 will be needed (Meredith, 1995a, p. 48). The magnitude of the necessary adjustment means revenue measures are likely to dominate; options include further increasing social security contributions, increasing the consumption tax or eliminating the special deduction for pension income in the personal tax system. However, these measures would lower consumption by working age households and also reduce their savings rate. By incorporating such tax increases between 1990 and 2030, the IMF projects that household savings would decline from 21 per cent of disposable income to 10 per cent as the ratio of elderly to working age population rises from 18 per cent to 46 per cent (Figure 4.10).[13] Every percentage point change in the elderly to working age population ratio is expected to reduce aggregate household savings by around 0.4 percentage points.[14]

10 This measure of ageing differs from that discussed in Chapter 2 - *Socioeconomic Evolution* in that it looks at the ratio of the elderly to the working age population rather than the ratio of the elderly to the total population.

11 Holding the savings rates of elderly and working age households constant, each 1 percentage point rise in the ratio of the elderly to the working age population will lower the aggregate savings rate by 0.2 percentage point.

12 Meredith (1995a, p. 46) found that even after accounting for the 1994 pension reform plan which envisaged increases in contribution rates, decreases in benefits and postponement of the eligibility age to be phased in over 30 years, further measures, totalling almost 2 per cent of GDP if implemented in 1995, would be needed to fully offset the burden of the ageing population. This finding is in line with the OECD, which argues that a rise in national taxation of 3 per cent of GDP will be needed to cover the rising expenditure on health, welfare and the basic pension that will be associated with the ageing of the population (Organisation for Economic Cooperation and Development, 1996a, p. 63).

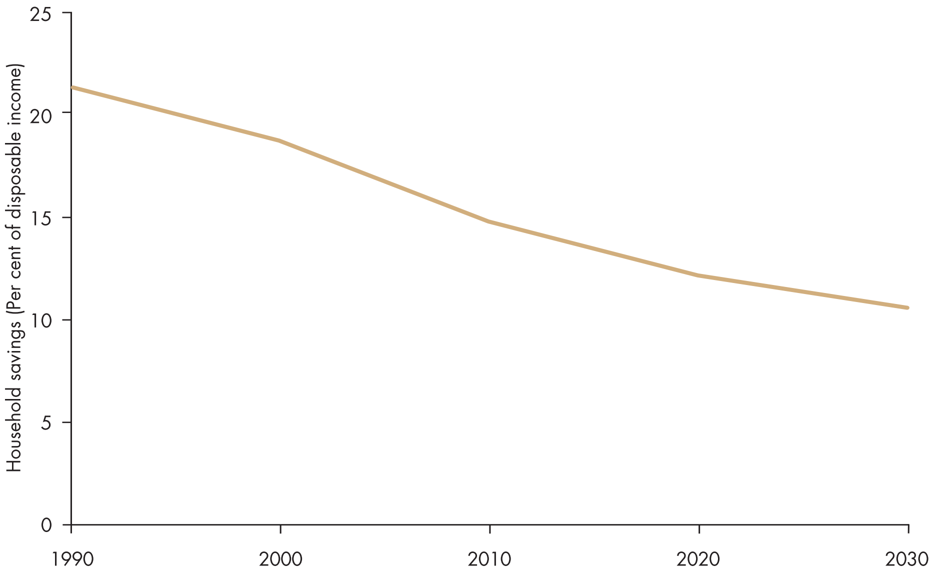
13 These figures assess household savings as a percentage of disposable income rather than GDP because they are based on the family income and expenditure survey.

14 This result compares to a 0.2 percentage point decrease from a one percentage point change in the elderly dependency ratio (the ratio of the elderly to the working age population) when only the population shares are changed (Meredith, 1995a).

Figure 4.10

... and Pressure on Savings Is Increasing

Projected Declines in the Gross Japanese Household Savings Rate



Source: Meredith, 1995b.

Other factors reducing Japanese savings over coming years include shorter working hours and slower growth rates.

Implications

Declining savings as a result of demographic factors probably will reduce substantially Japan's domestic investment, its external surplus or both. The decreased pool of savings will need to be allocated more efficiently, making further reform to the financial sector vital. (See Chapter 7 - *Finance*.) The impending decline in savings also increases the urgency of further broad economic reforms to increase the potential growth rate, as the pressures on government finances will make recourse to fiscal stimuli increasingly difficult.

BALANCE OF PAYMENTS

Japan's balance of payments situation is the focus of significant domestic and international (mainly US) attention, and drives foreign and domestic pressure for trade liberalisation in Japan.

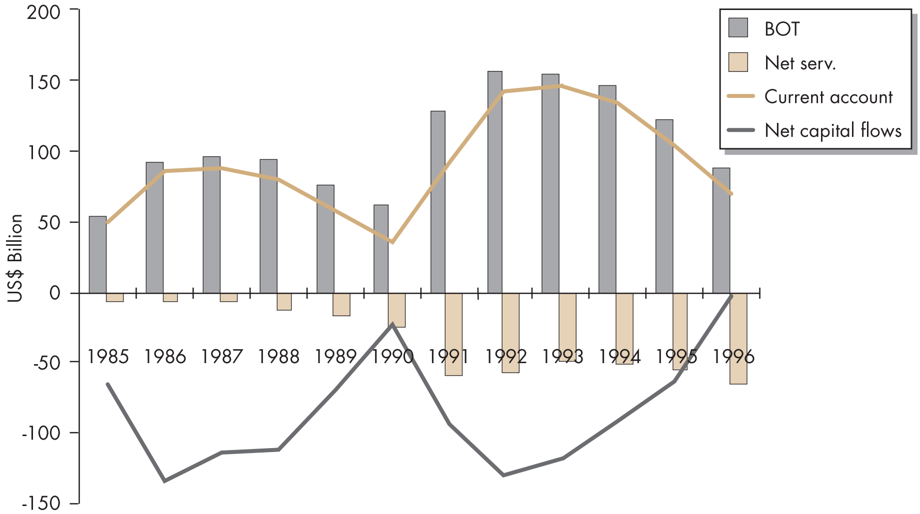
Current Account Situation

On an annual basis, Japan's current account surplus has been declining sharply since 1993 (Figures 4.11 and 4.12).[15] This is due mainly to the falling trade surplus as a result of yen appreciation. In 1995, the net services balance also deteriorated by US$4.9 billion as increasing numbers of Japanese travelled abroad; it deteriorated even more in 1996.

Figure 4.11

Japan's Current Account Surplus Has Declined ...

Japan's Balance of Payments Components



Note: Negative values for net capital flows denote outflows of capital in net terms.

Source: Organisation for Economic Cooperation and Development, 1997b and previous years.

In the second half of 1996, with the weaker yen stimulating export growth, the current account surplus increased 6.3 per cent on its levels in the first half of the year. Provided the yen does not appreciate sharply, the current account surplus is likely to increase further as exports continue to grow in 1997 and 1998.[16] However, over the long term, the current account surplus is expected to shrink as Japan's ageing population increasingly runs down its savings[17] and import penetration grows.

15 All this discussion of Japan's current account is in US dollar terms but the trends are similar in yen terms.

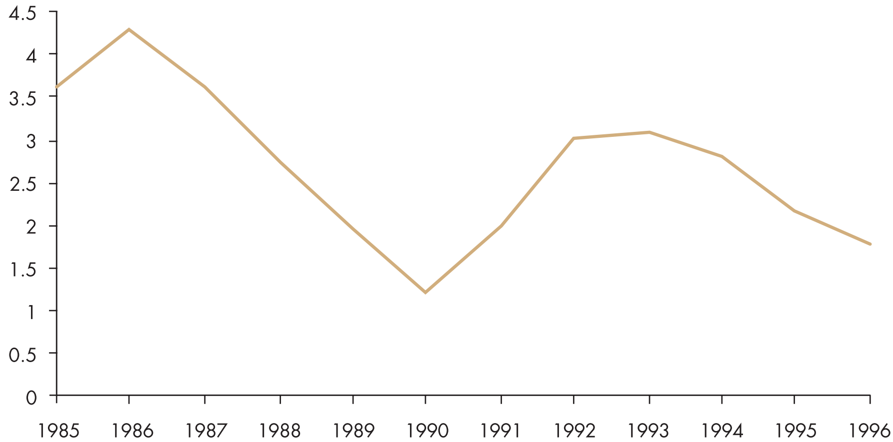
16 The OECD forecasts a current account surplus as a percentage of GDP of 1.4 per cent in 1997 and 1.5 per cent in 1998, with growth in export volumes of 7.5 per cent in 1997 and 8.7 per cent in 1998.

17 The impact of ageing on savings was examined in detail in a previous section on savings.

Figure 4.12

… and Has Also Fallen as a Percentage of GDP

The Current Account Surplus as a Percentage of GDP



Source: Organisation for Economic Cooperation and Development, 1996b.

Capital Account Movements

Net capital flows[18] mirror movements in the current account surplus (Figure 4.11). Over the longer term, as Japan's current account surplus decreases, its net capital outflows will fall.

The key components of capital flows vary considerably from year to year (Figure 4.13). Changes in the forces driving different types of capital flows also have been substantial.[19] Understanding the changes that have occurred over the last decade helps in interpreting recent movements in Japanese capital flows and in assessing likely future trends.

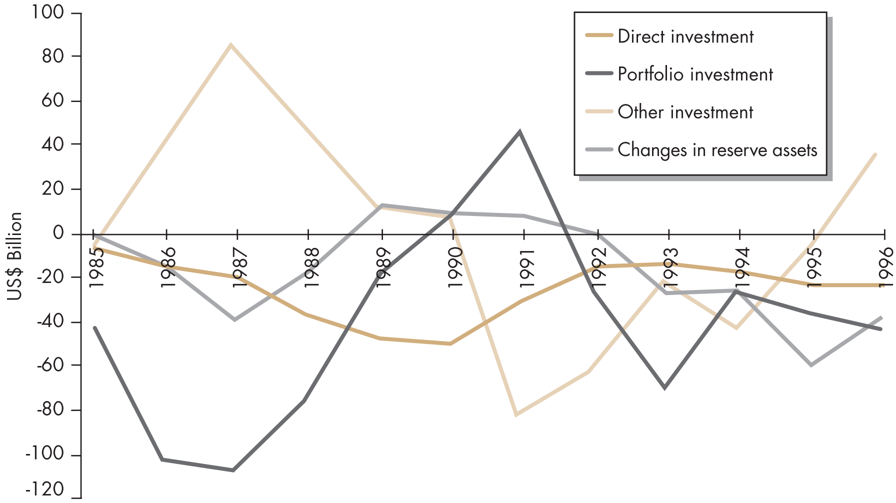
18 Net capital flows refer to inward flows less outward flows. A negative number in any of the charts in this section for any category indicates a net capital outflow.

19 For further details see Kahkonen (1995).

Figure 4.13

Main Components of Capital Flows Vary

Main Components of Japanese Capital Flows



Note: 1. Negative values for capital flows denote outflows of capital in net terms.

2. Figures have been converted to US dollars using year average exchange rates.

3. Other investment includes long-term and short-term loans, trade credits, currency and deposits, other accounts receivable and payable.

Source: Bank of Japan, 1996a.

The key force driving capital flows in the 1980s was the liberalisation of regulations. For instance, net portfolio investment outflows surged from the early 1980s and exceeded US$100 billion in 1986 and 1987 as capital controls were liberalised progressively.[20] From 1985 on, this asset accumulation was matched closely by borrowing in foreign currencies, which shows up in the other investment category of Figure 4.10, to satisfy regulations forcing banks to keep a low level of overall exposure to foreign currency risk. Liberalising rules governing capital flows, together with an appreciating yen, steadily increased net direct investment outflows from the mid-1980s through 1990.

By the late 1980s, investment stocks had adjusted following the relaxation of capital controls, and net portfolio investment outflows and associated borrowings in foreign currency decreased rapidly. Completed stock adjustment increased Japanese investor

[20] Other factors included deregulation of the domestic financial sector, which induced domestic financial institutions to search for profit opportunities abroad; a structural change from depository-type financial institutions (such as postal savings banks) towards securities-oriented institutions (such as insurance companies) which increased a trend towards foreign securities holding; and the increase in land and equity prices in the late 1980s which contributed to the accumulation of foreign assets by Japanese residents.

sensitivity to fundamentals, such as interest rate differentials and exchange rate risk. Consequently, tighter monetary policy from mid-1989, the already heavy exposure to foreign currency assets and reduced interest rate differentials in their favour saw Japan become a net recipient of portfolio investment in 1990, while net direct investment declined under lower pressure from the exchange rate. This turnaround in capital flows was given further impetus by the bursting of the asset price bubble in 1990. According to Kahkonen (1995) this event:

- reduced financial institutions' 'hidden assets' (unrealised capital gains), decreasing the extent to which exchange rate losses could be offset by domestic capital gains, thereby reducing capacity to face exchange rate risk on foreign securities
- attracted foreign buyers of Japanese equity and discouraged direct investment abroad, especially in real estate
- created some concerns about capital adequacy, particularly the need to conform to Bank of International Settlement guidelines, which led banks to downsize their international positions
- forced firms facing stringent cash flow conditions domestically to liquidate holdings of foreign assets (including real estate).

After 1992, net outflows of portfolio investment resumed as Japanese interest rates declined. This portfolio investment has primarily been in debt securities, such as bonds, rather than overseas equities. However, since the major stock adjustments had been made, swings in the level of portfolio investment were not as great as in the 1980s. The implication for the future is that while net portfolio investment will remain sensitive to fundamentals such as interest rates and exchange rate expectations, swings like those of the 1980s will be unlikely.

Three other important developments occurred in recent years:

- Net direct investment outflows increased 66 per cent between 1993 and 1996.
- Growth in reserve assets accelerated after 1992 as the Bank of Japan purchased monetary gold and foreign exchange to counter yen appreciation (Figure 4.13).
- A high net inflow of other investment in 1996 reflected the extension and repatriation of loan investment as Japanese banks tried to improve capital adequacy ratios and liquidity by decreasing offshore loans (Australia-Japan Economic Institute, 1997, p. 8).

Japanese Capital Flows to Australia

Japanese capital flows to Australia are closely related to the forces determining overall Japanese capital flows and profoundly affect the Australian economy. Japan's willingness to buy Australian bonds helps keep down the cost of funding long-term projects in Australia. Direct investment flows from Japan significantly contribute to real economic activity in Australia. In addition, Japanese capital flows influence the level of demand for the Australian dollar and trading on the local share market.[21]

....

21 One market participant claims that Japanese capital currently accounts for about 2 days' turnover per year on the Australian Stock Exchange.

In the 1990s, securities dominated Japanese long-term capital flows to Australia, mostly in semigovernment bonds, with equities investment small but increasing (Figure 4.14). From 1992 to 1994, Japanese investors withdrew heavily from Australian securities, while continuing investment elsewhere in the world (Figures 4.14 and 4.15). Factors driving the disinvestment in Australia included a fall in Australia's long-term bond yields relative to the USA and key European countries, such as Germany, and an exchange rate that depreciated against the yen and the US dollar until late 1993.

In 1995 securities investment surged due to:

- perceptions, which proved to be correct, that exchange rate gains could be made by investing in Australian dollar securities
- an increase in yields on Australian securities relative to those on US and German securities
- recognition that Australia had 'beaten' inflation
- the surge in holdings of dual currency instruments which allow Japanese institutions and individuals to extract a yield in yen from bonds redeemable in Australian dollars.[22]

This strong investment in securities fell in the first half of 1996.[23] Japan's purchases of Australian securities totalled US$1.1 billion in the first half of 1996, compared to US$2.3 billion in the first half of 1995 and US$7.5 billion in the second half (Bank of Japan, 1996b). Weakness continued in the second half of 1996 driven by perceptions that other currencies (such as the Canadian and New Zealand dollars) had become more attractive than the Australian dollar and by investors taking capital gains on Australian dollar bonds.

However, subject to perceptions of likely trends in the A$:¥ exchange rate and continued low inflation, interest in securities investment in Australia is likely to remain high on average. Unless major structural change occurs, Australia's shortage of local savings, its current account deficit and its heavy international debt burden will keep long-term interest rates relatively high. These high returns will attract Japanese investment from pension funds, insurance companies and householders.

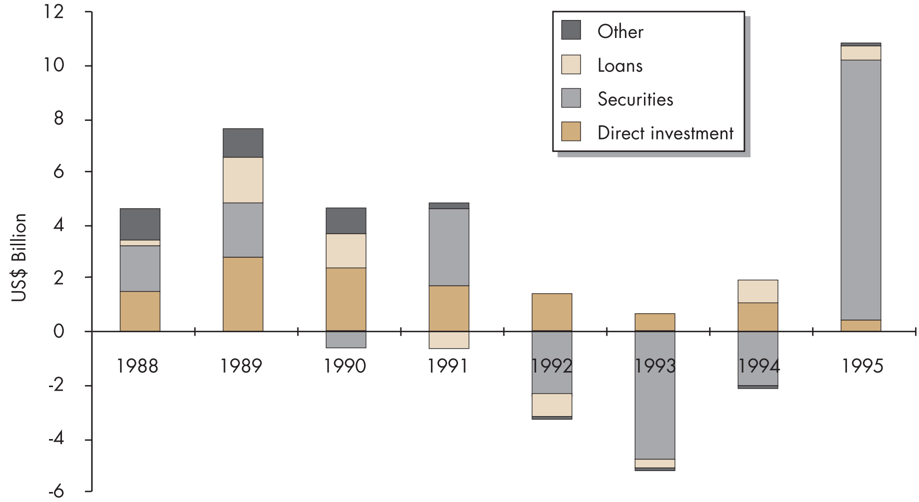
22 Issuance of dual-currency bonds increased from A$5.5 billion in 1994 to A$13.4 billion in 1995. In the first nine months of 1996, issuance stood at A$13.3 billion (Stammer, 1997).

23 Because of changes in the classification of Japan's balance of payments figures, it is difficult to make more extensive comparisons of capital outflows to Australia between 1995 and 1996. Nonetheless, the overall decline in Japan's financial flows to Australia in the first half of 1996 was much larger than the decrease in outflows of debt securities, as Japanese banks repatriated capital to Japan (just as they did in the world as a whole) thus decreasing their loan assets in Australia. In the first half of 1996, loan assets fell by US$1.2 billion compared to a rise of US$190 million in the first half of 1995.

Figure 4.14

Securities Dominate Japanese Capital Flows to Australia ...

Japanese Gross Long-Term Capital Flows to Australia

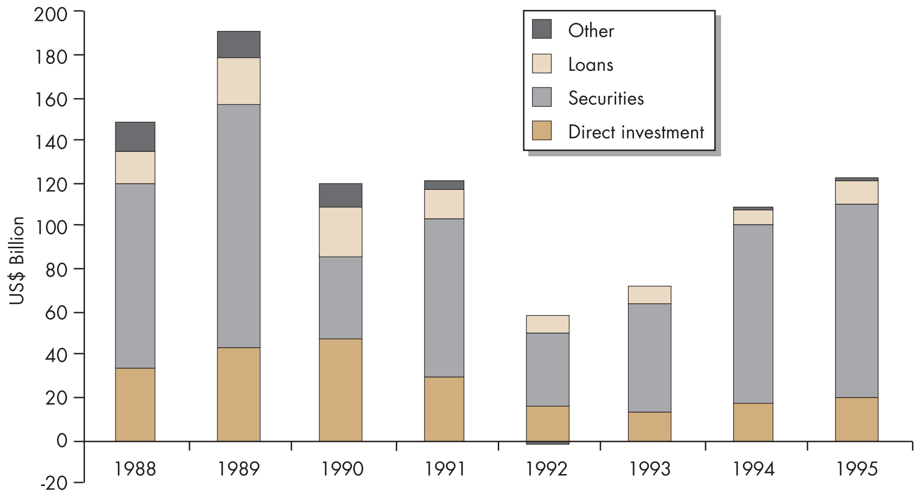


Source: Bank of Japan, 1996a.

Figure 4.15

... and to the World

Total Japanese Gross Long-Term Capital Flows



Source: Bank of Japan, 1996a.

THE YEN: TRENDS AND FUTURE PROSPECTS

Exchange rate instability has affected significantly economic activity in the 1990s.

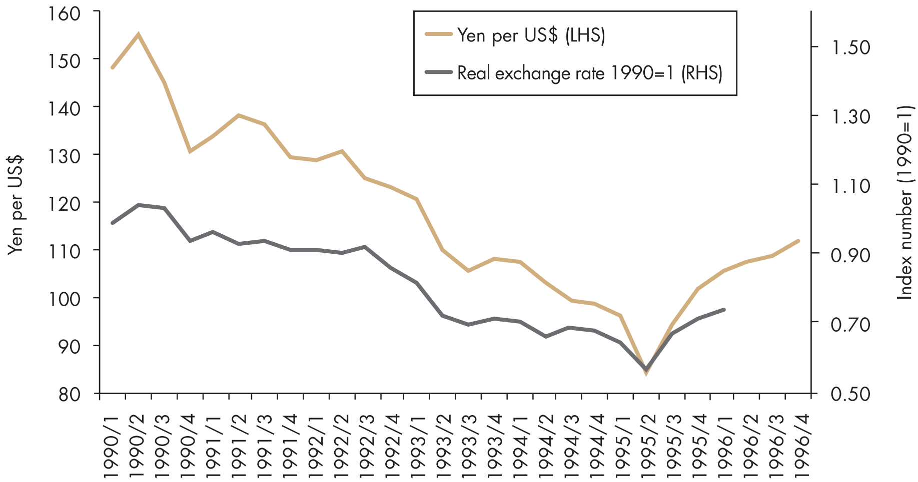
Appreciation

Between mid-1990 and April 1995, the yen appreciated steadily against both the US dollar and in real effective terms (against all currencies after inflation). In April 1995 the yen peaked at just over ¥80:US$1 (Figure 4.16).

Figure 4.16

Yen Peaks in 1995

The Yen:US$ Exchange Rate and the Real Exchange Rate



Source: Nikkei data base; International Monetary Fund, 1996c and previous years.

Japan's relatively low inflation made Japanese exports more competitive and necessitated the yen's appreciation against the US dollar and other currencies to stabilise the real exchange rate (or real competitiveness). Other factors causing the yen to appreciate were:

- a vicious circle whereby appreciation reduced the yen value of overseas wealth, leading to reduced capital outflows and further yen appreciation, which in turn produced more sales and fewer overseas purchases of foreign assets
- Japan's long-running current account surplus
- expansionary fiscal policy, which increased real interest rates, attracting foreign capital inflows that put pressure on the exchange rate. Expansionary Japanese fiscal policy probably helped the yen appreciate between December 1993 and August 1994, when Japanese long-term bond yields increased by 1.7 percentage points and the yen appreciated 10.2 per cent against the US dollar. (See box.)

- the 'Great Hanshin' (Kobe) earthquake of 17 January 1995 which the Economic Planning Agency estimates damaged around 0.8 per cent of Japan's net fixed assets. This reduction in capital stock may have caused the yen's value to surge in the first half of 1995 as capital was repatriated from overseas to meet Japan's investment needs.

STIMULUS PACKAGES AND THE EXCHANGE RATE

Economic modelling work undertaken for the East Asia Analytical Unit indicates that the expansionary fiscal packages between 1992 and 1995 (five 'minibudget' stimulus packages totalling almost ¥60 trillion) at times could have contributed to the yen's appreciation,[24] which in turn contracted economic activity (McKibbin, 1996).

Economic Stimulus Packages, 1992 to 1995

	Date proposed				
	August 1992	April 1993	September 1993	February 1994	September 1995
Total package (¥ trillion)	10.7	13.2	6.2	15.3	14.2
Per cent of GDP	2.3	2.8	1.3	3.2	3.0

Source: International Monetary Fund, 1996.

Base Case

In his base case scenario, McKibbin found a permanent fiscal expansion of 2 per cent of GDP would, without other 'shocks', increase real short-term interest rates by 60 basis points and long-term interest rates by 45 basis points[25] due to an expected fall in public saving. This rise in interest rates would appreciate the yen by 9 per cent in real terms relative to all other currencies.[26]

The effect of fiscal policy on interest and exchange rates was most apparent between December 1993 and August 1994, when after two packages, long-term interest rates increased 1.7 percentage points and the yen appreciated 10.2 per cent against the US dollar (Figure 4.17). Moreover, Japanese long-term rates increased before US long-term rates suggesting domestic causes of the appreciation: expectations that public savings would fall due to expansionary Japanese fiscal policy and a growing consensus that the Japanese business cycle had reached its trough. While long-term interest rates subsequently fell, this was because the effects of expansionary fiscal policy on interest rates were offset by other factors. These included lower growth prospects in Japan and the expectation of substantial fiscal consolidation in the USA, both of which reduced expectations about the future global demand for capital.

....

24 The other major component of the overall fiscal expansion were income tax reductions in Japan Fiscal Year (JFY) 1994, 1995 and 1996 which reduced government revenues by ¥17 trillion (Organisation for Economic Cooperation and Development, 1996a, p.205).

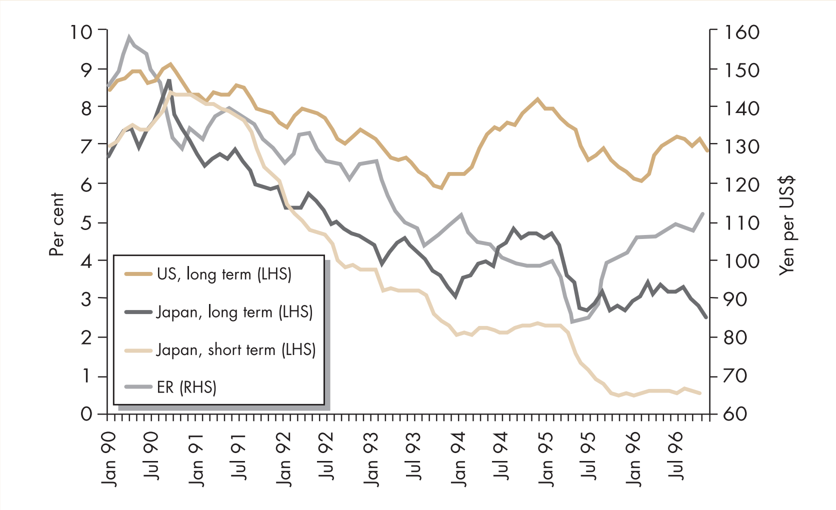
25 A basis point is one hundredth of a percentage point.

26 The OECD (1996a) in work examining the effectiveness of fiscal policy in Japan in recent years, assumed interest and exchange rate effects that, when compared to the actual size of the packages relative to GDP, are less than the sensitivities derived from McKibbin's model.

Figure 4.17

Interest Rates and the Yen

The Yen-US$ Exchange Rate and Japanese and US Interest Rates



Source: Organisation for Economic Cooperation and Development, 1997b.

Delays between Announcement and Implementation

The stimulus package of February 1994 was characterised by significant delays between announcement and implementation, with actual JFY1994 expenditure growing by only 1.5 per cent (¥0.6 trillion). Spending announced in the February 1994 package and completion of projects from earlier packages together should have increased government spending by ¥7.5 trillion in JFY1994 (OECD, 1996a, p.207). In a simulation where fiscal expansion is announced well ahead of implementation, higher long-term interest rates and yen appreciation precede the actual fiscal stimulus, leading to an initial contractionary effect.[27] This suggests that at this crucial time in the recovery process, the significant gap between announcement and implementation may have exacerbated the existing weakness in economic activity. It could be argued that the Government had an incentive to maximise the 'headline' cost, compared to the true fiscal cost, because it was subjected to considerable international, particularly US, pressure at the time to stimulate growth to promote imports.

27 Minimising the actual fiscal costs of packages compared to the 'headline cost' will have effects similar to delaying implementation of packages. In particular, crowding out of private sector investment will occur instantly due to expectations pushing up interest rates, while economic activity is only lifted by the extent of the true stimulus rather than the headline figure. The Japanese Government has minimised the fiscal costs of all the packages by counting local government expenditure, spending already included in previous budgets, and spending that is not a net addition to baseline government expenditure, such as disaster relief and compensation for Uruguay Round liberalisation measures.

Depreciation

When the yen surged to ¥80:US$1 in April 1995, it overshot sustainable levels. Exchange rates of well above ¥100:US$1 were not sustainable because such rates were inconsistent with maintaining even a moderate external surplus, which population ageing is likely to necessitate (International Monetary Fund, 1995, p. 35). Indeed, by early May 1997, the yen had depreciated by almost 60 per cent against the US dollar and was back to 1988 levels, although it has since appreciated.

The depreciation was largely due to a combination of domestic measures and coordinated international actions. The major initial factor pushing the yen from ¥85:US$1 in July 1995 to ¥98:US$1 in September 1995 was the coordinated intervention by the monetary authorities of the major industrialised countries, responding to concern that the yen's sharp appreciation could reduce drastically Japan's economic activity.[28] This action was aided by further relaxation of Japanese monetary policy from July 1995,[29] culminating in the cut in the official discount rate to a record low of 0.5 per cent on 8 September.

In August, the Japanese Government announced a package of measures, effective immediately, to promote capital outflows, increasing demand for foreign currencies and reducing appreciation pressures on the yen. (See box.) This reform package responded to the view that large institutional investors had been very limited supporters of offshore investment after suffering from the recent yen appreciation, and had actually added to demand-side pressures on the yen by reducing offshore real estate, equity and securities investments. While the regulations affected were not major constraints on capital outflows, the announcements were well timed and, with concerted currency interventions, saw the US dollar appreciate by around 10 per cent against the yen in August 1995.

In early 1996, partly due to lagged effects of the appreciation, the Japanese current account surplus continued to contract rapidly. This fuelled further depreciation, as did movements of USA-Japan long-term interest rate differentials in favour of dollar-denominated assets (International Monetary Fund, 1996, p. 33). Central bank intervention remained important in maintaining downward pressure on the yen. Indeed, G7 member[30] central banks (including the Bank of Japan) were the largest single source of demand for US dollars in 1996 (*The Economist*, 2 November 1996, p. 95).

....

28 This intervention was clearly in the interests of Japan, the USA and Germany. The USA would avoid substantial Japanese divestment, while Germany's competitiveness would be boosted by a stronger dollar vis-à-vis the yen and the Deutschemark.

29 On 7 July 1995, the Bank of Japan, in an effort to further push down short-term market rates, announced that it expected them to fall on average to somewhat below the official discount rate and supplied abundant liquidity to the market.

30 The G7 consists of the USA, Japan, France, Italy, UK, Germany and Canada.

MEASURES TO PROMOTE CAPITAL OUTFLOWS IN 1995

Key elements of the package on 2 August 1995 to promote capital outflows were:

- liberalising restrictions on external loans denominated in foreign currency by institutional investors
- abolishing restrictions on external yen loans by insurance companies which involved other lending partners
- providing institutional investors with greater flexibility in their accounting treatment of offshore bond holdings
- easing the regulation of foreign exchange banks' foreign exchange positions to enable investment into foreign denominated bonds
- promoting the capacity of public funds (including development funds and investment funds) to expand foreign denominated investments.

OUTLOOK FOR THE YEN

In coming months, the stabilisation of Japan's current account surplus and the maintenance or widening of the gap between Japanese and US interest rates are factors which could prevent the yen from appreciating above ¥115:US$1 and may even encourage further depreciation. In May 1997, Japan's long-term interest rate was 2.7 per cent versus 6.7 per cent in the USA.[31]

However, if the increase in Japan's current account surplus evident in late 1996 and early 1997 is sustained, central banks may become less committed to a weak yen.[32] In addition, if the detorioration of the US current account evident in late 1996 continues, this would put pressure on the yen to appreciate relative to the US dollar, as would any narrowing of differentials between US and Japanese interest rates late in 1997.[33] These short-term factors are likely to remain dominant influences on the ¥:US dollar exchange rate in the medium term.

US progress in reducing its budget deficit will continue to influence the ¥:US$ rate. If the US fiscal consolidation program is viewed as serious, the yen will experience upward pressure because of reduced interest rate differentials between the USA and Japan; a watered-down program will reduce pressure. However, in the medium to long term, a major US structural fiscal contraction could reduce the US current account deficit, which in the long term may stimulate appreciation of the dollar.

....

31 The equivalent figures for short-term interest rates (3-month certificates of deposit) were 0.47 per cent and 5.69 per cent; prime rates were 1.63 per cent in Japan and 8.25 per cent in the US.

32 In 1996 a strong US dollar suited not only Japan, but the US and Germany as well; it helped the US reduce inflationary pressures and helped boost output in both Japan and continental Europe. An early sign that this commitment may be ending is G7 support for a lower dollar in late April and early May 1997 (*Asian Wall Street Journal*, 12 May 1997).

33 Between the second and fourth quarters of 1996, the US current account deficit deteriorated from 2.1 per cent of GDP to 2.4 per cent (Australia-Japan Economic Institute, 1997).

Assessing long-term trends in the yen's value is even more difficult than assessing the short to medium-term outlook. One view is that a declining current account surplus as savings rates fall will remove some pressure for yen appreciation. An alternative view is that in coming years, a trend appreciation of the yen in real effective terms is likely as funds move back to Japan to maintain an ageing population's consumption levels as savings rates fall (McKibbin, 1996). In this view, the main motivation for running current account surpluses is to fund future consumption.

INTERNATIONALISATION OF THE YEN

Internationalisation of the yen involves increasing the yen's role both as an international currency for trade and finance and as a nominal anchor currency against which other countries may peg their currencies (Kawai, 1994, p. 1). Greater internationalisation of the yen is likely to further strengthen the economic integration of Asia. It also may facilitate diversification of currency risk.

The most recent statistics from the Ministry of International Trade and Industry indicate that, as of March 1996, 36 per cent of Japan's exports were denominated in yen, compared to 20 per cent in the late 1970s, 34 per cent in 1988 and 40 per cent in 1994 (Kawai, 1994). The use of yen is strongest in services trade (50 per cent). Yen-denominated imports account for 18 to 20 per cent of the total, compared to 2 per cent in the late 1970s, 13 per cent in 1988 and 22 per cent in 1994. The decline in the use of the yen among Japanese importers after 1994 was probably a response to rapid appreciation in 1995. Recent depreciation may see increased use of the yen in Japan's international trade.

Much of the yen's increasing internationalisation over the past 15 years is due to Japan's strongly growing commercial ties with Asia. (See Chapters 5 - *Trade*, and 6 - *Internationalisation*.) The yen is most prevalent in trade flows between Japan and South East Asia; this trade was previously heavily dollar denominated. Most of Japan's international loans to the region now are also yen denominated. Finally, while it accounts for just 7 per cent of global currency reserves, the yen comprises at least 30 per cent of the foreign currency reserves of Indonesia, the Philippines, Singapore and Taiwan (Desai, 1996).

Outlook For Internationalisation

Increasing internationalisation of the yen will be driven by:

- ongoing changes in Japan's trade structure towards items which are traditionally more likely to be yen denominated, such as machinery and equipment
- increasing yen-denominated investment and lending flows between Japan and Asia
- growing complementarity and interdependence of the economic structures of Japan and other Asian countries
- Japan's low and stable inflation rate encouraging more Asian countries to hold yen as a reserve currency

- recent abatement in appreciation pressures, encouraging more countries to borrow in yen and peg their currencies to the yen.

However, Japan's short-term money market's continued shallowness, compared to that of the USA, significantly constrains yen internationalisation, making it difficult to use yen-denominated assets as liquid working balances for international trade and capital transactions. Money market liquidity would be increased by eliminating transaction taxes, stamp duties and withholding taxes (Garber, 1996, p. 5). (See Chapter 7 - *Finance*.)

LONG-TERM PRESSURES TO DRIVE CHANGE

Between 1992 and 1995, Japan experienced a period of unprecedented weakness in economic activity. Growth improved in 1996 and over the next year or two, the macroeconomic environment should be healthier, with stronger economic expansion and continued low inflation.

Pressures for structural reform and economic change will remain strong. These pressures include the rapidly ageing population, declining savings and potential growth rates, possible further yen appreciation and the need for broad-based reforms to overcome inefficiency in the economy and ensure international competitiveness. A return to higher levels of growth in the longer term will depend on astute macroeconomic policy management and microeconomic reforms. A key long-term macroeconomic issue will be bringing Japan's fiscal position back to a healthy state. Further microeconomic reforms are necessary across a broad range of areas, discussed in subsequent chapters.

REFERENCES

Asian Wall Street Journal, various issues.

Australian Bureau of Statistics, 1996a and previous years, *Australian National Accounts: National Income, Expenditure and Product*, Catalogue Number 5206.0, Canberra

____ 1996b and previous years, *Australian National Accounts: National Income, Expenditure and Product*, Catalogue Number 5204.0, Canberra.

Australia-Japan Economic Institute (AJEI), 1997, 'Capital and Financial Account Transactions', *Economic Bulletin*, Vol. 5, No. 2, February, pp. 7-9.

Bank of Japan, 1996a and previous April issues, *Balance of Payments Monthly*.

____ 1996b, *Balance of Payments Monthly*, No. 364, November.

Desai, V., 1996, 'New Economic Cooperation Systems for Development in Asia: Emergent Issues Requiring Cooperative Arrangements', JETRO/IDE Symposium on Asia's Challenges in the Coming Century, Tokyo, November.

The Economist, various issues.

Garber, P.M., 1996, 'The Use of the Yen as a Reserve Currency', *Monetary and Economic Studies*, Vol. 14, No. 2, Institute for Monetary and Economic Studies, Bank of Japan, Tokyo, pp. 1-22.

International Monetary Fund, 1996, *World Economic Outlook*, World Economic and Financial Surveys, October, Washington DC.

____ 1995, *World Economic Outlook*, World Economic and Financial Surveys, Washington DC.

____ various issues, *International Financial Statistics*.

Kahkonen, J., 1995, 'Japan's Capital Flows', in Baumgartner, U. and Meredith, G. (eds), *Saving Behaviour and the Asset Price Bubble in Japan: Analytical Studies*, International Monetary Fund, Washington DC, pp. 16-35.

Kawai, M., 1994, 'The Japanese Yen as an International Currency: Performance and Prospects', *Discussion Paper Series No. F-40*, Institute of Social Science, University of Tokyo, Tokyo.

McKibbin, W.J., 1996, 'The Macroeconomic Experience of Japan since 1990: an Empirical Investigation', consultancy report prepared for East Asia Analytical Unit, Department of Foreign Affairs and Trade, Canberra.

Meredith, G., 1995a, 'Demographic Change and Household Saving in Japan', in Baumgartner, U. and Meredith, G. (eds), *Saving Behaviour and the Asset Price Bubble in Japan: Analytical Studies*, International Monetary Fund, Washington DC, pp. 36-45.

____ 1995b, 'Alternative Long-Run Scenarios', in Baumgartner, U. and Meredith, G. (eds), *Saving Behaviour and the Asset Price Bubble in Japan: Analytical Studies*, International Monetary Fund, Washington DC, pp. 46-50.

Nikkei data base.

Organisation for Economic Cooperation and Development (OECD), 1997a and previous years, *Quarterly National Accounts*.

____ 1997b and previous years, *Main Economic Indicators*.

____ 1996a, *Japan 1996*, OECD Economic Surveys, Paris.

____ 1996b, *Economic Outlook*, Number 60, Paris, December, pp. 49-53.

Stammer, D., 1997, 'Japanese Household Investors and A$ Bonds', paper presented at the Gaiko Forum on Australia and Japan: Asia-Pacific Economic Cooperation and Regional Security, Canberra, 21 April.

Chapter 5

TRADING IN ASIA'S MOST LUCRATIVE MARKET

Australia has a longstanding record of success in the Japanese market. Australian raw materials and energy are crucial to Japan's economic development; this enormous trade is still growing and remains vital to Australia. However, Japan's trade structure is changing, with imports of manufactures and processed food growing rapidly, and trade in services expanding strongly. To maintain its successful record, Australia's exports will have to evolve in line with Japan's changing patterns of import demand.

Australian companies keen to explore opportunities in emerging Asian markets often ignore potentially more lucrative opportunities in Japan. This chapter identifies a number of high-growth market segments that Australian companies could find very attractive. A case in point is Australia's sales of cheese to Japan which have been growing 20 per cent a year over the last decade and which now exceed Australia's total exports to Vietnam. In that sense, Japan could be seen as Asia's most lucrative 'emerging' market. However, increasing Australia's share in high-growth and other segments will require increasingly broad Australian business understanding of the factors driving change in Japan's trade structure and future demand trends.

This chapter assesses these factors and trends, examining Australia's performance in the Japanese market and identifying opportunities.

Some of the key conclusions of the analysis are:

- Japan's strong import growth in recent years is not just due to the strong yen.
- 'Reverse imports' (Japanese firms' exports to Japan) may slow in response to the weaker yen. However, they will remain substantial, reducing companies' vulnerability to yen appreciation and other cost factors.
- Australia's market share in Japan may continue to decline, but exporters should enjoy further expansion in such areas as processed foods, housing and construction materials, and some high-value-added manufactured items. In recent years, Australia's share of Japan's service imports has also declined.

JAPAN'S CHANGING TRADE STRUCTURE

Imports

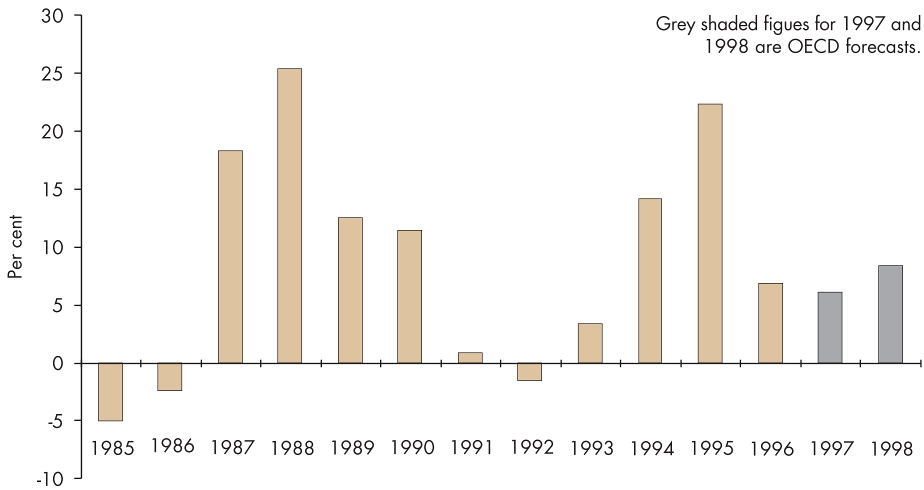
The last decade has seen both rapid overall growth in Japan's imports and substantial changes in composition. Strongest import growth occurred in the late 1980s and from 1994 to 1995 (Figure 5.1). The latter period of rapid import growth is particularly striking as it occurred despite extremely sluggish economic growth. In 1996, import growth dropped to 6.8 per cent; the OECD forecasts similar rates for

1997 and 1998. Although these growth rates are less spectacular than those of 1994 and 1995, they still entail vast opportunities as import growth of 6 per cent per year translates into an extra US$19 billion in imports.

Figure 5.1

Rapid Import Growth in Recent Years

Japanese Nominal Import Growth 1985 to 1998



Note: These growth rates and all subsequent growth rates are based on US dollar figures unless indicated otherwise.

Source: Department of Foreign Affairs and Trade, STARS data base; Organisation for Economic Cooperation and Development, 1996.

Three key trends occurred in the composition of Japan's imports between 1985 and 1995 (Figure 5.2):

- the plunge in the share of fuels from 43 per cent in 1985 to 16 per cent in 1995
- the rise in the share of processed food from 6 per cent in 1985 to 10 per cent in 1995
- the doubling in the share of manufactured goods to 56 per cent over the decade to 1995.

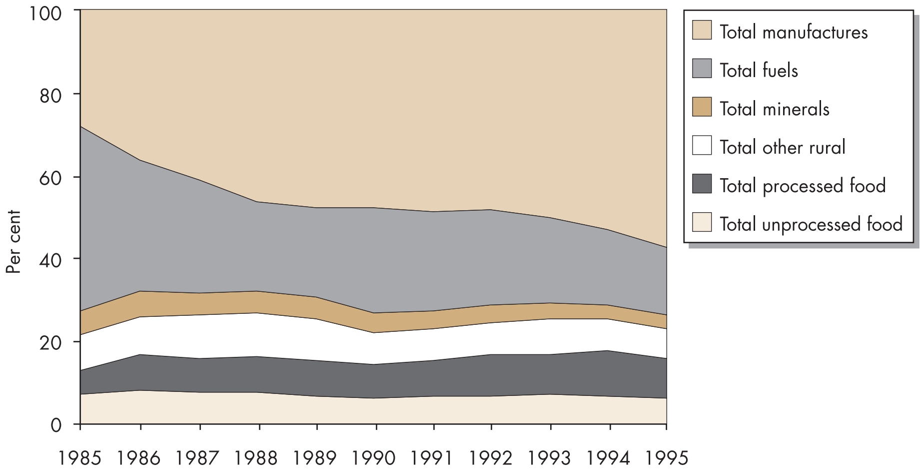
Fuels

Growth in mineral fuel imports has been slow, with substantial declines in the shares of petroleum, coal and coke, and natural gas in Japan's total imports. This contraction has been evident since the first oil shock. It reflects the continued restructuring of the economy away from energy-intensive activities, and rapid growth of other imports. Nonetheless, Japan remains the world's second largest fuels importer after the USA.

Figure 5.2

Substantial Changes in Import Composition

Japan's Merchandise Imports, 1985 to 1995



Source: Department of Foreign Affairs and Trade, STARS data base.

Processed Food

The rise in the share of processed food imports reflects an annual growth trend[1] of over 13 per cent between 1985 and 1995, compared to Japan's overall import growth of 9.4 per cent. Meat is the most important item within the processed food category (Figure 5.3). Over the last decade, alcoholic beverages, fish, and beef imports have grown dramatically. Other processed food items growing more than 15 per cent per year include:

- fruit juices
- non-alcoholic beverages
- eggs
- preserved fruit and fruit preparations
- sugar confectionery
- prepared or preserved meat and meat offal.[2]

....

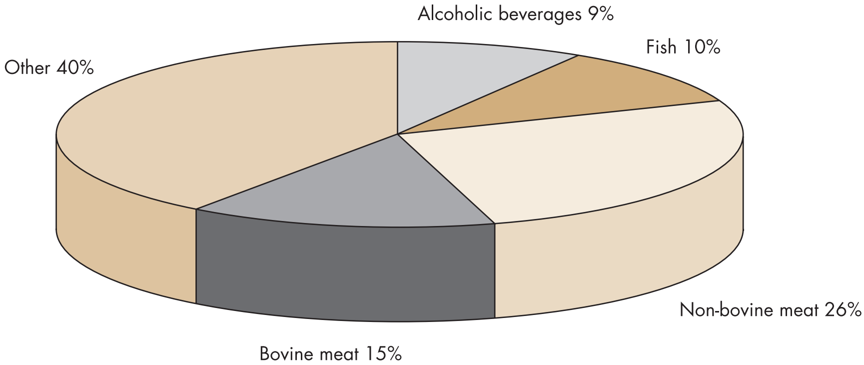
1 All annual average rates of growth in this chapter are trend rates derived by log-linear regression using the least squares method. This is more robust than the average (compound) annual growth rate as it takes account of all observations and is less likely to be affected by unusually high or low values at the end points of a given period (Department of Foreign Affairs and Trade, 1995).

2 This category includes items such as liver and sausages.

Figure 5.3

Meat Dominates Processed Food Imports

Japan's Processed Food Imports, 1995



Source: Department of Foreign Affairs and Trade, STARS data base.

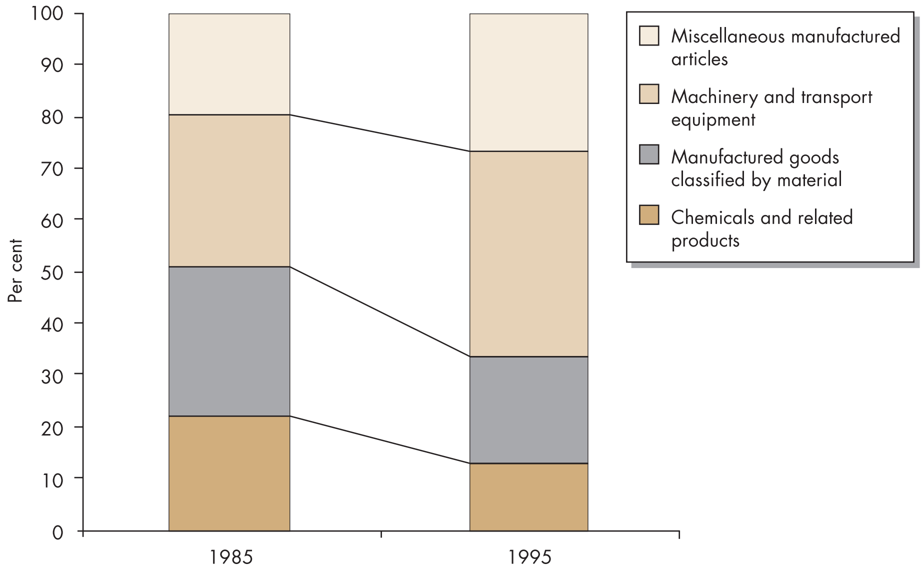
Manufacturing Imports

As manufacturing imports have grown, their composition has changed. The shares of machinery, transport equipment and miscellaneous manufactures (clothing, footwear, prefabricated buildings and travel goods) increased substantially, while the share of chemicals and 'manufactured goods classified by material' (iron and steel, nonferrous metals, textiles, leather, rubber and paper products) declined (Figure 5.4).

Figure 5.4

Expansion in Imports of Machinery and Transport Equipment

Japanese Manufactures Imports, 1985 and 1995



Source: Department of Foreign Affairs and Trade, STARS data base.

Strong growth in capital and consumer goods imports and weak growth in intermediate goods imports have driven these changes.

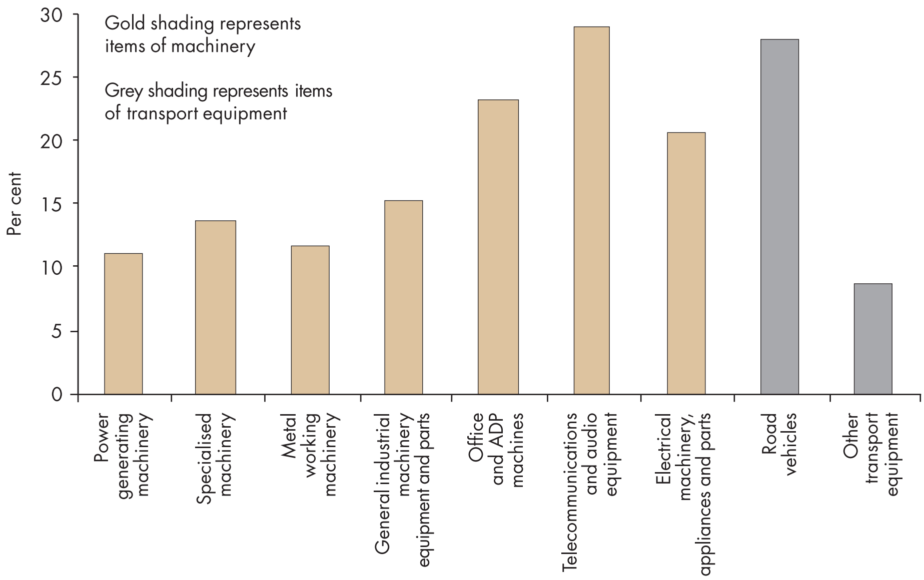
Machinery and Transport Equipment

Over the last decade, machinery imports grew 19.4 per cent per year and imports of transport equipment grew 18.7 per cent; machinery import growth was particularly strong in 1994 and 1995.[3] The fastest growing imports over the decade were telecommunications, sound recording and automatic data processing (ADP) equipment, office machines, electrical machinery and road vehicles (Figure 5.5).

Figure 5.5

Rapid Growth in Imports of Machinery and Transport Equipment

Trend Growth in Machinery and Transport Equipment Imports 1985 to 1995



Source: Department of Foreign Affairs and Trade, STARS data base.

The fastest growing individual items with trend annual growth rates of between 61 per cent and 26 per cent were:

- televisions
- audio and video recorders
- equipment for distributing electricity
- trailers and semi-trailers

....

3 In 1994 and 1995, machinery imports grew 28.7 per cent and 52.5 per cent compared to 28.7 per cent and 18.6 per cent for transport equipment.

- motor cycles
- motor vehicles
- parts and accessories for office and ADP machines
- radios
- telecommunications equipment and parts, and accessories of radios, televisions and videos
- household electrical and nonelectrical equipment.

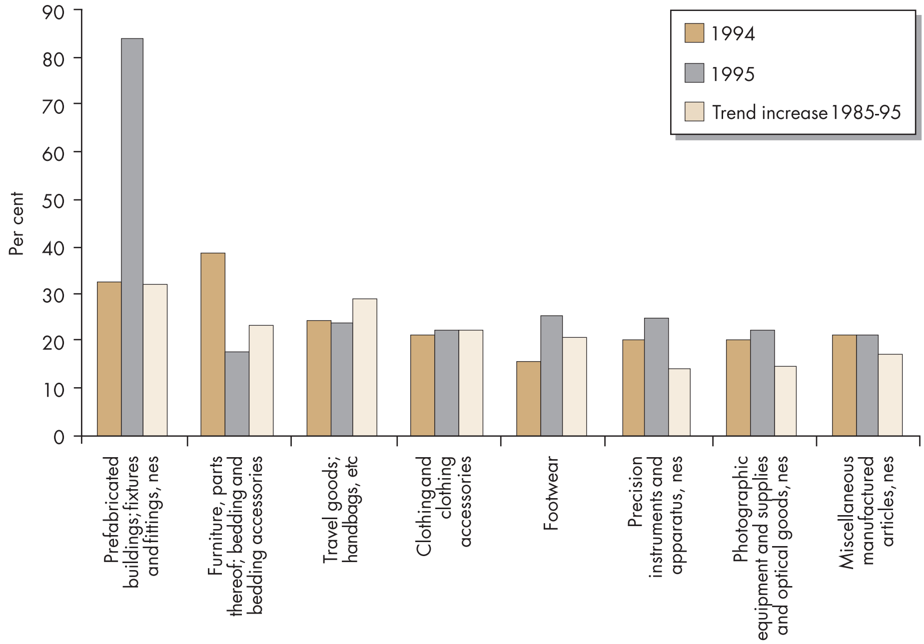
Other Manufactured Goods

Over the last decade, annual growth has surpassed 20 per cent across a broad range of commodities, including a variety of finished consumer goods (Figure 5.6). The most significant item is clothing and clothing accessories, which expanded from 1.5 per cent of Japanese imports in 1985 to 5.6 per cent in 1995.

Figure 5.6

Rapid Growth in Finished Consumer Goods

Import Growth Among Other Manufactures, 1985 to 1995



Note: nes: not elsewhere specified.

Source: Department of Foreign Affairs and Trade, STARS data base.

Imports of housing products are expanding rapidly; prefabricated buildings, nonexistent until 1990, reached US$289 million in 1995. Similarly, imports of household accessories such as furniture, mattresses and electric light fittings have expanded dramatically.[4]

....

4 In 1995, Japan's total imports of furniture, mattresses and bedding, and electric light fittings were US$1.1 billion, US$550 million and US$58 million respectively.

Chemicals and Manufactured Materials

Within these two slow growing import categories, fast growing segments include:

- veneers, plywood and particle board and clay construction materials, expanding at annual rates of 20 per cent and 11 per cent between 1990 and 1995
- iron and steel products and metals manufactures.

Opportunities exist to fill market niches in these areas. Strong demand in 1995 for iron and steel products and metal manufactures was manifested in growing imports of items as diverse as iron and steel ingots, tubes and pipes, wire and cutlery.

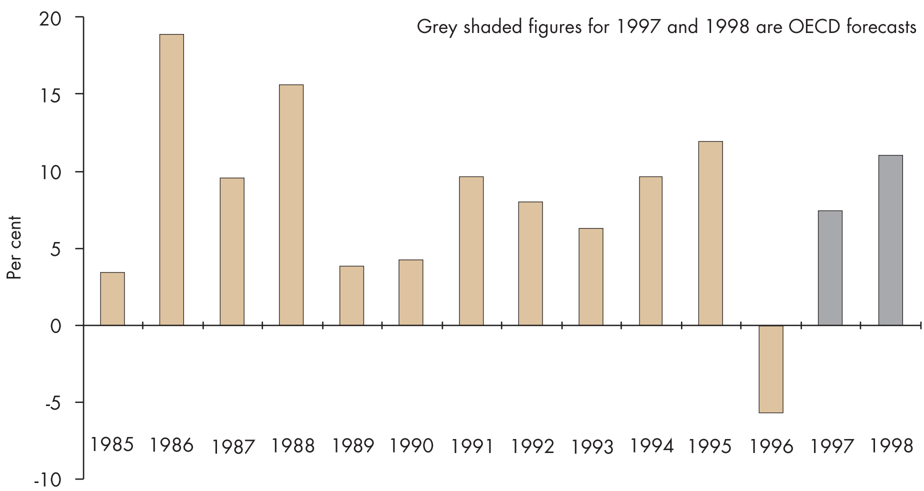
Exports

Export growth was solid in the first half of the 1990s, but not as high as in the peak years of the late 1980s (Figure 5.7). After a contraction of 5 per cent in 1996, growth should pick up again in 1997. Export composition has changed substantially, primarily within manufacturing sectors, which still dominate Japan's merchandise exports. Machinery exports' share rose solidly, while that of transport equipment fell (Figure 5.8).

Figure 5.7

Solid Export Growth over the 1990s

Japanese Export Growth, 1985 to 1998

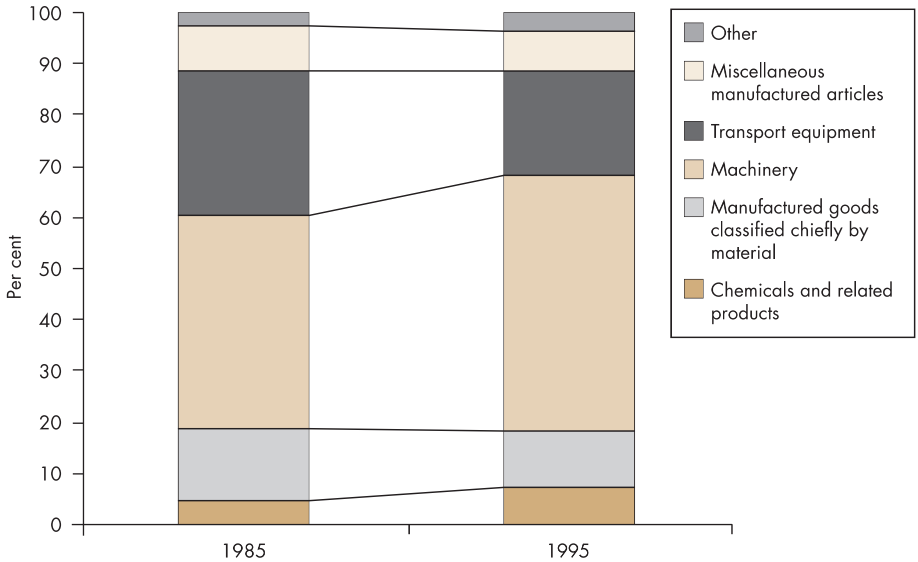


Source: Department of Foreign Affairs and Trade, STARS data base; and Organisation for Economic Cooperation and Development, 1996.

Figure 5.8

Machinery Exports Expand

Japanese Exports, 1985 and 1995



Source: Department of Foreign Affairs and Trade, STARS data base.

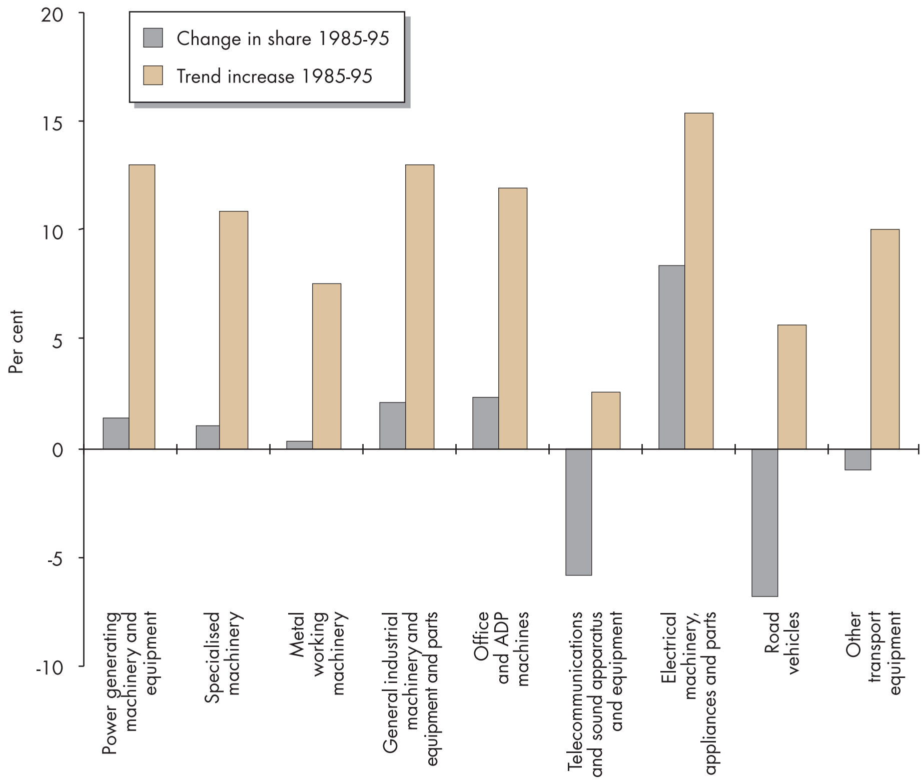
Machinery

Electrical machinery and parts, office and automatic data processing (ADP) machines, general industrial machinery and parts, power generating machinery and equipment, and specialised machinery contribute most to export growth (Figure 5.9). In general, the fastest growing items in all these categories have been either parts or capital goods in which it has been easier for Japan to remain competitive, while exports of final products have been extremely weak. In the case of electrical machinery and parts, and office and ADP machines, exports of valves, tubes, semiconductors and integrated circuits, electrical apparatus used in circuits, and parts and accessories for office and ADP machines, have expanded strongly over the last decade. Exports of office machinery and household electrical and nonelectrical equipment have been weak (Figures 5.10 and 5.11).

Figure 5.9

Exports Grow in the Machinery Sector

Machinery and Transport Equipment Exports, 1985 to 1995



Source: Department of Foreign Affairs and Trade, STARS data base.

The share of telecommunications and sound recording equipment fell over the past decade (Figure 5.9). Exports of televisions, radios and audio and video recorders experienced trend annual growth rates close to, or below zero. However, exports of telecommunications and sound recording equipment parts grew at a trend annual rate of 11.4 per cent from 1990 to 1995, to be worth more than US$7 billion.

Transport Equipment

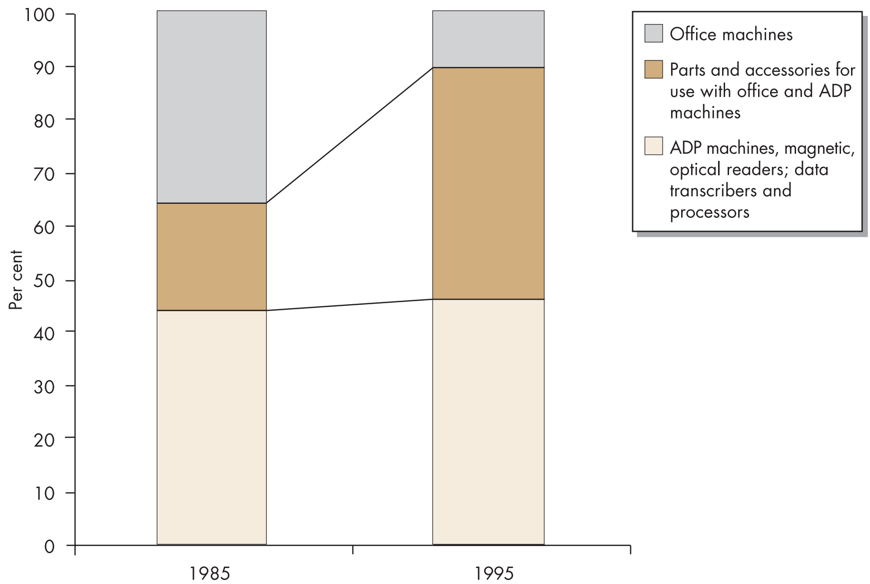
The share of both road and nonroad vehicles in total exports fell (Figure 5.9). The divergence between the export performance of final products and parts is again apparent.[5]

5 Exports of road vehicles grew at a trend annual rate of 0.2 per cent from 1990 to 1995, with the equivalent rate for exports of parts of road vehicles being 13.0 per cent.

Figure 5.10

Exports of Parts Expand ...

Share of Major Items in the Electrical Machinery and Parts Segment

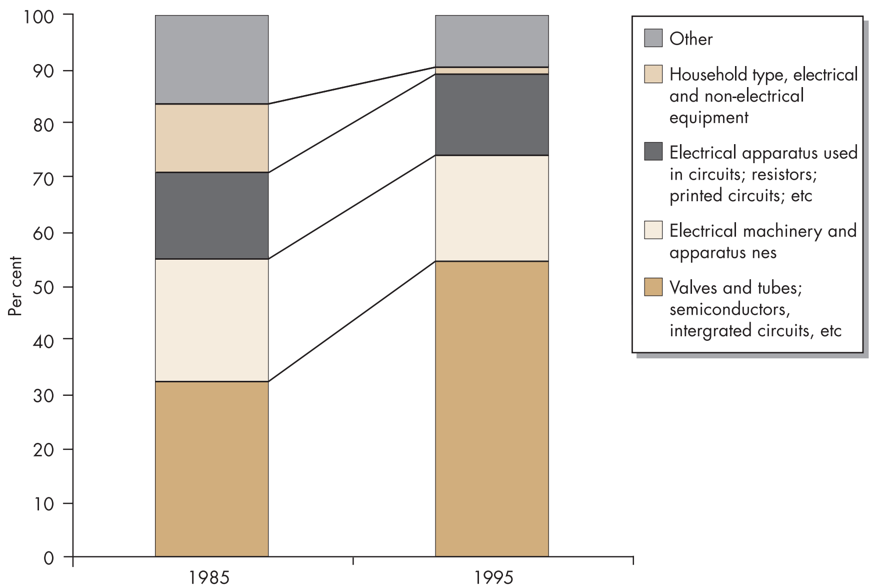


Source: Department of Foreign Affairs and Trade, STARS data base.

Figure 5.11

... and Expand

Major Exports in the Office Machinery and ADP Equipment Segment



Source: Department of Foreign Affairs and Trade, STARS data base.

FACTORS DRIVING CHANGING TRADE PATTERNS

Several factors have been responsible for the striking changes in Japan's trade structure over the last decade, including:

- the appreciation of the yen
- outward foreign direct investment (FDI) flows
- the increase in supply capacity in Asia
- reforms in the distribution sector
- changes in tastes
- income growth
- reductions in formal and informal barriers to entry into the Japanese market.

As distribution sector reforms, changes in tastes and market access issues are analysed in later chapters, only their interaction with other trade related factors is examined here.

The Role of the Appreciating Yen

The yen appreciated from around ¥260:US$1 in early 1987, to ¥80:US$1 in mid-1995, but by early May 1997, had depreciated back to ¥127:US$1, although it has since recovered somewhat. In the first half of the 1990s, the appreciation was greater in real terms against a basket of currencies than in the late 1980s (Figure 5.12). Consequently, the appreciation in the first half of the 1990s more seriously strained Japan's competitiveness and had a greater impact on its trade structure.

Effects on the Structure of Trade

Exchange rate changes affect prices and, consequently, the structure of trade. Yen appreciation causes the yen price of imports to fall and increases the foreign currency price of Japanese exports.[6]

Estimates of responsiveness of demand for various imports to changes in their relative price[7] indicate that if the relative price of consumer goods imports decreases by 1 per cent, demand increases by 0.9 per cent. A 1 per cent price decrease will increase demand for capital goods by 0.6 per cent, for food by 0.3 per cent and for industrial supplies by 0.1 per cent (Table 5.1). However, as these figures are from 1981 to 1992, price responsiveness may have increased further.

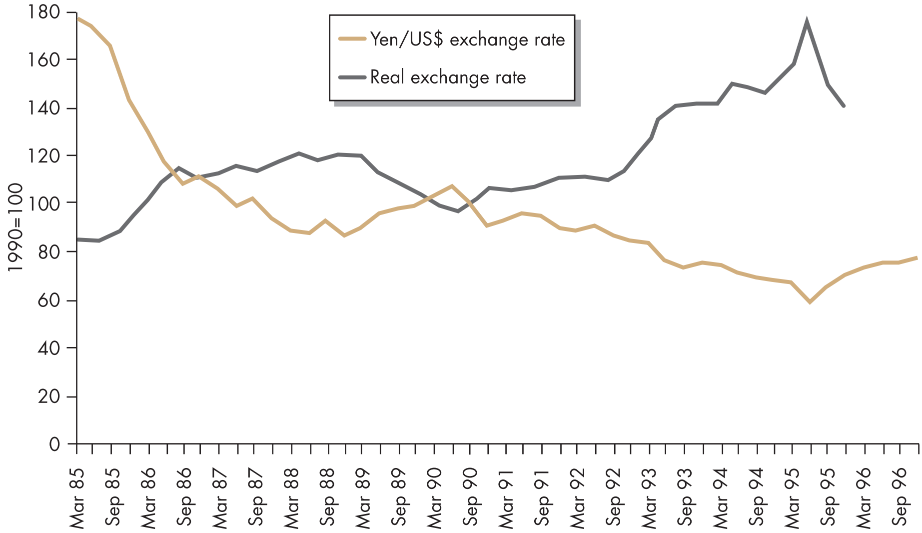
6 Except in those few cases where Japanese producers fully absorb the appreciation by announcing a proportionate drop in their yen prices. Overall, Athukorala and Menon (1993) found that after adjusting for reductions in the price of imported inputs, a 1 percentage point appreciation of the yen resulted in a 0.42 to 0.53 per cent increase in foreign currency export prices in Japan's main manufacturing export sectors.

7 In the equation from which these estimates are derived, the price factor is represented by the ratio of the import price index to the relevant domestic wholesale price index.

Figure 5.12

Real Appreciation Greater in Early 1990s Than Late 1980s

Divergence of ¥:US$ Exchange Rate and the Real Effective Exchange Rate



Note: To ensure a correct basis for comparison, both series are converted to indices, with a base of 1990 = 100. The real exchange rate series is only available to March 1996.

Source: International Monetary Fund, 1996a.

Table 5.1

Consumer Goods Most Price Sensitive

Price and Income Elasticities of Demand for Imports by Commodity Type

	Food	Mineral fuels	Industrial supplies	Capital goods	Consumer goods
Price elasticity	-0.3	na	-0.1	-0.6	-0.9
Income elasticity	1.6	0.7	0.9	1.2	1.9

Note: Estimates made for 1981 to 1992.

Source: Economic Planning Agency, 1993, p.183.

Two factors which have progressively strengthened the price effects of a given change in the exchange rate over the last decade are:

1. the greater extent to which exchange rate appreciation changes final prices as a result of distribution sector reforms and greater competitive pressures
2. the increased sensitivity of demand for consumer goods, capital goods and food to changes in prices. For consumer goods, flat incomes and changes in tastes and values may have made demand more price sensitive. Intensified international competition may have similarly affected demand for capital

goods. For food, continued liberalisation of Japanese agricultural trade, and changes in tastes and values may have increased the observed price sensitivity of demand for imports.

The increasing responsiveness of the import penetration index for final goods to the yen/US dollar exchange rate since the mid-1980s indicates these forces have been at work (Takao and Nemoto, 1995, p. 13). Further support comes from an Organisation for Economic Cooperation and Development (OECD) finding of a structural break in the price responsiveness of Japan's demand for imports in 1990 to 91 (OECD 1996, p. 26).[8]

Future Trends

In the medium to long term, price variations from changes in the value of the yen are less likely to contribute to import growth than in 1994 and 1995. At that time, high import growth occurred in a stagnant economy and with a sharply appreciating yen. Since mid-1995, the substantial yen depreciation probably has detracted from import growth. However, the exchange rate may well reemerge as an important factor driving growth in Japan's imports.

Effects on Exports

The appreciating yen has hurt consumer goods, as this sector faces fierce international competition, and demand is especially sensitive to even small changes in foreign currency prices. The effect has not been as severe in exports of capital goods and sophisticated parts, where Japan maintains a competitive advantage.

Foreign Direct Investment

Foreign direct investment (FDI) has a strong impact on Japanese trade. In the second half of the 1980s, Japanese investment in the USA and Europe increased significantly due to fears about the introduction of protectionist barriers in those markets. (See Chapter 6 - *Internationalisation*.) The main effect was to replace exports from Japan. An illustration of this is Japanese investment in the US auto industry. Japanese FDI increased Japanese car makers' production capacity in the USA to above 2 million units by 1996, reducing Japan's car exports to the USA from 2.7 million in 1985 to 1.2 million in 1995. Moreover, Japan is now importing cars made by Japanese companies in the USA.[9]

Japanese FDI in Asia has been driven by pressures on competitiveness arising from the yen appreciation, Asia's lower unit labour costs and increased supply capacity.

8 In a similar result, Sanwa Bank (1997) found that growth in Japan's imports since 1994 has been faster than would be expected, based on previous relationships between imports and price and income factors. Another factor contributing to these results is the increase in the price sensitivity of Japan's aggregate imports that occurs as a result of the increasing share over time of consumer goods, which are the most price-sensitive class of import. This underlines the need to do more disaggregated econometric work looking for structural breaks in the price and income responsiveness of Japanese imports.

9 In 1996, Japan imported 69 317 passenger cars from the USA (Japan Automobile Importers Association, 1997).

Asia's rapidly growing domestic markets have also been an important factor. This FDI has affected the structure of Japan's trade by:

- contributing to the strong growth in Japan's exports of capital equipment
- contributing to the switch towards parts exports, and from exporting to importing finished products. These trends are clear in the consumer electronics and electric machinery industries, in which capital and technology-intensive intermediate goods are exported from Japan to local operations in Asia for labour-intensive assembly. A proportion of the final product is then exported back to Japan
- facilitating the continued move by Japanese exports up the 'value chain'. For example, while Japan both exports and imports colour televisions, the exported televisions have a higher unit value (Economic Planning Agency, 1994, p. 284).

Overall Effects on Trade

Economy-wide studies of the link between FDI and trade indicate that FDI tends to expand both exports and imports. For instance, in a study of Japan's food, textiles, wood and pulp, chemical products, ferrous and nonferrous metals, general machinery, electrical machinery and transport equipment industries, Kawai and Urata (1995, p. 23) found a significant positive relationship between Japan's FDI and imports in all sectors, and a positive relationship between FDI and exports in all sectors except wood and pulp.[10] In all sectors except food, Japan's FDI tends to worsen its bilateral trade balances.[11]

In contrast, the Ministry of International Trade and Industry (1996) found that the effects of overseas production activities on Japan's trade balance were positive between JFY1991 and JFY1994. However, these positive effects decreased since JFY1992 and turned negative in JFY1995. This is due to a relatively slow growth rate in the export inducement effect of FDI (whereby parts and capital equipment are exported to offshore plants) and strong increases in 'reverse imports' from these plants (Figure 5.13).

Will Reverse Imports Go Backwards?

Rising reverse imports helped drive rapid import growth in 1994 and 1995; they comprised 16 per cent of total imports in 1995 versus 5 per cent in 1992. This in turn reduced major Japanese companies' vulnerability to exchange rate appreciation.

The substantial depreciation of the yen since mid-1995 may reduce or slow the growth of reverse imports. For example, reverse imports of passenger cars declined by 15 per cent in 1996. Other indications of likely slowing in reverse imports include:

- Kyushu Matsushita Electric Company's transfer in February 1996 of production of personal fax machines from Malaysia back to Japan

10 Coefficients for ferrous and nonferrous metals and transport machinery were positive but not statistically significant.

11 This finding is supported by Hufbauer et al (1994) who found that direct investment tends to increase imports more than exports. In both these studies, the FDI data used was on a notifications basis. This means that the results need to be treated with caution. (See Chapter 6 - *Internationalisation*.)

- Hitachi-Maxell's decision in 1996 to move production of videotapes from Malaysia and the USA back to Japan.[12]

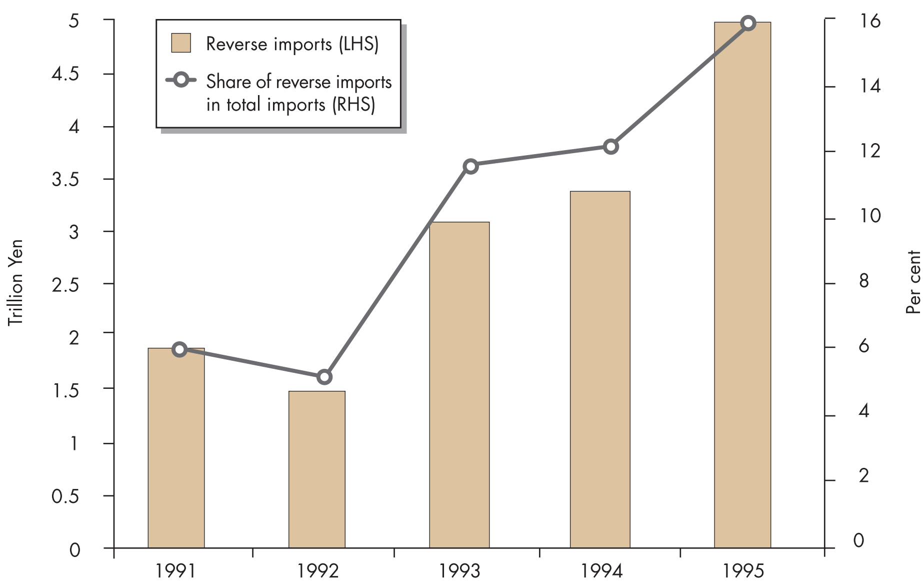
However, shifting production from one location to another is part of the highly flexible system that Japanese companies have developed in response to sustained yen appreciation. To preserve this flexibility, pulling back from overseas production or reducing the level of reverse imports is not likely to occur on a large scale, unless companies are confident that the yen is unlikely to appreciate strongly again.

The composition of reverse imports may change over time. For instance, as Japanese demand for high-end consumer products (such as digital video disks) expands, reverse imports of final products may fall because these high-end products are still largely produced in Japan. On the other hand, reverse imports of more standard parts for these fairly complex new products may grow faster.

Figure 5.13

Reverse Imports a Key Factor Behind Recent Import Growth

Imports from Offshore Enterprises



Source: Ministry of International Trade and Industry, 1996.

....

[12] See *Asian Wall Street Journal*, 4 November 1996, p. 1.

Supply Capacity in Asia

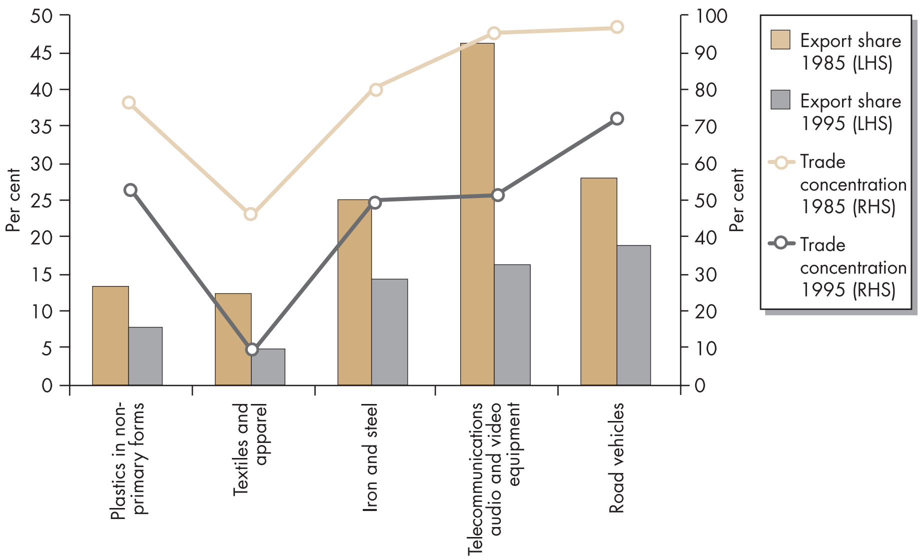
The effects of FDI in Asia on Japanese trade flows are part of a more general increase in supply capacity in Asia (Table 5.2). The Newly Industrialised Economies (NIEs)[13] have substantially increased their world market share of plastics, textiles and apparel, iron and steel, machinery and transport equipment products. ASEAN nations[14] have strongly raised their share of world exports of office and ADP machines, telecommunications, audio and video recording equipment, footwear, clothing, travel goods and furniture. China has increased its world market share of clothing, footwear and, to a lesser extent, telecommunications and audio and video recording equipment.

These increases in supply capacity put pressure on the structure of Japan's trade, as falling Japanese trade concentration ratios and world export share in many of these trade categories show (Figure 5.14).

Figure 5.14

Pressure on the Structure of Japan's Exports …

Export Share and Trade Concentration[a], Japan, 1985 and 1995



Note: a. The trade concentration ratio is a commonly used measure for examining patterns of trade specialisation. The trade concentration ratio for a given industry is defined as [(exports-imports)/(exports+imports)]x100.

Source: Department of Foreign Affairs and Trade, STARS data base.

[13] The NIEs are Hong Kong, the Republic of Korea, Taiwan and Singapore.

[14] These figures are for four ASEAN members: Indonesia, Malaysia, the Philippines and Thailand. The other members, Singapore, Brunei and Vietnam, are excluded.

These rapidly growing, export-oriented economies supply an increasing share of Japan's imports and compete with Japanese exports in third countries. They also represent markets for Japanese products, particularly capital goods and parts.

While Asia's supply capacity has been increasing for years, these increases have only recently had strong affects on Japan's trade structure because of interactions with factors such as the yen appreciation, the increase in Japanese offshore operations, reform in the distribution sector and the recession in Japan.

Table 5.2

… From Rising Supply Capacity in Asia

World Export Share of Asian Countries and Country Groups (Per Cent)

	1985	1990	1992	1993	1994	1995
China						
Apparel and clothing accessories	na	9.3	12.8	14.3	17.0	17.4
Footwear	na	6.4	11.5	13.7	14.9	15.8
Telecommunications, and sound recording and reproducing equipment	na	2.5	3.2	3.4	4.1	4.8
ASEAN(4)						
Furniture and parts thereof; bedding, mattresses, mattress supports, cushions and similar stuffed furnishings	1.6	3.5	4.8	6.3	6.8	7.3
Travel goods, handbags	1.2	3.8	4.3	4.8	4.8	4.9
Articles of apparel and clothing accessories	4.6	6.2	7.4	8.1	7.6	8.5
Footwear	1.6	5.1	7.0	7.8	9.2	10.7
Office and ADP machines	0.2	1.8	3.3	3.9	5.0	5.7
Telecommunications, and sound recording and reproducing equipment	0.9	4.4	6.7	7.9	9.2	10.2
NIEs						
Plastics in primary forms	3.2	7.7	11.7	13.2	14.4	16.7
Plastics in nonprimary forms	2.4	6.8	8.5	9.2	9.6	10.0
Textile yarn, fabrics, made-up articles	14.3	20.1	22.7	24.8	25.8	27.0
Iron and steel	4.2	5.6	7.4	8.9	8.0	8.8
Power generating machinery and equipment	1.9	3.4	3.7	4.4	4.8	5.4
Machinery specialised for particular industries	2.1	4.2	6.1	7.3	7.0	7.3
Metal working machinery	1.8	4.5	5.8	7.6	8.0	8.1
General industrial machinery and equipment and machine parts	2.3	4.3	6.0	6.8	7.2	7.5
Office and ADP machines	6.3	16.9	20.0	21.5	23.0	24.7
Telecommunications, and sound recording and reproducing equipment	11.7	23.3	22.5	24.5	25.3	25.7

Note: ASEAN(4): Association of South East Asian Nations members Indonesia, Malaysia, Philippines, Thailand.
NIEs: Newly Industrialised Economies: Hong Kong, Republic of Korea, Singapore, Taiwan.

Source: Department of Foreign Affairs and Trade, STARS data base.

Income Effects

Japanese income growth affected import structure more in the second half of the 1980s than in the first half of the 1990s because income grew very slowly in the latter period. Income growth generally reinforces the effects on import structure flowing from price changes (Table 5.1). The exception is imports of food, which have a high degree of income responsiveness despite a low degree of observed price responsiveness.

Continuing economic recovery, ongoing trade liberalistion and distribution sector reform should further stimulate food imports, offering important opportunities to food exporters such as Australia. In 1996, when GDP growth was at its highest level since 1991, food imports grew by over 15 per cent (Ministry of Finance, 1997).[15]

Imports of some luxury items, such as jewellery and designer fashion labels also rose strongly in line with increased economic activity.[16] These emerging trends may create niche opportunities at the top end of the Japanese market.

Exports and Growth in World Income

The sensitivity of Japan's exports to the growth in world income has decreased[17] due to changes in Japan's export structure. The two most important related changes have been:

1. the fall in the share in Japan's total exports of consumer goods (which tend to be more sensitive to growth in world income than other exports)
2. the rise in the share of capital goods exports (which tend to be less sensitive to growth in world income).

Nonetheless, robust growth in world income clearly boosts Japan's export performance and has helped sustain export growth despite the appreciating yen.[18]

AUSTRALIA'S PENETRATION OF THE JAPANESE MARKET

Japan's imports from Australia show continuing dependence on primary products[19] (Table 5.3). Fuels account for 33 per cent and minerals, unprocessed food and other rural products account for a further 30 per cent. Nonetheless, over the last decade Japan's imports of processed food and elaborately transformed manufactures (ETMs) have increased strongly.

....

15 This growth rate is derived from yen figures. It is thus not directly comparable with other growth rates mentioned in this chapter which are derived from US$ figures.

16 According to the *Nikkei Weekly* (22 April 1996, p. 22), sales of expensive designer label fashions have been booming for some time. Imports of jewellery, in yen terms, grew 5.5 per cent in 1995 and 10.1 per cent in 1996.

17 For instance, according to the Economic Planning Agency (1993) the responsiveness of Japan's exports to a 1 per cent rise in world income fell from 1.2 per cent between 1974 and 1985 to 0.5 per cent between 1985 and 1992.

18 Between 1991 and 1996, annual growth in world output has been rising, with growth rates of 0.5 per cent, 1.7 per cent, 2.5 per cent, 3.7 per cent, 3.5 per cent and 3.8 per cent respectively (International Monetary Fund, 1996b).

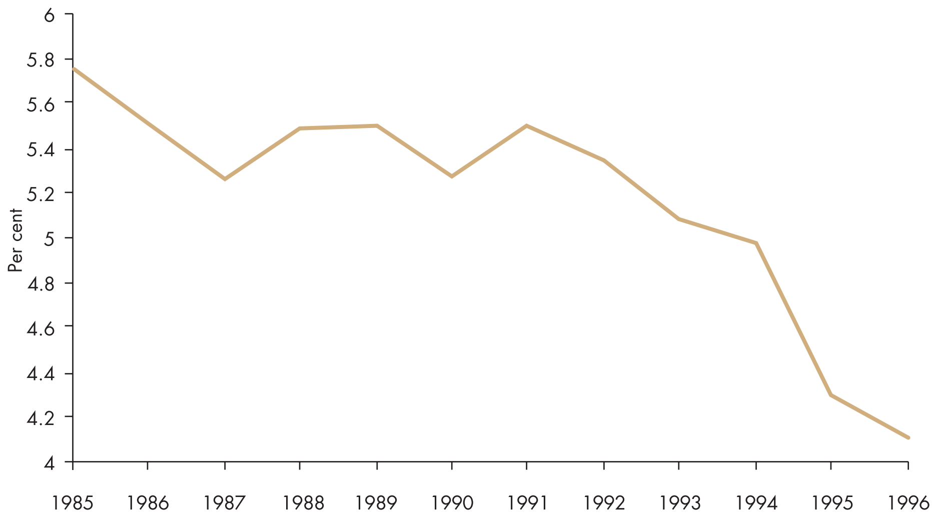
19 The material in this section draws substantially on work done in the North Asia Projects section in the Department of Foreign Affairs and Trade. Some of this appears in Walters (1997).

In 1995, merchandise imports from Australia reached US$14.5 billion, up 6 per cent from 1994, but well below the overall 22 per cent increase in Japan's imports.[20] Between 1991 and 1995, imports from Australia grew 2 per cent per year, compared to total import growth of 10 per cent per year. This performance was down from 1985 to 1990 when Japan's imports from Australia grew 13 per cent per year, versus the 15 per cent growth of total imports. Over the decade from 1985, Australia's market share has declined substantially, especially since 1991 (Figure 5.15).

Figure 5.15

Australia's Market Share Is Falling Dramatically

Australia's Share in Total Japanese Imports, 1985 to 1996



Source: Department of Foreign Affairs and Trade, STARS data base.

Primary commodities' domination of Japan-Australia trade has driven the fall in Australia's market share, because manufactured imports are the most rapidly growing areas of Japan's merchandise imports. Australia's export penetration index for Japan (which shows the average change in market shares for individual products) increased by 7.5 per cent from 1989 to 1995 (McNamara, 1997).[21]

....

20 Unless indicated otherwise, figures for Japan-Australia trade are for Japan's imports from Australia. This is to facilitate comparison of our performance with that of other countries.

21 Formally, the export penetration index measures the change in Australia's market share that would have occurred in the absence of changes in the product composition of imports from their 1989 level. Drysdale (1997), who undertook a similar analysis to McNamara (1997), also emphasises the importance of the commodity composition effect in explaining the fall in Australia's market share in Japan.

Table 5.3

Continued High Incidence of Primary Products

Japan's Imports from Australia: Percentage Share and Value
Value in US$ million in parentheses

	1985	1990	1993	1994	1995
Fuels	39.7	32.0	37.1	33.0	34.9
	(2 961)	(3 964)	(4 527)	(4 506)	(5 079)
Processed food	7.5	11.4	14.6	16.0	15.3
	(559)	(1 412)	(1 786)	(2 180)	(2 224)
Minerals	24.3	19.8	16.5	15.1	15.8
	(1 809)	(2 450)	(2 018)	(2 063)	(2 301)
Other rural	10.8	11.7	9.0	9.5	8.8
	(801)	(1 443)	(1 093)	(1 302)	(1 282)
Unprocessed food	7.6	4.7	6.5	6.8	6.5
	(569)	(576)	(799)	(925)	(947)
Total Primary Products	**89.9**	**79.6**	**83.7**	**80.5**	**81.3**
	(6 699)	**(9 845)**	**(10 223)**	**(10 976)**	**(11 833)**
Simply Transformed Manufactures	6.6	10.2	6.4	7.2	7.7
	(488)	(1 262)	(778)	(981)	(1 122)
Elaborately Transformed Manufactures	1.3	3.1	3.9	4.2	4.6
	(99)	(388)	(479)	(575)	(666)
Total Manufactures	**7.9**	**13.3**	**10.3**	**11.4**	**12.3**
	(587)	**(1 650)**	**(1 257)**	**(1 556)**	**(1 788)**
Other	2.2	7.1	6.0	8.2	6.4
	(166)	(873)	(737)	(1 109)	(937)
Total	**100**	**100**	**100**	**100**	**100**
	(7 452)	**(12 368)**	**(12 217)**	**(13 641)**	**(14 558)**

Note: Other items consist of confidential items, monetary gold and unclassified trade.
Source: Department of Foreign Affairs and Trade, STARS data base.

Performance by Import Category

Unprocessed Food

Crustaceans, wheat, animal feed and barley constituted 87 per cent of Japan's unprocessed food imports from Australia in 1995. From 1991 to 1995, the value of fruit and vegetable imports from Australia grew from US$25 million to US$45 million, a trend annual rate exceeding 20 per cent.[22]

....

[22] Imports of other cereals also have risen strongly over the 1990s but were adversely affected by the drought, falling from US$45 million in 1994 to US$12 million in 1995.

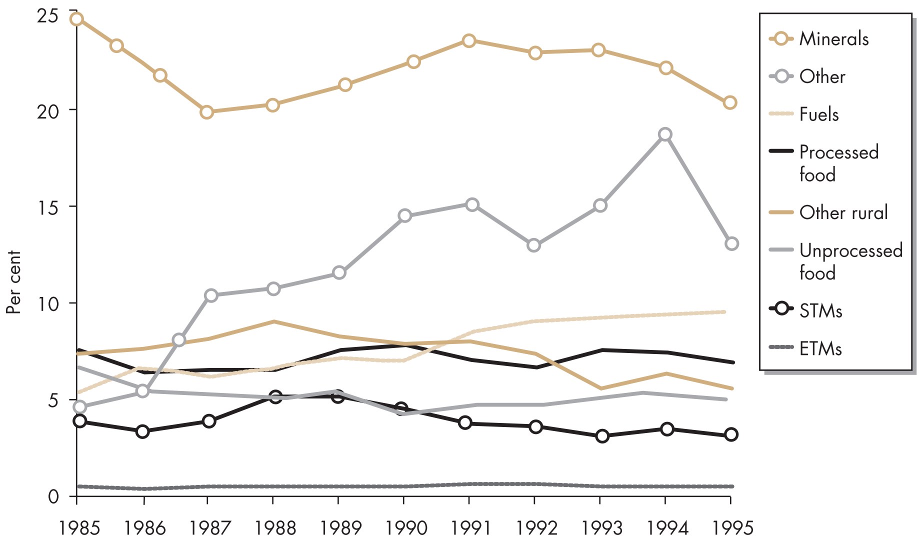
However, over the decade, Australia's overall share of Japan's unprocessed food imports fell (Figure 5.16). This is largely because Japan's total imports of crustaceans, its single most important unprocessed food import, grew twice as fast as its crustacean imports from Australia.[23]

In the unprocessed and processed food sectors, significant market access issues affect Australian exporters. These, together with more general policy influences on agricultural imports, are examined in Chapter 11 - *Agrifood*.

Figure 5.16

Australia's Performance Varies across Sectors

Australia's Market Share by Import Type, 1985 to 1995



Source: Department of Foreign Affairs and Trade, STARS data base.

Processed Food

As the growth rate for Japan's imports of processed food from Australia (14.5 per cent per year over the decade to 1995), is slightly higher than for Japan's overall processed food imports, market share in the 7 to 8 per cent range has been maintained (Figure 5.16).

Beef accounted for more than 50 per cent of Japan's imports from Australia and was the most important item in imports worth over US$100 million in 1995 (Figure 5.17). However, beef's steady market share of around 40 per cent over 1988 to 1994 is changing. It declined to below 38 per cent in 1995 and declined further in 1996 due to strong US competition.

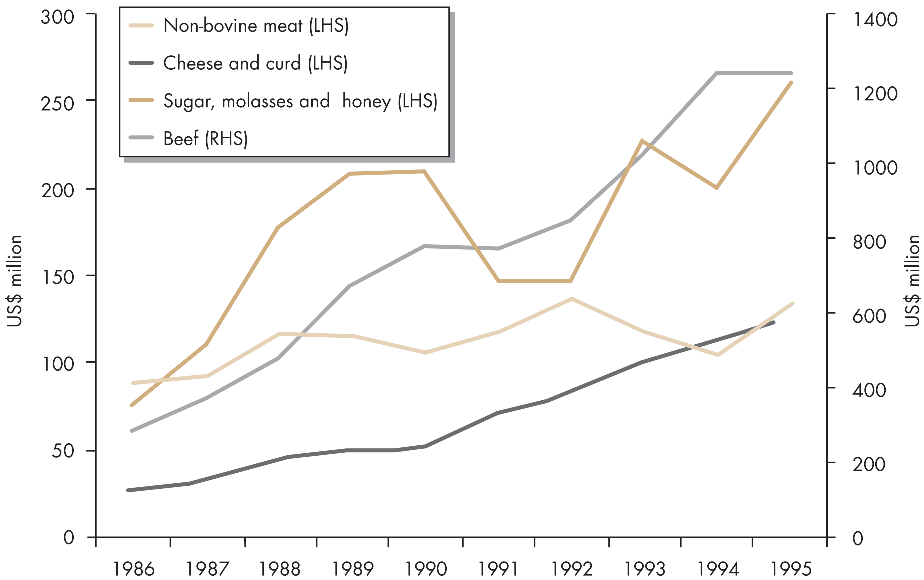
23 Japan's total imports of crustaceans grew at an annual rate of 9.8 per cent between 1985 and 1995 compared to growth in imports from Australia of 5.4 per cent.

Japan's imports of Australian sugar, molasses and honey, the next most important item, grew at twice the rate of Japan's overall imports of these items. This strong and sustained growth increased imports from US$64 million in 1985 to US$259 million in 1995.

Figure 5.17

Generally Strong Performance of Major Processed Food Items

Japan's Imports of Australian Processed Food Worth More than US$100 million in 1995



Source: Department of Foreign Affairs and Trade, STARS data base.

Australia's performance in Japan's dairy markets has been impressive in the 1990s. (See box.) Imports of Australian cheese and curd grew 19 per cent per year from 1990 to 1995, twice the rate of Japan's overall cheese and curd imports. Since 1993 Australia has overtaken New Zealand to become Japan's top supplier, with 27 per cent of the market in 1995. Imports of Australian milk, cream and milk products also have expanded strongly since the late 1980s, although they fell sharply in 1995 despite strong growth in Japan's overall imports of these items.[24]

[24] Japan's imports of milk, cream and milk products from Australia fell from US$72 million in 1994 to US$54 million in 1995. The drought in Australia does not seem to have reduced exports, with total Australian exports rising from US$626 million in 1994 to US$655 million in 1995.

HOW TO SUCCEED IN DAIRY EXPORTS TO JAPAN

The Australian Dairy Corporation (ADC) operates as a single entry channel for selling bulk Australian dairy produce on the Japanese market. It has a nonexclusive right to import and distribute branded final dairy products.

Three key success factors are to work closely with important customers, use major promotional campaigns, and coordinate well between Australian and Japanese offices.

Working Closely with Important Customers

Most of ADC's business consists of supplying bulk cheese to major food companies and cheese repackers. In recent years, it has imported branded finished products such as ice cream, Australian camembert and cream cheese for niche marketing into the wholesale/retail system. However, it does not sell bulk cheese directly into the markets of its main customers. This ensures that the main distribution channel for Australian cheese in the market is not jeopardised. ADC also is keen to keep its existing means of distribution because Japan's product liability laws make it risky to have a high exposure to branded food, and as a government corporation, ADC cannot assume a high level of brand marketing liability.

Using Promotional Campaigns

Four years ago, ADC cooperated with Japanese cheese producers, repackers and retailers to launch the 'Dairy Good' logo for cobranding Japanese dairy produce made from Australian cheese. A major promotion campaign raising public awareness of the level of Australian content in Japanese cheese products followed. This campaign supported the individual marketing efforts of Japanese producers and retailers.

Cooperating between Offices

ADC in Australia liaises directly with dairy producers, such as Bonlac and Murray Goulburn, negotiates prices, takes orders from the major trading companies, prepares all shipping documents and negotiates freight rates. ADC Japan negotiates supply contracts with major trading companies, acts as a coordinator between the trading companies and ADC in Australia, deals with any claims arising out of shipments, and undertakes the promotion of Australian dairy produce.

Source: Economist Intelligence Unit Australia, 1996a.

In 1994, with partial opening of the Japanese rice market, imports from Australia reached US$133 million, up from nearly zero. This high level of imports was largely due to a drought-induced shortfall in domestic production; imports from Australia dropped to US$15 million in 1995. Many other processed food imports from Australia have expanded strongly in the 1990s (Table 5.4). (See Chapter 11 - *Agrifood*.)

Table 5.4

Areas Where Australia is Doing Well ...

Rapid Growth Areas in Processed Food

Item	Trend growth, Australia 1990-95 per cent	Trend growth, world 1990-95 per cent	Imports from Australia 1995 US$ million	Total Japanese imports 1995 US$ million
Fruit and vegetable juices	57.6	16.2	46.7	538.9
Chocolate and other foods containing cocoa	20.1	6.4	37.5	319.3
Malt	63.3	35.9	54.3	300.0
Alcoholic beverages	11.6	2.0	16.8	1 955.9

Source: Department of Foreign Affairs and Trade, STARS data base.

Australia could improve substantially its exports of fish, vegetables, roots and tubers, preserved fruit and foods and non-alcoholic beverages (Table 5.5).

Table 5.5

... and Missing Out

Areas of Processed Food Where Australia's Market Share Is Low

Item	Imports from Australia 1995 US$ million	Total Japanese imports 1995 US$ million	Australian market share per cent
Fish	34.1	2 336.2	1.4
Vegetables, roots and tubers	4.6	1 236.1	0.4
Preserved fruit and foods	13.4	854.2	1.6
Non-Alcoholic beverages (mainly mineral water)	1.2	315.9	0.4

Source: Department of Foreign Affairs and Trade, STARS data base.

Other Rural Products

Wool and woodchips dominate Japan's imports of other rural products from Australia, with 75 per cent of imports in the 'other rural products' category in 1995. Cotton accounted for a further 10 per cent. Between 1988 and 1995, Japan's imports of Australian 'other rural' products fell 4.8 per cent per year, losing market share (Figure 5.16). Medium-term prospects are poor because of the likelihood of continued contraction in Japan's textiles sector.

The weak performance since 1988 is largely due to the halving of wool prices in 1989 to 1993 and Japan's contracting textiles sector. Japan's woodchip imports have overtaken wool as the leading 'other rural' category item since 1993. Nevertheless, Australia's share of Japanese woodchip imports has fallen in the 1990s.[25] Australian woodchip export restrictions limit export potential, although export quotas were increased in July 1996. This and recent investments by Japanese trading houses in Australia should increase woodchip exports. (See Chapter 6 - *Internationalisation*.)

Minerals

Iron ore dominates Japan's minerals imports from Australia, accounting for 65 per cent of the total in 1995. Other significant items were ores and concentrates of nonferrous base metals such as lead and zinc (13 per cent), copper ore and concentrates (8 per cent), and nickel ore and concentrates (8 per cent).

Japan's mineral imports from Australia grew at around 4 per cent per year between 1985 and 1995, similar to the overall mineral imports growth, but well below manufactured imports growth. Australia's market share was steady at around 23 per cent from 1991 to 1994 but fell to 20 per cent in 1995 (Figure 5.16). This decline was driven by rapid expansion of Japan's imports of copper ores and concentrates. It occurred despite 10 per cent growth in Japanese imports of iron ore from Australia in 1995.[26]

Japan's emphasis on diversity of supply and Australia's high existing share of the Japanese market (Figure 5.18), could compound the effect of Japan's slowly expanding mineral imports on Australia's overall share of Japan's imports.

Figure 5.18

Australia a Dominant Supplier of Minerals

Sources of Japan's Iron Ore, Lead and Zinc Imports, 1995

Source: Australia-Japan Economic Institute, 1996.

[25] In 1996, Australia had a 24 per cent share of Japan's woodchip imports (Ministry of Finance, 1997).

[26] Japanese statistics indicate that further growth occurred in 1996.

Japanese imports of nonmonetary gold (which dominate the ‘other’ category in Table 5.3) have performed strongly over the last decade, growing from negligible levels to almost US$1.1 billion in 1994. Gold imports from Australia fell in 1995 to around US$900 million and fell again in 1996.[27] The diversion of sales to the Republic of Korea, whose imports of Australian nonmonetary gold doubled in 1995, may partly explain this fall (Walters, 1997).

Fuels

Over the last decade, Japan’s imports of Australian fuels have grown at a trend annual rate of 7.4 per cent, compared to a 0.8 per cent annual growth in Japan’s overall imports of these items. Consequently, Australia’s share increased substantially, reaching 9.4 per cent in 1995 (Figure 5.16).

Coal accounted for 64 per cent of Japan’s total fuel imports from Australia in 1995. Australian coal has maintained a market share of over 50 per cent throughout the 1990s, well above the level in the second half of the 1980s.

Since 1990, imports of natural gas have increased dramatically. They were valued at US$1.3 billion in 1995 and accounted for 25 per cent of Japan’s fuel imports from Australia. Imports of crude petroleum were significant in the first half of the 1990s, with the level of these imports reflecting spot market conditions. (See Chapter 12 - *Energy*.)

Simply Transformed Manufactures

Australia’s share of Japan’s imports of simply transformed manufactures (STMs) has fallen since 1988 (Figure 5.16), due largely to trends in the world aluminium market and fluctuations in Japan’s imports of aluminium. Over the last decade, these accounted for 60 to 80 per cent of Japan’s total STM imports from Australia. Japan’s imports of aluminium from Australia peaked at US$1.1 billion in 1988 and 1989, but fell back to US$0.5 billion over the four years to 1993. Australia’s share in Japan’s total aluminium imports fell from 23 per cent in 1989 to 14 per cent in 1993. Despite 20 per cent growth in 1994 and 1995, Australia’s market share fell to 13 per cent in 1995. Japanese figures indicate it recovered to 14 per cent in 1996 (Ministry of Finance, 1997).

Pearls and precious stones imports from Australia totalled US$161 million in 1994 but fell to US$116 million in 1995, despite a 10 per cent expansion in Japan’s imports of these items. With further growth likely, Australian suppliers need to be alert for new opportunities.[28]

Imports of iron and steel flat rolled products and clay construction materials grew strongly to US$74 million and US$22 million, respectively, by 1995.[29] Clay

....

27 In yen terms, imports of nonmonetary gold from Australia fell by over 40 per cent in 1996.

28 *The Australian Financial Review* (7 April 1997, p. 11) reported that in 1996 Japan’s imports of precious stones and metals from Australia fell 30 per cent (in yen terms) due to the collapse of a large Japanese distributor. This indicates the need for suppliers to gather good market intelligence.

29 From 1990 to 1995, trend annual growth in Japan’s imports from Australia was 21 per cent for flat rolled products of iron and steel and 32 per cent for clay construction materials. This compared to growth in total Japanese imports of these items of -0.7 per cent and 11 per cent.

construction materials, used in Japan's rapidly growing housing products market, had a 15.8 per cent market share in 1995.[30] (See Chapter 9 - *Distribution*.)

Elaborately Transformed Manufactures

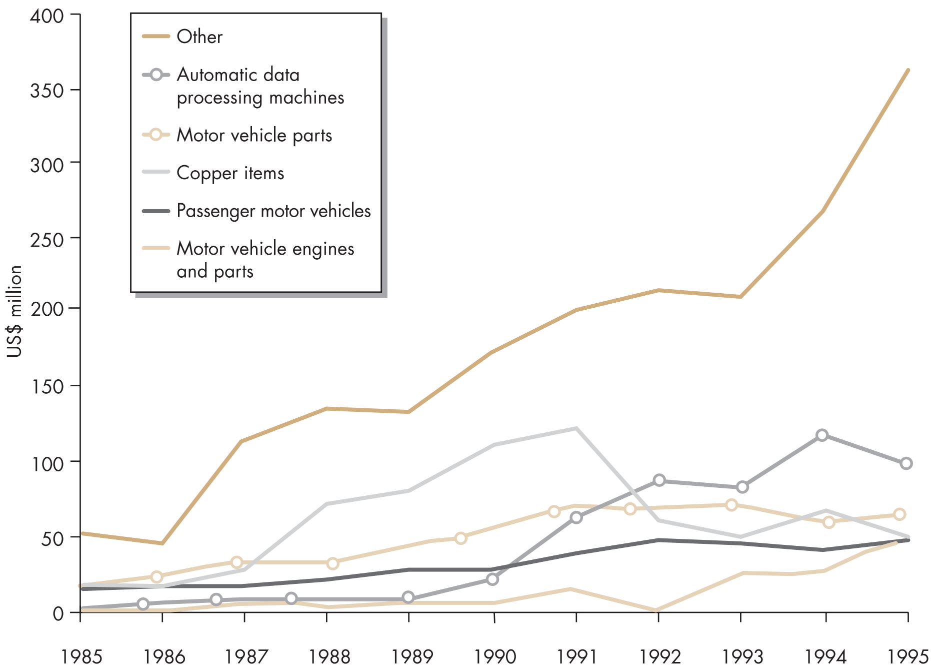
Japan's most rapidly growing imports are consumer and capital goods, which largely fall into the category of elaborately transformed manufactures (ETMs). In 1985 to 1991 the trend annual growth rate of ETM imports from Australia was 32.5 per cent. This was higher than for ETM imports from OECD countries and similar to growth from Asian countries.[31] In recent years, performance has weakened to 13 per cent during 1992 to 1995, versus 17 per cent for the OECD and 28 per cent for Asia.

Japan's imports of ETMs from Australia are diverse (Figure 5.19). Since 1992, Japan's largest ETM import from Australia has been ADP equipment, which attained a 2 per cent market share in 1991 to 1994. However, strong growth in ADP imports in 1995 and declining imports from Australia (from US$117 million in 1994 to US$98 million in 1995) cut the share by half.

Figure 5.19

Other ETM Imports Surge

Selected Japanese Imports of ETMs from Australia



Note: ETMs: elaborately transformed manufactures.

Source: Department of Foreign Affairs and Trade, STARS data base.

....

30 These imports from Australia are dominated by ceramic building bricks, flooring bricks and support tiles. They were worth US$15 million in 1995.

31 Japan's imports of ETMs from the OECD grew at an annual rate of 17.2 per cent during 1985-89, and from Asia 28.3 per cent.

Japan imported almost US$50 million worth of passenger motor vehicles from Australia in 1995 (0.5 per cent of the import market). Most came from Mitsubishi Australia. Competition is fierce as Japanese, European and US players vie for market share and because Australian plants are relatively small scale and high cost.[32] Indeed, in 1996, Australia's share of Japan's passenger car imports fell to 0.3 per cent, and Mitsubishi Australia's exports dropped from 2 281 vehicles in 1995 to 1 434 (Ministry of Finance, 1997; and Japan Automobile Importers Association, 1997).

Japanese imports of Australian internal combustion piston engines/parts and motor vehicle parts/accessories grew rapidly in the late 1980s and early 1990s, but have since slackened. Australia's market share peaked at 13 per cent and 7 per cent, respectively, in 1991, falling to 9 per cent and 4 per cent, respectively, in 1995. To maximise such exports, Australia needs to establish internationally competitive auto component makers with the economies of scale and scope to integrate into Japanese auto companies' international division of labour. (See box.)

OPPORTUNITIES AND CHALLENGES IN AUTO PARTS EXPORTS

Japanese parts suppliers are organised in tiers around their major customers, the car makers. The first tier comprises 10 to 20 companies, many of which are substantial. The second tier comprises a few hundred suppliers and the third tier comprises thousands of small suppliers and subcontractors.

In the Japanese motor vehicle components industry, pressure is intense to globalise operations to meet continuing parts standardisation requirements and generate large-scale economies. In this environment, car makers have moved closer to their first-tier suppliers to ensure access to joint design and development capability, flexible and reliable delivery, and support in achieving high-quality production in offshore locations. Lower-tier suppliers, particularly of low-technology items such as mufflers and pressed parts, are hit hard as car makers and upper-tier suppliers increase in-house production to better utilise capacity, standardise parts and seek cheap supply sources, usually offshore.

Foreign suppliers can access the Japanese global parts supply chain by:

- licensing technology to first-tier suppliers (some US and German companies have achieved this)
- becoming a qualified supplier in offshore locations where Japanese manufacturers and parts suppliers are actively seeking to increase the proportion of locally made components
- establishing joint venture production in Japan and other locations
- replacing lower-tier suppliers by exporting directly to Japan.

Australian producers tapping into these opportunities need:

- a high degree of technical sophistication
- sufficient production capacity to meet export demand
- the availability of capital for offshore investment.

Source: Economist Intelligence Unit, 1996b.

32 Motor vehicle production in Australia is relatively costly and new motor vehicle imports face a tariff of 22.5 per cent. Also, exports rely on the export facilitation scheme whereby exports earn credits which can be used for the purchase of duty-free inputs for motor vehicle production.

Strong demand for refined copper was important in boosting Australia's ETM exports to Japan in the late 1980s and early 1990s. Such imports peaked at US$122 million in 1991, representing 24 per cent of Japan's ETM imports from Australia. Between 1992 and 1995, Japan's annual imports of copper products from Australia fell by half, driving down Australia's share in Japan's ETM imports.[33]

Japan's imports of 'other ETMs' from Australia rose rapidly over the last decade (Figure 5.19). Chemical products are particularly significant, worth US$54 million in 1995. Pigments, paints and varnishes grew 30 per cent per year between 1990 and 1995, reaching almost US$27 million by 1995, representing 5.6 per cent of Japanese imports of these items.

Among the most rapidly growing imports from Australia in the 'other manufactures' category are measuring instruments, nonelectric parts, sporting goods, veneers and other worked wood (Table 5.6). Recently a Japanese company invested A$90 million to produce medium-density fibreboard for export. (See Chapter 6 - *Internationalisation*.)

Table 5.6

Much Potential Remains

Selected Rapidly Growing Japanese Imports from Australia

Commodity	1995 imports from Australia US$ million	1995 level of total Japanese imports US$ million	Trend growth 1990 to 1995 in imports from Australia per cent	Trend growth 1990 to 1995 world imports per cent
Nonelectric parts and machine accessories	35.1	289.1	26.4	8.0
Measuring, checking, analysing and controlling instruments and apparatus	28.4	3 373.9	40.9	7.5
Tyres, tyre treads and inner tubes	17.7	654.7	14.5	3.2
Veneers, plywood, particle board and other worked wood	13.0	2 601.0	23.8	19.9
Sporting goods	11.7	2 131.1	29.0	10.9

Source: Department of Foreign Affairs and Trade, STARS data base.

Opportunities and Challenges for Australia

While Japan's demand for energy and fuels is likely to remain enormous by world standards, Australia will have to work hard to maintain its impressive market share. The rewards would be large. For example, even if Japan's demand for fuels grows a fairly sluggish 5 per cent overall between 1995 and 2000, and Australia maintains its

33 Even in 1995, Japan's imports of copper items from Australia represented 7.4 per cent of Japan's total ETM imports from Australia, while Japan's overall imports of copper items represented 1 per cent of Japan's total ETM imports.

1995 market share of 9 per cent, Australian exports would expand US$250 million by 2000.

Another fundamental challenge is to increase Australia's share of Japan's rapidly growing imports of manufactured goods and processed food. Japanese demand for processed food is income responsive, and the current post recession period is an opportune time. The income-sensitive markets for luxury items such as jewellery, pearls and precious stones, and designer clothes also offer lucrative opportunities.

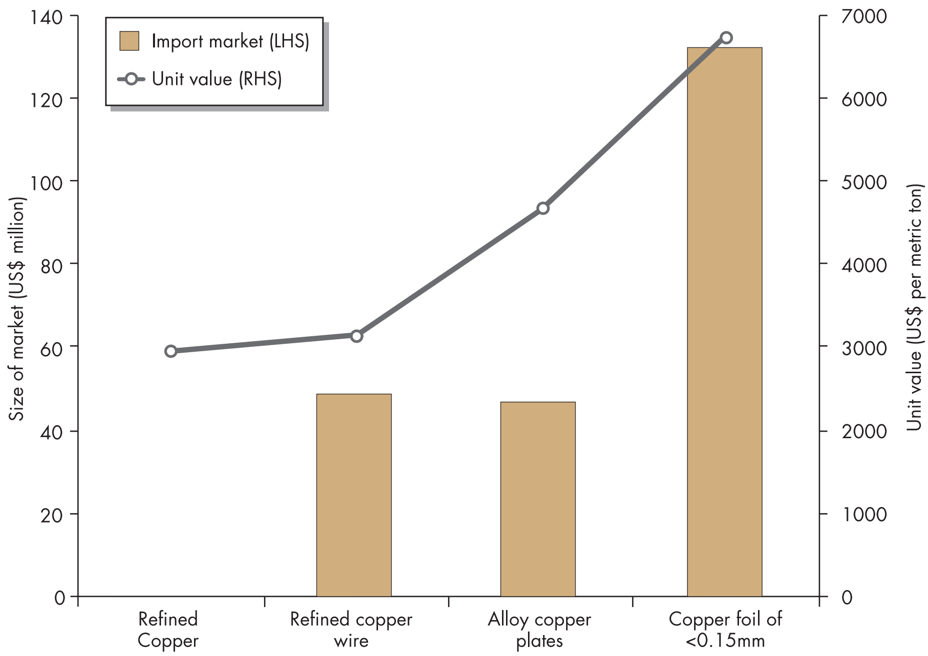
Australian companies already are exploring opportunities in housing and construction materials, including veneers, plywoods, particle board and other worked wood, pigments, paints and varnishes, and clay construction materials. (See Chapter 9 - *Distribution*.)

More generally, Australia must continue to move its exports up the value chain in the Japanese market. Refined copper is by far Japan's most important copper import.[34] However, in other important copper segments with higher unit values, Australia has no presence (Figure 5.20). Imports of all types of copper are likely to continue to expand as Japanese companies globalise their input sourcing.

Figure 5.20

A Key Challenge: Higher Unit Value Segments

Market Size and Unit value for Japanese Imports of Copper Items, 1995



Source: Department of Foreign Affairs and Trade, STARS data base.

---

[34] Total imports were US$1.1 billion in 1995.

JAPAN'S TRADE IN SERVICES

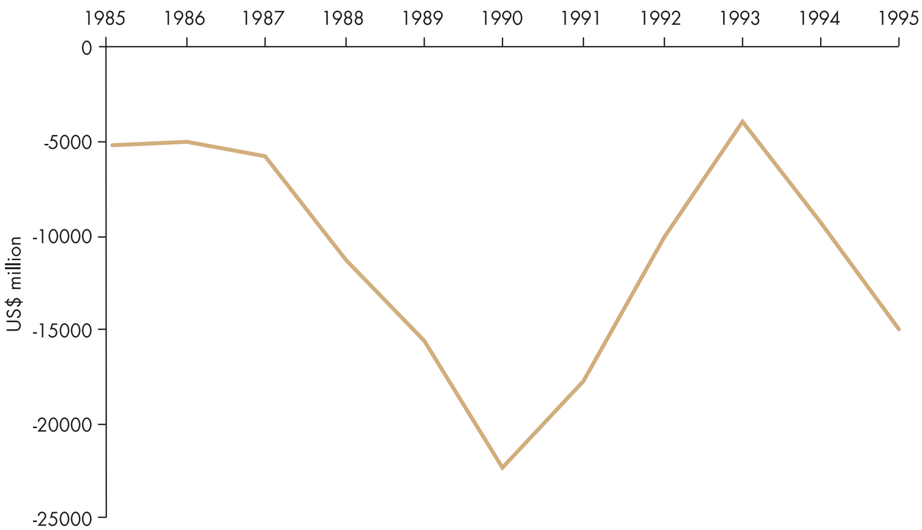
Japan's trade in services is growing rapidly. Over the last decade, service debits and credits have grown faster than merchandise imports and exports.[35] Two marked contrasts with Japan's merchandise trade are:

1. Japan is not a provider of internationally competitive services.
2. Japan consistently runs a deficit in services trade (Figure 5.21).

Figure 5.21

Japan Is a Net Importer of Services

Japan's Services Trade Balance, 1985 to 1995



Source: Bank of Japan, 1996.

Debits and Credits

Transport and travel dominate Japan's service debits with shares of around 25 per cent each (Figure 5.22). Since 1993, the most rapidly growing item has been construction services, followed by travel, and royalties and license fees.[36] Transport and business, professional and technical services dominate Japan's service credits with shares of around 25 per cent each; travel is of little significance (Figure 5.23).

....

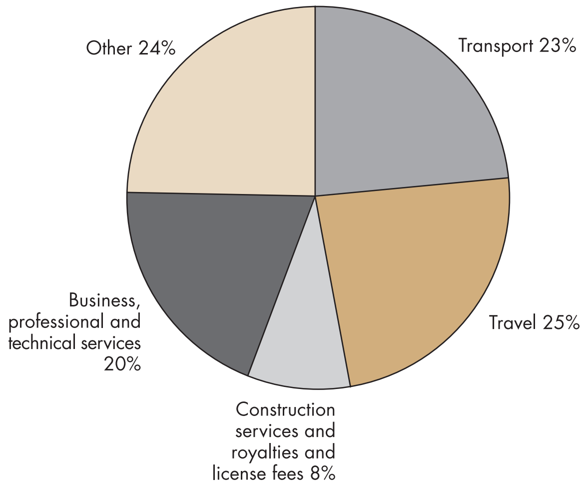
35 Over the period 1985-95, Japan's service debits and credits (in US$ terms) grew at trend annual rates of 17.5 per cent and 18.3 per cent compared to growth in merchandise imports and exports of 9.4 per cent and 8.7 per cent respectively.

36 In US dollar terms, these items increased by 48 per cent, 34 per cent and 28 per cent, respectively, between 1993 and 1995.

Figure 5.22

Transport and Travel Dominate Japan's Service Imports

Japan's Service Debits in 1995



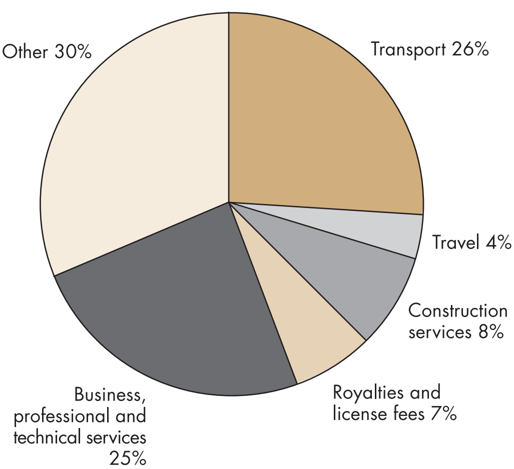
Note: The 'other' category consists of insurance services, financial services, merchandising and other trade related services, personal, cultural and recreational services, and government services.

Source: Bank of Japan, 1996.

Figure 5.23

Business and Transport Dominate Service Exports

Japan's Service Credits in 1995



Note: The 'other' category consists of insurance services, financial services, merchandising and other trade related services, personal, cultural and recreational services, and government services.

Source: Bank of Japan, 1996.

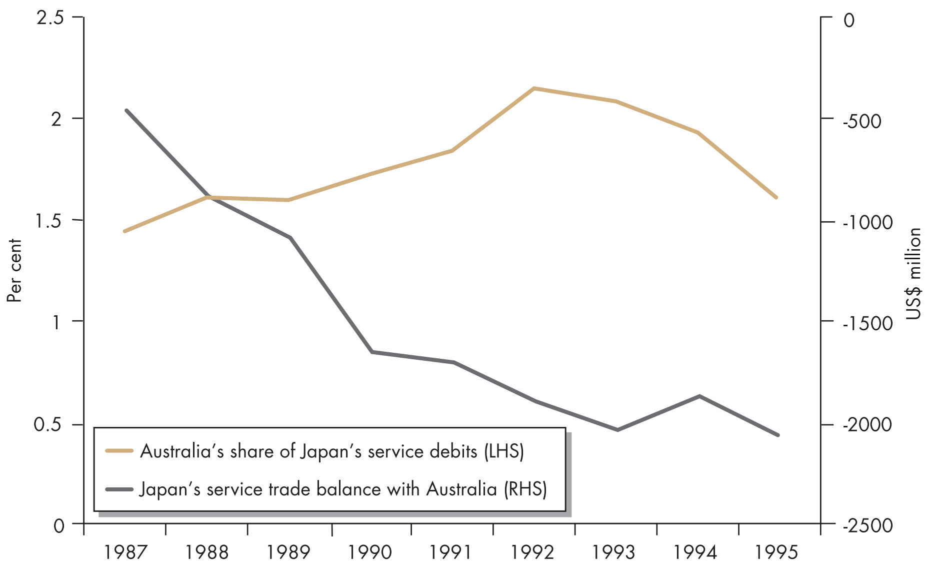
Japan-Australia Services Trade

Statistics on Australia-Japan services trade differ from those used above as they include investment income. Excluding investment income, Japan has a growing services trade deficit with Australia (Figure 5.24).

Figure 5.24

Australia Also Losing Market Share in Services

Japan's Service Trade Balance with Australia and Australia's Market Share



Source: Bank of Japan,1996.

Japan's most important services debits to Australia in 1995 were travel and transport, with shares of 39 per cent and 31 per cent, respectively.[37] Both grew rapidly between 1988 and 1993, but travel debits stalled in 1994 and 1995. This has been a major factor in Australia's declining share of Japan's services debits from 2.1 per cent in 1993 to 1.6 per cent in 1995.

Prospects for growth in Japan's services trade are bright. Ongoing deregulation will increase the relative size of Japan's service sector, as will higher incomes. Globalisation of corporate activities, one factor behind the growth in world services trade, offers good opportunities in Japan. Also, Japan's service industries are not internationally competitive and are often a receptacle for excess labour (Dodds, 1994). (See Chapters 13 - *Transport* and Chapter 14 - *Services*.)

[37] The shares quoted are those derived when investment income is included as a service. The share of investment income is 18 per cent.

OUTLOOK

Japan's trade structure has changed substantially over the last decade and will continue to evolve, reflecting currency movements, overseas investment patterns and growing supply capacity in other Asian countries.

While Japanese imports may not expand as rapidly as in 1994 and 1995 in coming years, they will still be enormous by world standards. As the recovery continues, income growth will drive imports. Just as changes in various aspects of Japan's economy, such as distribution system and market access reforms, magnified the yen's impact on imports in recent years, these factors may make demand for imports increasingly income sensitive.

Because most of Japan's imports from Australia are primary commodities, the slowest growing area of Japan's imports, Australia's overall market share may continue to decline in the short to medium term. However, the value of Australia's exports to Japan is rising, and good opportunities exist to expand them significantly, especially in a range of ETMs, processed foods, housing-related products, luxury goods and services.

REFERENCES

Australia-Japan Economic Institute (AJEI), 1996, 'Australia's Commodity Trade with Japan', *Economic Bulletin*, Vol. 4, No. 8, pp. 3-13.

Athukorala, P. and Menon, J., 1993, 'Exchange Rate Changes and Export Pricing Behaviour in Japan', *Pacific Economic Papers*, No. 222, August, Australia-Japan Research Centre, Canberra.

Australian Financial Review, various issues.

Bank of Japan, 1996 and previous April issues, *Balance of Payments Monthly*.

Department of Foreign Affairs and Trade, 1995, *Trade in Services: Australia 1994-95*, Trade Analysis Branch, Department of Foreign Affairs and Trade, Canberra.

Department of Foreign Affairs and Trade, Statistical Analysis and Reporting System (STARS) data base, Canberra.

Dodds, G., 1994, 'Japan's Import of Services: Potential for Australia', paper presented at Australia-Japan Economic Institute Conference, Sydney, 15 March.

Drysdale, P., 1997, 'The Past, Present and Future of the Australia-Japan Relationship', paper presented to the Japan-Australia Open University on Economy for the Year 2000, Tokyo, 20 January.

Economic Planning Agency (EPA), 1994, *Economic Survey of Japan 1993-94: A Challenge to New Frontiers Beyond the Severe Adjustment Experience*, Government of Japan, Tokyo.

____ 1993, *Economic Survey of Japan 1992-93: What We Learned from the Bubble and Our Challenge to a New Development*, Government of Japan, Tokyo.

Economist Intelligence Unit Australia, 1996a, 'Case study of food sector distribution in Japan: Australian Dairy Corporation in Japan', consultancy report prepared for East Asia Analytical Unit, Sydney.

____ 1996b, 'Japan's *Keiretsu* in Transition: Case studies of the construction and automotive components sectors', consultancy report prepared for East Asia Analytical Unit.

Hufbauer, G., Lakdawalla, D. and Malani, A., 1994, 'Determinants of Direct Foreign Investment and Its Connection to Trade', *UNCTAD Review 1994*, pp. 39-51, United Nations, New York.

International Monetary Fund, 1996a and previous issues, *International Financial Statistics*, International Monetary Fund, Washington DC.

____ 1996b and previous issues, *World Economic Outlook*, October International Monetary Fund, Washington DC.

Japan Automobile Importers Association, 1997, *Car Import News*.

Kawai, M. and Urata, S., 1995, 'Are Trade and Investment Substitutes or Complements? An Empirical Analysis of Japanese Manufacturing Industries', *Discussion Paper Series No. F-50*, Institute of Social Science, Tokyo University, Tokyo.

McNamara, J., 1997, 'An Update on Australia's Export Market Share Performance', *International Trade Papers 1996*, Department of Foreign Affairs and Trade, Canberra.

Ministry of International Trade and Industry, 1996, *Summary of The Survey of Trends in Overseas Business Activities of Japanese Companies*, 25th survey, MITI, Tokyo.

Ministry of Finance, 1997, *Japan Exports and Imports*, Ministry of Finance, Tokyo.

Nikkei Weekly, various issues.

Organisation for Economic Cooperation and Development (OECD), 1996, *Economic Outlook*, Vol. 60, December, pp. 49-53.

Sanwa Bank, 1997, *Economic Letter*, January.

Takao, Y. and Nemoto, N., 1995, 'Long-Term Outlook: Japan's Economy in an Era of Structural Change', *NRI Quarterly*, Summer, pp. 2-33.

Walters, R., 1997, 'A Review of Australia's Market Share Performance in Japan', *International Trade Papers 1996*, Department of Foreign Affairs and Trade, Canberra.

Chapter 6

INTERNATIONALISATION OF JAPANESE INDUSTRY

Increasingly the Japanese economy is feeling the impact of international forces. Japanese companies are the fastest growing group among the world's 100 most internationalised companies (ranked by foreign assets), increasing from 11 in 1990 to 19 in 1994 (United Nations 1996a). Furthermore, the Ministry of International Trade and Industry (MITI) expects Japan's overseas manufacturing production to soon exceed the value of its exports.[1]

Japanese foreign direct investment (FDI) totalled US$240 billion between 1988 and June 1996. It has focused on developing offshore markets and maintaining markets at home for products that can be manufactured more competitively abroad. (Chapter 5 examines the impact of this on trade). Asia will remain a major destination, with companies moving high-cost plants and functions out of Japan to lower-cost sites, producing goods for world markets as well as for Japan. 'Hollowing out' will not leave just a skeleton manufacturing sector in Japan; rather, Japanese manufacturing will continue to move up the 'value chain'. This in turn will stimulate the development of support functions such as production of inputs, research and development, and a variety of other services. (See Chapter 14 - *Services*.)

While Japanese direct investment in Australia has declined since 1989, it has switched from sometimes speculative real estate deals to longer-term manufacturing ventures. Attracting stronger flows of Japanese direct investment, particularly in manufacturing, will require Australia's economy to be competitive enough to support plants and R&D that can be integrated into multinational corporations' global activities. This will necessitate faster microeconomic reform.

As part of a worldwide trend, Japanese trading houses are diversifying their activities in Australia, engaging in downstream resource processing, infrastructure development and other 'nontraditional' areas. They represent valuable potential allies for Australian companies in the Asia-Pacific region.

FDI in Japan is minuscule relative to the size of the market, and no major increase is anticipated. While the investment environment in Japan has improved over the past 15 years, it remains challenging. That said, the trade pull effects may be strong enough to warrant increased Australian investment in Japan in order to broaden exports to that market.

This chapter examines Japanese FDI in a broad context and includes a detailed consideration of Japanese investment in Australia. It also looks at FDI in Japan,

1 In Japanese Fiscal Year (JFY) 1995 sales of products manufactured by Japanese companies overseas should be similar to Japan's total exports ¥40.9 trillion.

given its strong trade effects and its capacity to facilitate structural adjustment. Finally, the chapter assesses the trading houses' important role in trade and investment and the dynamic adjustment they are undertaking.

MEASURING OUTWARD FDI

Different Japanese data sources give different pictures of FDI. The Ministry of Finance (MOF), the most commonly quoted source, provides industry-level detail. However, these data have four major weaknesses in that:

1. they refer to notifications (not all projects notified are realised)
2. they do not record disposal of assets
3. transfer of ownership of an asset from one Japanese company to another may be recorded as FDI when it is not FDI, with divestment offsetting investment
4. they exclude reinvestment, which is funded by local borrowing and internal reserves.

The Balance of Payments data from the Bank of Japan (BOJ), on the other hand, exclude reinvestment until 1996 but does not suffer the other listed weaknesses. Consequently, where possible, BOJ data are used throughout this report. Australian Bureau of Statistics (ABS) data are used to examine the industry composition of Japanese FDI in Australia. These are also subject to important limitations, which are outlined later.

JAPANESE FDI OVER THE LAST DECADE

In the late 1980s, Japanese outward direct investment grew rapidly, mainly to the USA and Europe, although South East Asia also enjoyed substantial and sustained inflows (Figure 6.1). The additional liquidity generated by easy monetary policy and rising asset prices was the dominant macroeconomic force behind this investment. Robust economic activity, large markets and a desire to set up production bases pending the introduction of the North American Free Trade Area (NAFTA) and free trade within the European Union (EU) drove Japan's FDI in the USA and Europe. Pressure to reduce production costs was a more important factor in Japan's FDI in South East Asia.

Between 1990 and 1992 Japanese FDI flows fell sharply as liquidity was reduced by the tightening of Japanese monetary policy and the collapse in asset prices. Since 1993, Japanese direct investment has resurged, although it remains well below its 1990 peak. However, the increasing importance of reinvestment, funded by local borrowing and internal reserves and not counted in FDI statistics, means that the total level of Japanese FDI is understated.[2]

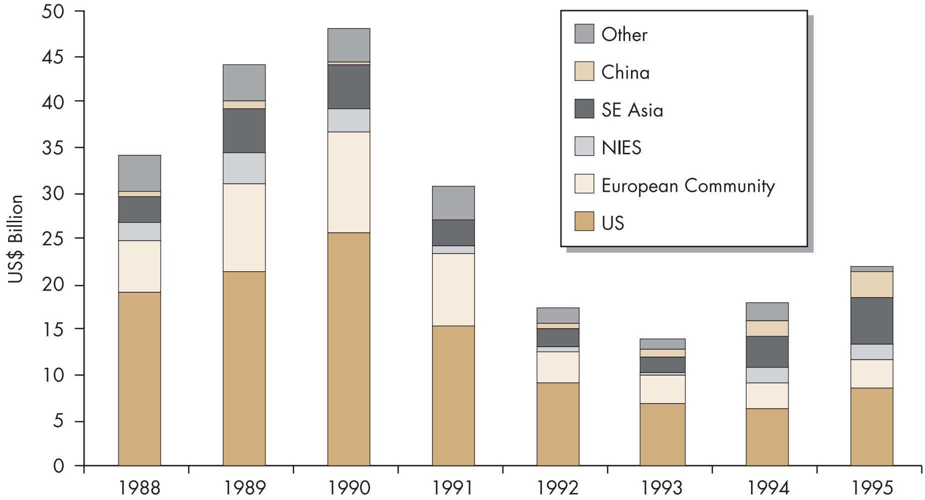
....

2 See Ministry of International Trade and Industry, 1996a, p. 43.

Figure 6.1

Direct Investment Remains Well Below Late 1980s Levels

Japanese FDI Flows by Region



Source: Bank of Japan, 1996.

Investment in Asia since 1993

The FDI surge since 1993 has been dominated by strong investment in South East Asia and China (Figure 6.1). MOF data indicate that manufacturing investment led this surge (62 per cent of FDI between 1993 and 1995). In China, FDI in electrical machinery became the single most important sector by JFY1995, followed by machinery and textiles (Figure 6.2). In ASEAN(4),[3] the fastest growth has occurred in iron, steel and nonferrous metals.[4]

Yen appreciation and relative competitiveness have been important in driving Japanese investment in Asia. Other contributing factors are strong economic expansion and relatively higher profitability than in other regions (Figure 6.3).

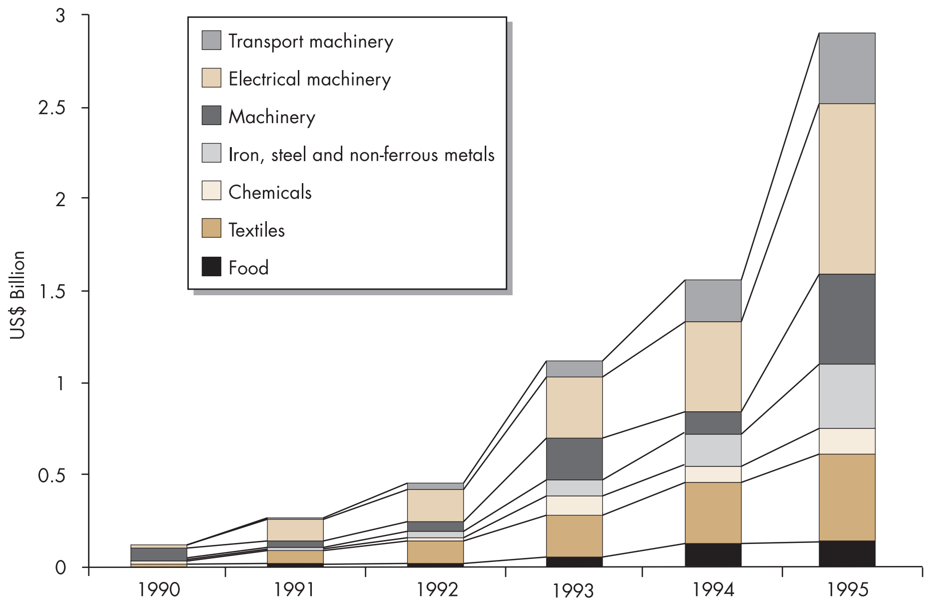
[3] The ASEAN(4) countries are Indonesia, Malaysia, the Philippines and Thailand.

[4] Between 1990 and 1995, investment notifications in iron, steel and nonferrous metals grew at a trend annual rate of more than 20 per cent. Growth rates in machinery and electrical machinery were in excess of 5 per cent while investment notifications in food and chemicals contracted.

Figure 6.2

Direct Investment in China Has Surged

Japanese FDI in Chinese Manufacturing JFY1990 to 1995

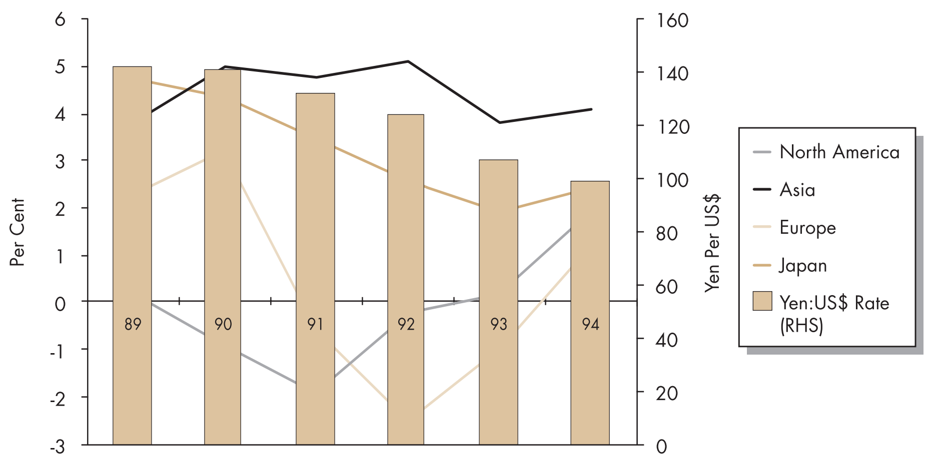


Source: Ministry of International Trade and Industry, 1996b.

Figure 6.3

FDI in Asia Is Most Profitable

Ratio of Ordinary Profit to Sales by Region



Source: Ministry of International Trade and Industry, 1996a; Nikkei data base.

Investment in the USA and Europe since 1993

Investment in the USA and Europe, despite some recovery in 1995, is only 33 per cent and 28 per cent, respectively, of the 1990 peak. Overcapacity due to excessive investment in the late 1980s has contributed to this weakness as have relatively weak economic growth, profitability[5] and lower levels of investment in real estate in the 1990s.

FUTURE TRENDS IN OUTWARD FDI

Japanese FDI remains strong, rising 22 per cent in the first half of 1996 over the first half of 1995. A recent survey indicates that among companies with medium-term investment plans (JFY1996 to JFY1998), 70 per cent of respondents plan to increase FDI and less than 10 per cent plan to decrease it (Nakatani et al, 1996). Interest focuses on China and South East Asia. The Newly Industrialising Economies (NIEs)[6] have become substantially less popular because of rising costs, and the USA continues to be a more attractive investment destination than Europe. The industries most favoured for manufacturing FDI are chemicals, electrical and electronic equipment (both assembly and parts), general machinery and automotive parts.

In the long term (the next ten years), companies view India and Burma as attractive prospects (Export-Import Bank of Japan, 1996). Japan's relatively small presence in Latin America and Eastern Europe could also grow.

Influence of the Yen

The yen's relative weakness at present is unlikely to halt strong FDI growth in Asia. Uncertainty about the yen's future value will drive FDI as Japanese companies seek to decrease vulnerability to exchange rate fluctuations and associated changes in competitiveness, particularly as they remain less internationalised than their counterparts in the USA and Germany (Figure 6.4). Matsushita, for example, plans to increase its overseas production ratio from 23 per cent in 1996 to 30 per cent by April 2000 (*Financial Times*, 18 January 1996, p. 23), while Toyota plans to manufacture 33 per cent of its production offshore by 2000, versus 25 per cent in 1995 (Economist Intelligence Unit [EIU], 1996a, p. 14).

Since 1989, the exchange rate has not greatly affected profitability in Asia (Figure 6.3). This suggests that even if the yen remains weak, investment in Asia will continue to be relatively profitable, given Asia's strong economic growth outlook and Japan's relatively high cost structures.

5 Because of lower risk in Europe and North America, investors would not expect either profitability or sales growth to be as high as in Asia.

6 The NIEs are Hong Kong, Taiwan, the Republic of Korea and Singapore.

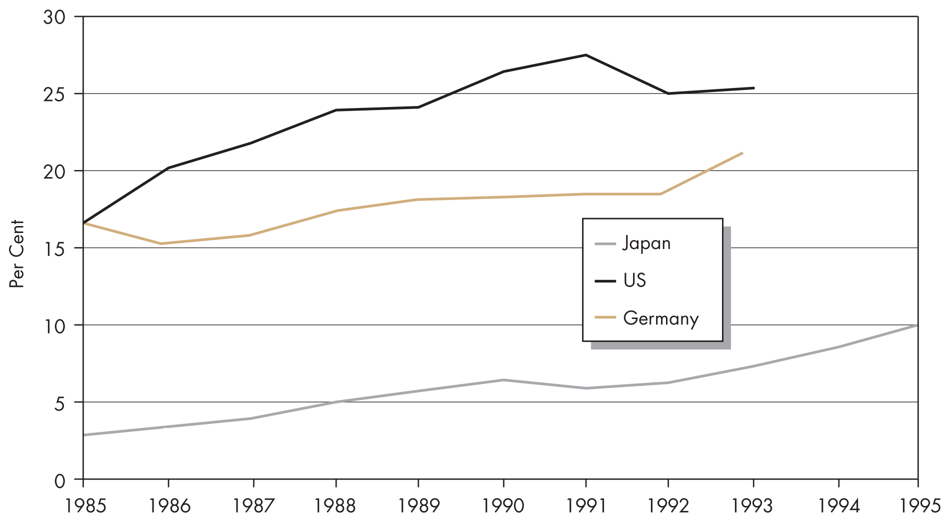
Other factors encouraging FDI in Asia include:

- the continuing trend for Japanese companies to utilise more local parts, as reflected in the relatively strong FDI intentions in the automotive parts and electric machinery parts sectors
- the growing attractiveness of the nonmanufacturing sector.

Figure 6.4

Japanese Industry Globalising

Share of Overseas Production in US, German and Japanese Output



Source: Japan External Trade Organisation, 1996.

Investment Risk

Increased investment risk in a particular country would rapidly reduce direct investment flows to that country. Many low-cost destinations, including China, Indonesia, Vietnam, India and Burma, are competing for FDI, making switching between countries relatively easy. Increased risk in one location is more likely to lead to a transfer of investment to other Asian sites, rather than a withdrawal from Asia.

Producing for World Markets and Value Adding

Offshore production of high-value-added goods is likely to gain momentum over the next decade, with production for world markets increasingly motivating overseas production. Overseas R&D will increasingly motivate FDI over the next decade (Table 6.1).

Table 6.1

Offshore Production of High-Value-Added Goods to Increase

Motivations for FDI

Motivational factors	Percentage of respondents seeing the various factors as a motivation for FDI[a] Short to medium term	Long term
Reinforcing of overseas production of high-value-added goods for host country markets	19	35
Reinforcing of overseas production of high-value-added goods for world markets	10	41
Reinforcing overseas R&D	7	30
Reinforcing domestic R&D and production of high-value-added products in Japan	33	45

Note: a. Multiple responses allowed.

Source: Adapted from Tejima, 1995, p. 81.

These trends have encouraging long-term implications for Australia's ability to attract Japanese FDI. The increasing importance of production for world markets means that Australia's small domestic market will become less important provided the country can fit competitively into the global production and innovation chain. This underscores the importance of continued microeconomic reform. Moreover, FDI expansion in high-value-added products and R&D should favour Australia, as it has comparative advantages in these areas. However, Australia needs to market these advantages if it is to win a share in emerging opportunities such as global networks for round-the-clock R&D.

EFFECTS OF FDI ON JAPAN

In addition to its impact on trade, FDI affects domestic R&D, employment, investment and the Japanese economy's ability to restructure.

Research and Development

After expanding almost 350 per cent between JFY1989 and JFY1993, R&D expenditure by Japanese offshore manufacturing enterprises fell 16.4 per cent overall in JFY1994, although it rose 19 per cent in Asia (Ministry of International Trade and Industry [MITI], 1996a). A mere 3 per cent of Japanese companies see the shift to overseas production having substantial negative effects on domestic R&D (Nakatani et al, 1996, p. 66).

Offshore enterprises help R&D in Japan as they facilitate access to leading-edge technology and integrate new production technology (Economic Planning Agency, 1995). They also allow Japanese companies to spread R&D costs over a wide range of activities and access lower-cost capabilities and highly experienced professionals offshore. This is particularly important as many technologically advanced industries vital to Japan's future, such as semiconductors, electronics, pharmaceuticals and telecommunications, have high and rising R&D costs (United Nations, 1995).

Employment

The net effects of outbound FDI on employment were positive between JFY1992 and JFY1994. They were expected to become negative in JFY1995 (MITI 1996a, p. 58). Employment in the motor vehicle industry, in particular, has declined as the industry expanded offshore.

FDI and Domestic Investment

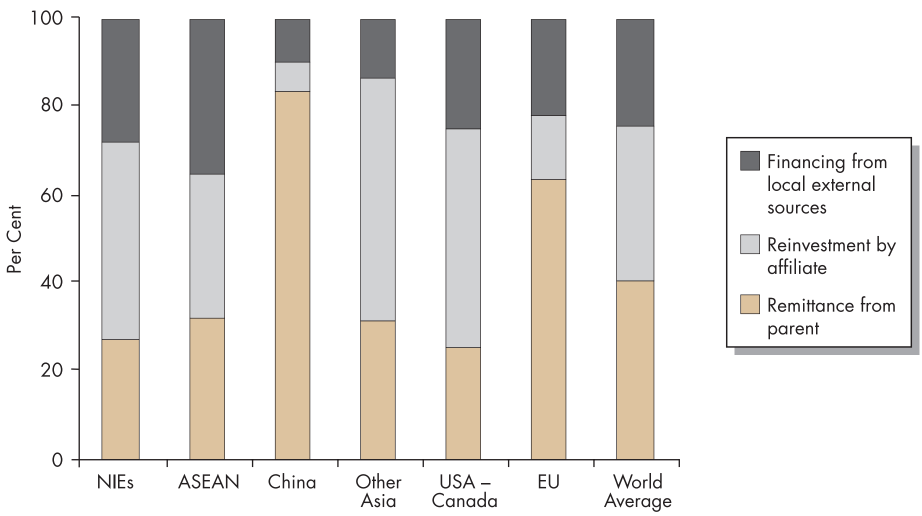
Different forces determine domestic investment and FDI, so FDI is unlikely to restrain domestic investment to a large extent.[7] This is mainly because:

- while the exchange rate significantly determines FDI in Asia, domestic demand fundamentally determines domestic investment; an appreciating exchange rate indirectly forces down domestic demand (Economic Planning Agency, 1995)
- in addition to remittances from the Japanese parent, strong reinvestment by offshore affiliates and local external financing characterise the funding of Japanese FDI, especially in more mature locations (Figure 6.5).

Figure 6.5

Reinvestment an Important Source of Investment Funding

Financing of FDI by Source and Region, JFY1994



Source: Export-Import Bank of Japan, 1996.

7 Rao et al (1994) found a positive and statistically significant relationship between outward Japanese FDI and domestic gross capital formation. The United Nations (1996a, p. 98) found that since 1988 outbound FDI in manufacturing has been associated with less domestic investment. Both these studies use Ministry of Finance data which is based on notifications and is too unreliable for econometric uses. Moreover, the United Nations used fairly crude and arbitrary econometric equations and did not explicitly account for the influence of changes in economic growth in Japan and the rest of the world, or pressures on competitiveness.

Moreover, much of the investment substitution that does occur involves restructuring whereby Japan moves out of areas in which it has lost competitiveness (Table 6.2).

Table 6.2

Restructuring Working

Japan's Export Structure, 1960 to 1994

	Per cent share of total exports				
	1960	**1970**	**1980**	**1990**	**1994**
Textiles	**30**	12	5	3	2
Steel	10	**13**	12	4	4
Motor vehicles	3	7	**18**	18	14
Electrical machinery	7	15	17	**23**	**25**
Other	50	53	48	52	55
Total	100	100	100	100	100

Source: Economist Conferences, 1996.

IS FDI HOLLOWING OUT JAPANESE INDUSTRY?

Hollowing out has been variously described as the transfer of production bases to overseas sites, a fall in domestic employment levels, a decline in technological standards, the replacement of domestic production by imports and the replacement of manufacturing by nonmanufacturing industry (Okina and Kohsaka, 1996, p. 51). Some of these changes, such as falling levels of overall employment and declining technological standards, have not occurred in Japan. Others are part of economic restructuring which underpins Japan's movement into higher-value exports (Table 6.2).

Inappropriate 'hollowing out' will occur if industries that could be competitive in Japan are forced offshore because of policy failures. Overshooting of the exchange rate caused considerable concern in 1995. More seriously, inefficiency of the domestic service sector (such as utilities, transport, distribution and finance) retain the capacity to drive inappropriate hollowing out and consequently motivate business pressure for reform of these sectors.

JAPANESE FDI IN AUSTRALIA

Of the total stock of FDI in Australia at 30 June 1995 (A$129.4 billion) Japan accounted for A$18.7 billion, or 14 per cent, compared to shares of 27 per cent for the USA and 24 per cent for the UK.[8] Japanese FDI is most prominent in finance and

....

8 These figures are derived from unpublished ABS statistics.

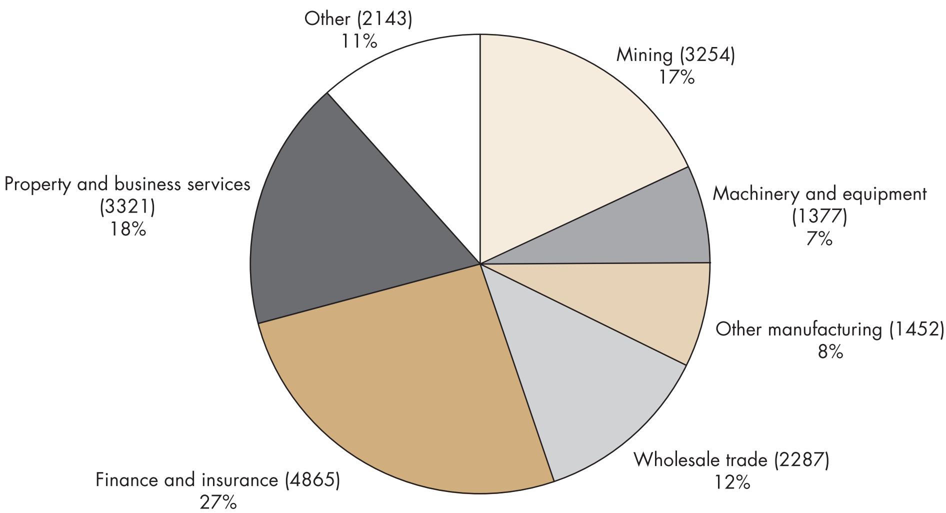
insurance, then in property, business services and mining (Figure 6.6). Manufacturing attracts 15 per cent, split between machinery and equipment, and other manufacturing.

While Australia's high competitiveness in mining and energy products is a major factor, strong Japanese investment in mining has also helped to expand exports to third markets.

Figure 6.6

Finance, Insurance, Services, Mining Predominate

Japanese FDI in Australia, 30 June 1995
A$ Million and Per Cent Share



Source: Australian Bureau of Statistics, unpublished data.

Japanese FDI in Australia totalled US$12.5 billion between 1988 and the first half of 1996, peaking in 1989 (Figure 6.7).[9] Australia's share of total Japanese FDI fell rapidly from 8 per cent in 1992 to 3.3 per cent in the first half of 1996 as Japanese FDI in Asia rapidly expanded. The decline is consistent with broader trends; a steady reduction in Australia's share of world FDI flows since the late 1980s (EIU 1996b) and Japan's increased investment in Asia at the expense of OECD countries.

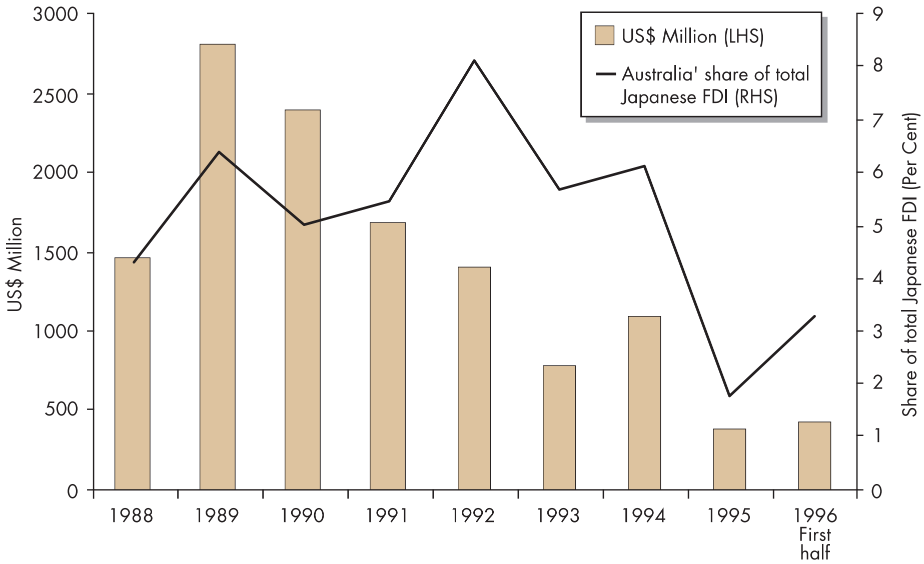
9 These Bank of Japan statistics are on a calendar year basis and are calculated using a separate methodology to the ABS statistics and thus cannot be compared directly with the ABS statistics quoted above.

The composition of Japanese FDI in Australia has changed substantially over the past decade. The shares of finance, property, business services and insurance fell markedly, while the shares of manufacturing and mining rose (Figure 6.8).[10] The change in composition is especially marked in the two years to June 1995 (Figure 6.9). Japanese FDI went to mining (A$486 million), wholesale trade (A$434 million) and machinery and equipment manufacturing (A$216 million). The investment in wholesale trade largely reflects increased activity by Japanese trading houses (discussed later in the chapter), while Toyota and Mitsubishi invested in machinery and equipment production. In property and business services, Japanese banks and real estate companies continued to liquidate assets.[11]

Figure 6.7

Direct Investment in Australia Drops

Japanese FDI in Australia, 1988 to 1995



Source: Bank of Japan, 1996.

---

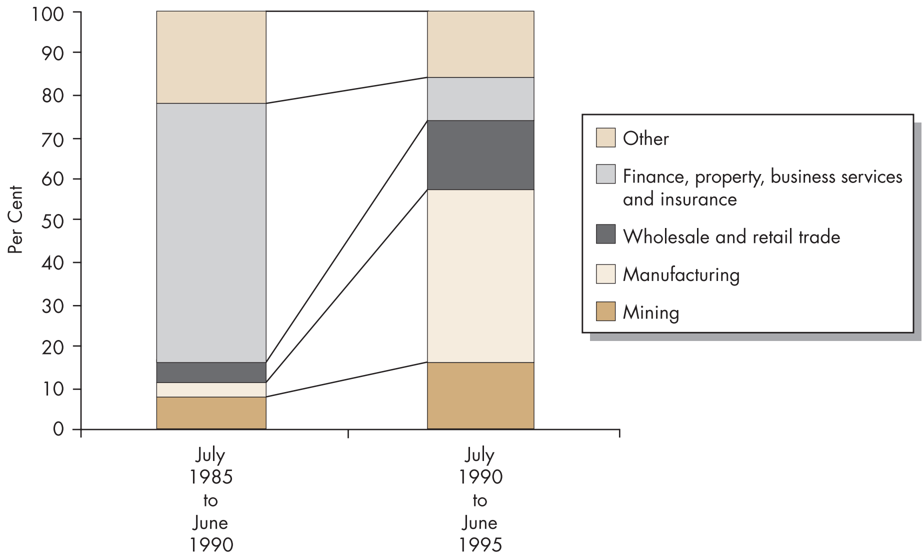
10 The change in composition is borne out by Ministry of Finance statistics on Japanese investment notifications in Australia which show a substantial fall in the share of real estate and a rise in the share of manufacturing (Australia-Japan Economic Institute, 1996a).

11 In Figure 6.8 data on investment in property and business services are not presented separately because of confidentiality restrictions between July 1985 and June 1990. Divestment in property and business services has occurred since 1992.

Figure 6.8

Manufacturing Investment Rises

Composition of Japanese FDI in Australia, July 1985 to June 1990; July 1990 to June 1995



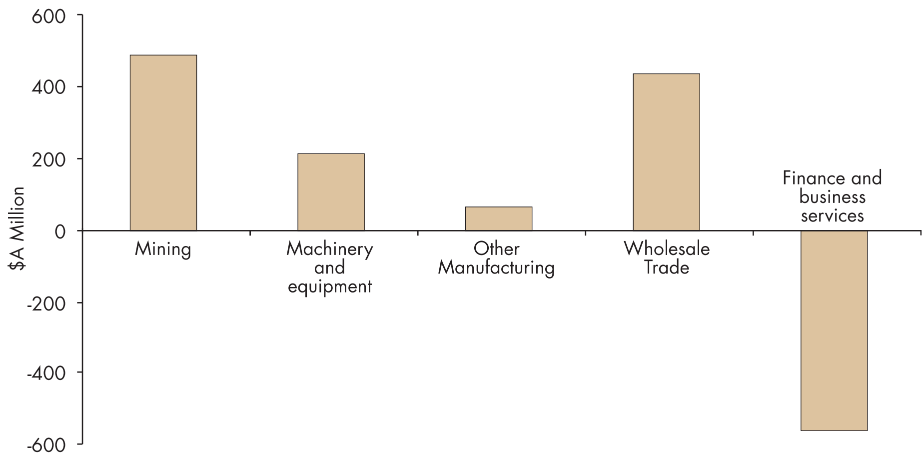
Note: These shares are approximate as data for some industries are confidential. However, this problem appears to be neither widespread nor of strong quantitative significance.

Source: Australian Bureau of Statistics, unpublished data.

Figure 6.9

Mining Investment Dominates in 1993 to 1995

Japanese Direct Investment in Australia, July 1993 to June 1995



Source: Australian Bureau of Statistics, unpublished data.

ABS data reported in this section are the best available statistics on the industry breakdown of Japanese FDI in Australia. However, their coverage is limited because:

- investment is recorded against the country which was the immediate departure point for the funds
- funds are allocated to the 'predominant industry' of a foreign subsidiary even if the funds are invested in another sector[12]
- investment funds, except reinvested profits, obtained in the host country will not show up as direct investment. If they are borrowed from a foreign bank operating in Australia which in turn obtains these funds from its parent, then they will show up as direct investment by the foreign bank's home country.

EXPORT ORIENTATION AND SUPPLY SOURCING

Two key questions arise regarding Japanese investment in Australia.

1. To what extent is it export oriented?
2. To what extent are inputs sourced locally?

Export Orientation Growing

Japanese FDI in the mining sector is highly export oriented, with overseas sales comprising 93 per cent of the total in JFY1994. A 1993 survey found that the dominant motivation for Japanese manufacturing FDI in Australia was to supply the local market (Nicholas et al, 1996).[13] Nevertheless, MITI data indicate that in Oceania, which is dominated by Australia, export orientation within manufacturing has been increasing steadily since 1992 (Figure 6.10). In manufacturing, exports of food rose from 33 per cent of sales in 1990 to 64 per cent in 1994, while exports of transport equipment rose from 3 per cent to 8 per cent of sales. The outlook remains bright. Projects recently completed or underway with substantial export potential include:[14]

- A$900 million investment in a third potline for the Boyne Island aluminium smelter
- Mitsubishi Australia's A$500 million investment in the replacement model for the Magna/Diamante range and Toyota's A$600 million investment in new model development (Mitsubishi Australia exported 1 434 vehicles to Japan in 1996 and significant numbers to the USA)

....

12 The most pertinent example of this in a Japanese context is that trading companies' investment in wholesale trade (their principal area of business) is not all occurring in wholesale trade.

13 On a scale of 1 (not important) to 4 (very important) Japanese manufacturing firms rated supplying the Australian market as easily the most important reason for investing in Australia with a score of 3.9 compared to 2.7 for supplying other countries (Nicholas et al, 1996).

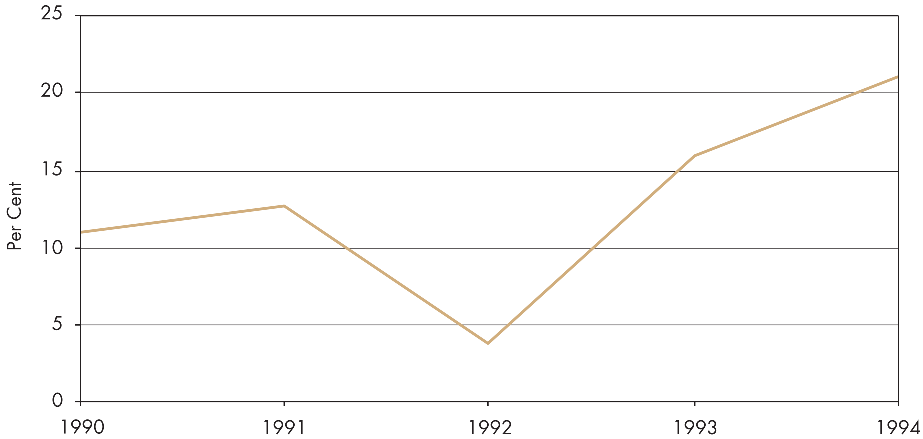
14 Because of the way ABS statistics are collected, the full value of some of these projects may not be showing up in ABS statistics.

- investment in food processing including dairy products, sake, rice crackers and infant formula (annual exports of baby and powdered food total A$115 million)
- A$90 million investment in the production of medium-density fibreboard (annual exports of A$70 million).[15]

Figure 6.10

Export Orientation Rising in Manufacturing

Export Orientation by Japanese Affiliates in Australia 1990 to 1994



Source: Ministry of International Trade and Industry, 1996c.

Most Inputs Sourced Locally

The ratio of Japanese subsidiaries' imports of intermediate goods to total purchases of intermediate goods has trended down since 1980, particularly in the manufacturing sector (Table 6.3). For plant and equipment, the share of imports in total purchases fell from 12.5 per cent in 1989 to 2.9 per cent in 1992 for all sectors, and from 9.1 per cent to 2.8 per cent in manufacturing (MITI 1989, 1992). Nicholas et al (1996) also found that Japanese operations in Australia source most inputs locally.[16]

15 All these export statistics, except for the exports of Mitsubishi, come from Austrade's records of Japanese investment projects in Australia. The statistics on Mitsubishi Australia come from Japan Automobile Importers Association (1997).

16 In contrast to the MITI results, however, Nicholas et al found that Japanese investors relied more on Australian suppliers for raw materials and component parts than for capital goods. Virtually no Japanese firms in Australia sourced inputs from other Japanese firms.

Table 6.3

Use of Local Inputs Increasing

Ratio of Imports to Total Purchases of Intermediate Goods by Japanese Affiliates in Oceania, 1980 to 1994

	1980	1987	1988	1989	1990	1992	1994
All sectors	46.2	61.8	46.6	35.5	35.5	43.0	35.8
All manufacturing	80.5	61.0	61.8	65.5	55.5	39.8	50.7
Transport equipment	97.9	60.4	53.9	72.7	57.0	40.7	71.0

Source: Ministry of International Trade and Industry, 1996c, 1992, 1989 and 1980.

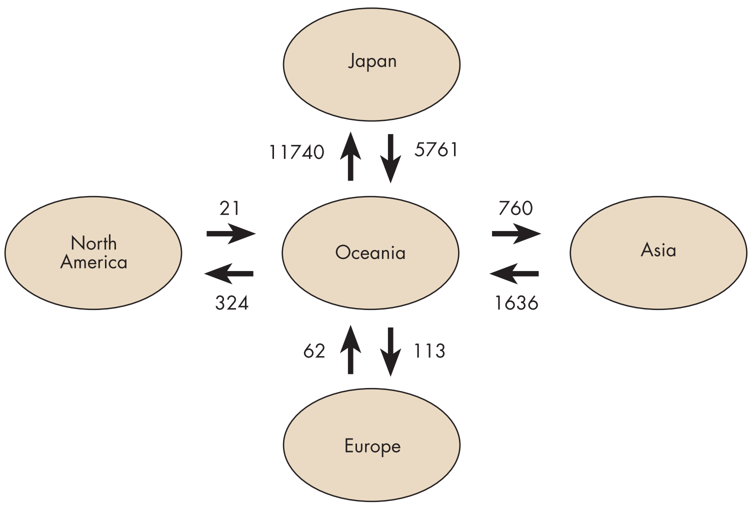
Japanese Affiliates Provide Positive Trade Effects

Figure 6.11 shows that Oceania's trade balance benefits from Japanese investment. Japanese affiliates export nearly twice as much to Japan as they import. Although they import from other parts of Asia twice as much as they export to the region, the overall balance is in Oceania's favour.

Figure 6.11

Exports of Japanese Affiliates Dominate

Trade Flows of Japanese Affiliates in Oceania in JFY1994, US$ Million



Source: Ministry of International Trade and Industry, 1996c.

ATTRACTING FURTHER JAPANESE FDI

Rapid growth in Asia, the lure of emerging markets, and the huge rich markets of North America and Europe make it very difficult for Australia to compete for Japanese investment capital. Policies conducive to attracting FDI will be vital.

Reforms to Improve the Business Environment

High rates of return are a major factor driving Japanese investment in Asia. Japanese investors are least satisfied with their Australian operations' profitability, production costs and productivity (Nicholas et al 1996). The most crucial step that Australia can take to increase Japanese FDI is to continue the process of microeconomic reform to provide a low-cost and competitive business environment.

THE TRANS-TASMAN CHALLENGE

In JFY1994, the ratio of profit to sales among Japanese affiliates in Australia was 1.4 per cent, compared to 4.8 per cent in New Zealand. Within manufacturing, the respective profit rates were 2.3 per cent and 15.6 per cent.

Source: Ministry of International Trade and Industry, 1996c.

Tariff reductions are an important aspect of the ongoing microeconomic reform process. The small size of Australia's domestic market means that in the future only internationally competitive projects within global production chains will be attractive to Japanese and other investors. To facilitate this, Australia must ensure that globally oriented manufacturing can secure inputs at internationally competitive prices. Reforms which decrease international shipping costs, increase the efficiency of ports and reduce domestic transport costs will be crucial.

Tax reform is also important. Australia as an investment site is generally competitive with Asia, but two contrasts are that:[17]

1. tax regimes in Asia impose a far lower burden on personal savings, which are ultimately utilised to finance business investment
2. Australia's narrow indirect tax base is increasingly an anomaly in the region.

The former feeds into the overall macroeconomic assessment of a country, while the latter contributes to the prevalence of seemingly arbitrary taxes, such as the fringe benefits tax and the financial institutions duty.[18]

While a 1989 JETRO survey found that labour problems were perceived as the major disadvantage to locating in Australia, a 1993 survey found that Japanese investors

....

17 Pender and Ross (1995) found that for parent companies from OECD countries wishing to invest in the Asian region, Australia's average real effective tax rates compare favourably with Indonesia, Korea, Taiwan and Thailand. Only investments into Malaysia and Singapore face lower rates. They also noted that Australia relies less on tariffs and import duties than these Asian countries.

18 The existence of seemingly arbitrary taxes emerged as a significant problem in the EIU's 1996 survey of a group of major foreign investors in Australia. This was because head offices of overseas investors found it hard to understand why these taxes were imposed (EIU, 1996b).

were fairly satisfied with their Australian labour relations and work practices (Nicholas et al, 1996, p. 5).[19] The ongoing reform of Australia's industrial relations system may have played a role in this reversal. Also, 70 per cent of manufacturing firms in the 1993 survey had successfully transplanted Japanese work practices into their operations.

However, the same survey revealed that Japanese firms saw Australian managers as 'amateurish, indulgent with labour and delivering poor product quality and customer service' (Nicholas et al, 1996, p. 5). More recently, a survey of Asian managers found that on most management qualities examined (including ability to look into the future, acceptance of responsibility and managerial expertise), Australian managers were less competitive than their counterparts in Japan, the USA, Germany, the UK and Taiwan.[20] Improving management quality could make Australia considerably more attractive, given its competitive labour costs.[21]

Nicholas et al (1996) also found that Japanese firms were dissatisfied with the Australian suppliers' reliability of delivery. Price, quality, standards and specifications, after-sales service and product availability were also 'less than satisfactory' (Table 6.4). Australian firms will need to improve their performance as suppliers to generate more business from Japanese subsidiaries in Australia.[22]

Table 6.4

Delivery Reliability a Key Problem

Satisfaction with Australian Manufacturing Input Suppliers
Standard Error in Parentheses

Criteria	Ranking[a]
Quality	2.7 (0.18)
Price	2.8 (0.15)
Reliability of delivery	2.4 (0.20)
Availability	2.5 (0.20)
Adequate standards and specifications	2.7 (0.11)

Note: a. Scores calculated by assigning 1: very unsatisfied, 2: unsatisfied, 3: satisfied and 4: very satisfied.

Source: Adapted from Nicholas et al, 1996.

19 A late 1996 survey of 55 multinationals (but no Japanese firms) operating in Australia also found that industrial relations problems were relatively minor, being only the seventh biggest hurdle to investment after high local taxes, little incentive from the government to invest, small size of the Australian market, high port and shipping costs, uncertain outlook for industry policy and physical distance from export markets (EIU, 1996b).

20 Industry Task Force on Leadership and Management Skills (1995).

21 The NSW Department of State and Regional Development (1996) provides figures which indicate that in Sydney, Melbourne and Brisbane, wages and salaries in skilled occupations (office administrator, systems analyst, accountant, engineer and plant manager) are in the bottom half of a list of major world cities, including Asian cities.

22 As seen earlier, the propensity of Japanese subsidiaries to import intermediate inputs has already fallen substantially over the last decade.

Reforms require continued and vigorous implementation to demonstrate a clear and consistent priority to industry. Corporate headquarters see this as vital for investment (EIU, 1996b, p. ix).

Specific Incentives

While less important than an attractive business environment, investment incentives are nevertheless an element which must be considered, given their availability in competing host nations. There are two broad types of incentives:

1. product-based incentives, such as tariffs and import quotas, which directly affect returns from domestic sales
2. factor-based incentives, such as cash grants and tax holidays, which directly affect after tax profits.

Product-based incentives may attract import substitution industries. However, for multinationals seeking a cheap export base such policies raise input prices (Bureau of Industry Economics, 1993, p. 155). Factor-based incentives can increase a particular site's relative attractiveness, but are unlikely to outweigh factors like costs of raw materials, local work practices and quality of infrastructure. The available evidence indicates that investment incentives are not an important factor in attracting Japanese FDI; Japanese companies rate federal and state financial assistance as of minor importance in their decision to locate in Australia (Nicholas et al, 1996).[23]

Moreover, even when incentives influence investment decisions, they may not be of real national benefit because:

- where decisions to invest are already justifiable on economic fundamentals, incentives simply transfer wealth to overseas companies
- when incentives are crucial for gaining an investment, and are made in 'bidding war' circumstances, their cost could exceed any benefits
- practical difficulties of designing, applying and monitoring effective incentives compound these problems (Bureau of Industry Economics, 1993).

23 Financial assistance from both Commonwealth and State governments was rated among the least important location factors by Japanese manufacturing, financial services and tourism firms in Australia. This indicates that such incentives are likely to be a waste of taxpayers' money, particularly when states are bidding against each other to attract investors.

THE INVESTMENT APPROVAL PROCESS IN AUSTRALIA[24]

The Australian Government welcomes foreign investment. The Foreign Investment Review Board, a non-statutory body, advises the government on foreign investment policy and its administration. Responsibility for foreign investment policy and for making decisions on proposals rests with the Treasurer.

Prior approval is required for acquisitions of substantial interests in existing Australian businesses with total assets over A$5 million (A$3 million for rural properties) or new businesses involving a total investment of over A$10 million. Projects where investment is above A$50 million are scrutinised more carefully than smaller projects. However, objections are not normally raised unless proposals are contrary to the national interest. Very few projects are rejected outright.

In restricted sectors (real estate, banking, civil aviation and media), proposed investments require prior approval against well established criteria.

FOREIGN DIRECT INVESTMENT IN JAPAN

The Japanese market is one of the largest and wealthiest in the world, yet inbound investment remains low. Between 1988 and 1995, it totalled only US$5.3 billion, just 2.3 per cent of Japanese outward direct investment over the same period.[25] In 1994, inward FDI was 0.02 per cent of Japan's GDP, compared to 0.75 per cent in the USA, 0.77 per cent in the G7 (excluding Japan) and 1.33 per cent in Australia. The low level of foreign investment is an important policy issue for Japan as industry continues to move offshore, and for Japan's trading partners as inbound investment can stimulate imports.

FDI flows into Japan were relatively strong between 1990 and 1992, but weakened during the post-bubble recession (Figure 6.12). Ministry of Finance data on investment notifications indicate that the ratio of manufacturing FDI to nonmanufacturing FDI has declined, reflecting the growing importance of services in the Japanese economy. (See Chapter 14 - *Services*.) In manufacturing, FDI focuses on chemicals and machinery, although their relative importance varies.

The dominant foreign investor in Japan is the USA. The 1990s featured three key trends: strong European investment, particularly from the UK, Germany and France, between 1990 and 1992; fairly sustained US investment from 1992; and increased Asian investment, from the NIEs and South East Asia, from 1993 (Figure 6.13).

....

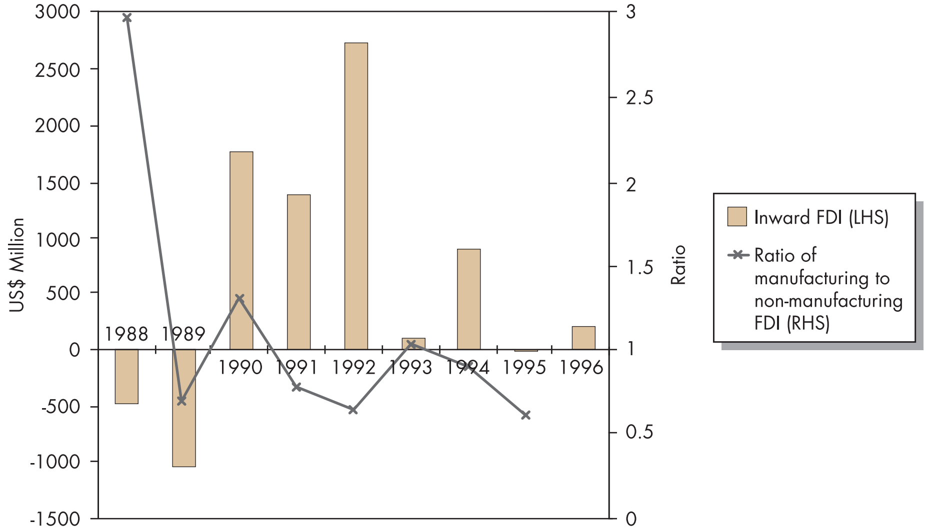
24 For further details see Treasury Department (1996).

25 Outward FDI flows in 1988 to 1995 were recorded as US$ 228 billion (Bank of Japan, 1996).

Figure 6.12

Inbound Direct Investment Remains Minuscule

Foreign Investment in Japan

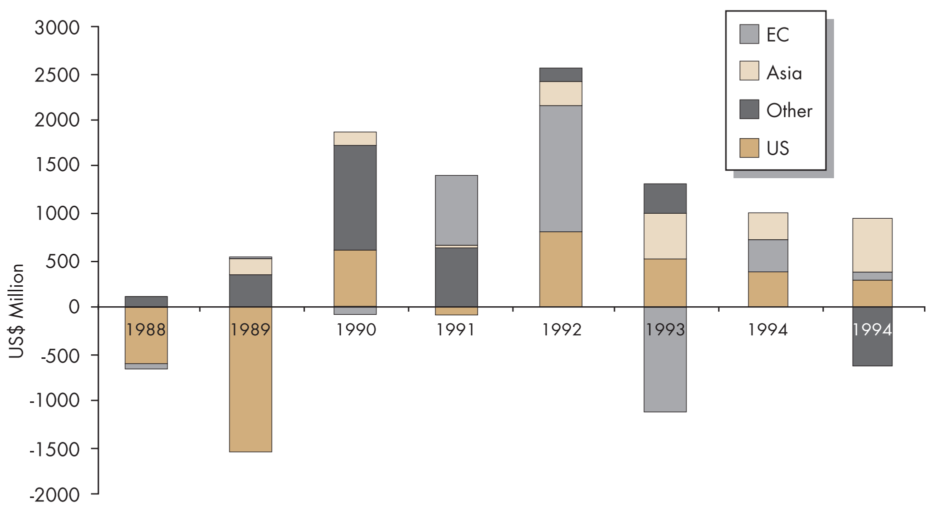


Source: Bank of Japan, 1996; Ministry of Finance data from Ministry of International Trade and Industry, 1996d.

Figure 6.13

Asian Investment in Japan Growing

Foreign Investment in Japan by Origin



Source: Bank of Japan, 1996.

Australian FDI in Japan is minuscule, compared to investment in other important trading partners (Table 6.5). Between 1988 and 1995, it constituted 0.8 per cent of total inward FDI in Japan.

Table 6.5

Australian Investment in Japan Minuscule

Australian Direct Investment in Selected Countries (A$ Million)
July 1989 to June 1995

	Japan	USA	UK	New Zealand
Australian FDI	16	5 229	7 607	3 330

Source: Australian Bureau of Statistics, unpublished statistics.

Factors Inhibiting Foreign Investment in Japan

In recent decades, official controls on FDI inflows have been liberalised gradually. Significant changes took place in 1980, when Japan adopted a policy of allowing all foreign investment in principle, and in 1992, when administrative requirements were reduced, entry requirements eased, and benefits such as tax breaks and loan guarantees offered to foreign entities to reduce start-up costs (Japan External Trade Organisation [JETRO], 1995; and *Nikkei Weekly*, 27 May 1996).[26]

Factors inhibiting direct investment flows into Japan include high business costs, especially of employment, real estate and distribution (Table 6.6).[27] Although average rents in Tokyo fell 60 per cent between 1991 and 1995, and restoration and fitout costs fell almost 50 per cent, real estate costs continue to discourage FDI in Japan (American Chamber of Commerce in Japan [ACCJ], 1995b, p. 21). Interestingly, nonmanufacturing respondents considered Japanese business practices and demanding customers to rank above business costs as factors impeding investment.

Early profits on investments are rare; it takes eight years on average to establish a positive cash flow (ACCJ 1995a, p. 21). A relatively high effective tax rate on foreign investment (principally corporate tax and withholding tax on dividends) compared to other OECD members and Asian nations, also discourages investment (Pender and Ross, 1995, p. 18).[28]

....

26 See *Information for Companies*, at the end of this report.

27 Cost is a key obstacle to FDI in Japan, according to the ACCJ (1995a) and ACCJ (1995b). A January 1997 survey ranked cost-based factors (high labour and land costs) behind unofficial restrictions and official regulations but ahead of all other constraints (*Nikkei Weekly*, 13 January 1997, p. 1). The influence of regulations as a market barrier is examined in more detail in Chapter 8 - *Market Access*. These regulations are in turn a major contributor to Japan's high costs.

28 The average effective tax rate for foreign investment into a subsidiary in Japan was 30.2% (Pender and Ross 1995, p. 18).

Table 6.6

Costs a Key Constraint

Constraints to the Establishment of Foreign Corporations in Japan Number of Companies and Per Cent[a]

Constraint	Overall	Manufacturing	Nonmanufacturing
High business costs	433 (82.8)	105 (81.5)	323 (53.2)
Japanese-style business practices	349 (66.7)	87 (66.9)	263 (66.8)
Demanding customers	319 (61.0)	85 (65.4)	234 (59.4)
Difficulty in recruiting personnel	249 (47.6)	80 (61.5)	169 (42.9)
Exchange fluctuations	213 (40.7)	57 (43.8)	156 (39.6)
Administrative procedures	167 (31.9)	35 (27.7)	131 (33.2)
Insufficient preferential treatment	137 (26.2)	33 (25.4)	104 (26.4)
Insufficient information services	111 (21.2)	32 (24.6)	79 (20.1)
Difficulty in procuring materials and parts	102 (19.5)	38 (29.2)	64 (16.2)
Difficulty in raising funds	98 (18.7)	25 (19.2)	73 (18.5)
Government regulations	98 (18.7)	28 (21.5)	71 (18.0)
Infrastructure problems	77 (14.7)	21 (16.2)	56 (14.2)
Poor residential environment	51 (9.8)	13 (10.0)	38 (9.6)
Total number of responding companies	523	130	394

Note: a. Multiple responses allowed.
Source: Japan External Trade Organisation, 1996.

Limited use of mergers and acquisitions, which are an important mechanism for establishing a quick presence in a country, has also inhibited inward FDI flows. In Japan, only 46 cases of FDI through mergers and acquisitions, were reported in 1994, compared to 423 in the USA (JETRO, 1996, p. 27). Factors that inhibit them include: opaque auditing rules; tax statements making it hard for outsiders to adequately evaluate a company's financial position; high costs; cross-shareholdings; strict limits on the establishment of holding companies; and a 5 per cent ceiling on bank ownership of stock in other corporations (ACCJ 1995b, p. 21 and EIU 1996c). However, merger and acquisition activity is increasing, with deals by foreign companies totalling US$ 1.5 billion in the first nine months of 1996. Most prominent were Ford's purchase of shares in Mazda and News Corporation's purchase of a stake in Asahi Broadcasting in association with Softbank (*Australian Financial Review*, 25 September 1996, p. 12).

Several recent initiatives should facilitate mergers and acquisitions, including:

- the easing of restrictions on holding companies[29]

[29] The impact of the liberalisation of restrictions on holding companies depends on Japan adopting a system of consolidated taxation. If such a system is not adopted, companies could face a higher tax burden if they set up holding companies.

- the availability of loans from the Japan Development Bank to foreign-affiliated companies to purchase Japanese firms
- the planned streamlining of administrative and legal procedures
- the establishment by MITI of a merger and acquisition information centre within the Foreign Investment in Japan Development Corporation (FIND). Experts at the centre provide information on procedures and maintain information on Japanese companies seeking foreign partners or buyers.

In Japan as in Australia, a favourable business environment will be as conducive to foreign investment as it will be to local investment. Deregulation of banking and insurance, including removing barriers between banks and securities companies in 1992, encouraged strong FDI growth in JFY1994 and JFY1995. The 'Big Bang' financial market reforms are likely to stimulate further FDI inflows into the banking and insurance sectors. (See Chapter 7 - *Finance*.)

ECONOMIC SIGNIFICANCE OF INWARD FDI

Foreign investment's overall contribution to total domestic assets, sales, employment, investment and R&D is slim, but is higher in manufacturing than in nonmanufacturing, and substantial in the oil products sector (Table 6.7).[30]

Table 6.7

Inward Investment Not Contributing Much to Economic Activity

The Importance of Inward FDI in Domestic Activity

	Share in domestic economic activity				
	Assets[a]	Sales[b]	Employment[a]	Investment[b]	R&D[b]
All industry	0.8	1.2	0.4	1.3	2.9
Manufacturing	2.1	2.8	1.1	3.8	3.0
- oil products	21.5	26.6	15.4	27.7	14.4
- chemicals/ pharmaceuticals	na	na	na	4.3	5.5
- general machinery	na	na	na	5.2	8.7
Nonmanufacturing	0.3	0.6	0.1	0.2	na
- commerce	0.5	0.8	0.2	1.2	na
- services	0.5	0.3	0.1	0.1	na

Note: a. JFY1993 figures; b. JFY1994 figures.

Source: Ministry of International Trade and Industry, 1997.

....

30 These data are based on surveys undertaken by MITI (MITI, 1997). The surveys do not capture all foreign-affiliated firms and had response rates of around 50%. Thus they underestimate the level of activity generated by foreign firms.

INVESTING IN TRADE?

Inward investment affects Japan's trade, with the stimulus to imports exceeding the stimulus to exports.[31] MITI reports that in JFY1994 foreign companies accounted for more than 14 per cent of Japan's imports but only 5 per cent of its exports; imports exceeded exports by ¥2 trillion (US$20.1 billion).[32] Moreover, the ratio of imports to total purchases was 37 per cent, with purchases from parent companies accounting for about 50 per cent of imports (MITI 1997, p. 9). The largest foreign company importers are in textiles (72 per cent of procurement), precision equipment (72 per cent), pharmaceuticals (71 per cent) and petroleum (49 per cent).

Inward FDI can play a critical role in tapping into Japan's import market. First, FDI in Japan can increase imports from the parent company (Wood, 1994, the Wednesday Group, 1993 and Encarnation, 1992). This effect is greater when the foreign investor controls the operation.

Second, investment in distribution networks, local representation and initial marketing for brand identification are likely to generate new business links, build loyalty among customers, allow better monitoring of tastes, provide better after-sales service and thus play a stronger role in boosting Japanese imports. BMW successfully demonstrated this in its marketing and distribution networks in Japan (Kishi and Russell, 1996). Small and medium-sized enterprises (SMEs) in Japan also recognise that a presence in the market is vital and that agents and distributors are no substitute for this (Market Penetration Taskforce, 1994a).

THE IMPORTANCE OF A JAPAN PRESENCE FOR FOREIGN COMPANIES

In the late 1970s, when all foreign brands were sold in Japan by agents or produced locally via licensing arrangements, Louis Vuitton (which makes upmarket suitcases) invested directly. This allowed it to reduce prices over time, expand volumes, present a unified image and build staff loyalty.

Catering to Japanese tastes motivated dairy products producer, DMV KK, and kitchen and bathroom hardware manufacturer, Stanadyne, to move beyond agents to a branch office. These companies found that agents had different objectives, could not be relied on for market monitoring and did not invest enough in technical support or marketing.

The local presence of Clestra Hauserman, a French manufacturer of relocatable partitions, enhanced its ability to collaborate with the small subcontractors who installed its partitions and added accessories.

Source: Kishi and Russell (1996) and Market Penetration Taskforce (1994b).

31 Econometric studies of the relations between FDI in Japan and trade yield varying results but are of little value because they use Ministry of Finance data on investment notifications which are not closely related to actual FDI.

32 Even after excluding petroleum, the figure is ¥1 trillion.

FDI is essential to establish market access in service industries like business and financial services. Inward FDI can also develop supply contracts with local companies, giving foreign firms an edge in supplying them offshore (ACCJ 1995b, p. 46).

From Australia's perspective, increased investment in Japan could strengthen our noncommodity exports. The burgeoning trade in processed food and building materials presents some of the best opportunities for inward FDI (the case study of the Australian Dairy Corporation in Chapter 5 provides an illustration).

CRITICAL SUCCESS FACTORS FOR INVESTING IN JAPAN

High costs and complex regulations are largely beyond the control of individual companies, but many key success factors lie within their grasp.[33] The most important are outlined below.

- Capitalising on Differentiating Factors

  Differentiating factors can include proprietary technology, price, brand, franchise recognition, and product functionality or uniqueness. Companies possessing two or more of these differentiators achieved average profit increases of 43 per cent during 1991 to 1994 (ACCJ 1995b, p. 11). Outstanding 'multiple differentiators' include computer firms Compaq and Apple, multiline consumer products companies such as Amway and Johnson and Johnson, and auto makers Daimler Benz and BMW.

- Quickly and Effectively Transferring Core Competences into Japan

  Amway, McDonald's, Philips and Kentucky Fried Chicken have done this effectively.

- Assessing Realisable Scale of Activity

  Failure to assess a realisable scale of activity in the huge Japanese market can result in either over or underinvestment, as well as investment decisions based on unrealistic revenue goals (ACCJ 1995a, p. 34).

- Establishing and Maintaining a Positive Corporate Image

  Image goes with extensive after-sales service, timely delivery and meticulous attention to presentation and packaging. For example, Amway has a strict code of behaviour for its distributors. It also offers full refunds (Kishi and Russell, 1996).

- Ensuring Good Management

  Management quality can often explain why one company in Japan succeeds where another fails. High-quality management was a factor in Proctor and Gamble's ultimate success in the Japanese household goods market (Kishi and Russell, 1996). Good management includes strong leadership, open communication with employees, hiring and training of good staff, and the development of a solid, unified corporate culture.

....

33 See Kishi and Russell (1996), American Chamber of Commerce in Japan (1995b) and Market Penetration Taskforce (1994) for more comprehensive discussions of these and other factors.

- ### Identifying the Right Partners

  Factors to consider include the importance of long-term relationships and networks in Japan and the critical impact of distribution methods. Strong distributor relationships are central to the success of BMW and Amway in Japan.

- ### Recruiting and Motivating Staff

  Promoting teamwork, sharing information and conveying a sense of mission to employees are important management skills (Kishi and Russell, 1996). Hiring a high-quality manager and giving him/her sufficient autonomy are important to the success of a venture.

- ### Choosing the Right Set-Up When Moving Beyond an Agent

  A branch office may be an economical first-stage but joint ventures may better meet government investment requirements or achieve economies of scale. For instance, Ericsson regarded its joint venture with Toshiba as crucial for breaking into the Japanese mobile phone market (Market Penetration Taskforce, 1994b). Subsidiaries are preferable where competitiveness is already very strong and where maintaining control and protecting proprietary skills and technology are important.

OUTLOOK FOR FDI INTO JAPAN

Overall, it is becoming easier for foreign companies to enter the Japanese market, provided they adequately prepare for a fiercely competitive business environment. Some of the factors facilitating entry include:

- leaner and more flexible operations than local companies, and lower fixed cost structures
- a more favourable regulatory and cost environment
- greater acceptance of the idea of working for a foreign company. Indeed, ambitious young people, impatient with the slow pace of advancement under the traditional Japanese system are attracted to foreign companies by merit-based promotion
- greater acceptance of foreign products, provided they compete well on quality and price with local goods. (See Chapters 8 - *Market Access* and 9 - *Distribution*.)
- liberalised merger and acquisition procedures and holding company rules, which make it easier to establish a presence.

TRADING HOUSES

There are thousands of trading companies in Japan. The largest are the general trading houses, or *sogo shosha*, which have played a major role in developing Japan's international trading links and are increasingly involved in international investment activities. Their main source of revenue has been high-volume, low-margin trade in raw materials, commodities and manufactured goods. They are among the world's largest companies and are the most internationalised of Japanese companies.[34] Marubeni is a good example.

MARUBENI

Marubeni's global network comprises 300 offices and 1 000 subsidiaries and affiliated companies in more than 100 countries. The company has a client base of 100 000 people, and a product line of over 50 000 items. Its activities include trade and marketing, investment, engineering, infrastructure development, health and education programs, and consumer services.

Marubeni Australia has a head office in Sydney and branch offices in Adelaide, Brisbane, Darwin, Melbourne, Perth, Fremantle and Noumea (Ogawa, 1996).

Despite their high degree of internationalisation, the volume of exports and imports that trading houses handle has declined (Figure 6.14). While these volumes are clearly sensitive to domestic economic activity, other factors are also involved, many of which are related to the competitive pressures created by yen appreciation. These factors include:

- the increasing tendency of retailers and manufacturers to import directly, instead of through trading houses
- the ongoing trend for manufacturers of sophisticated goods (such as cars and electronics) to deal directly with retailers or set up their own marketing and distribution channels
- the stagnation of energy-intensive industries in Japan
- the continuing move of Japanese industry offshore, and the associated expansion in intracompany trade.

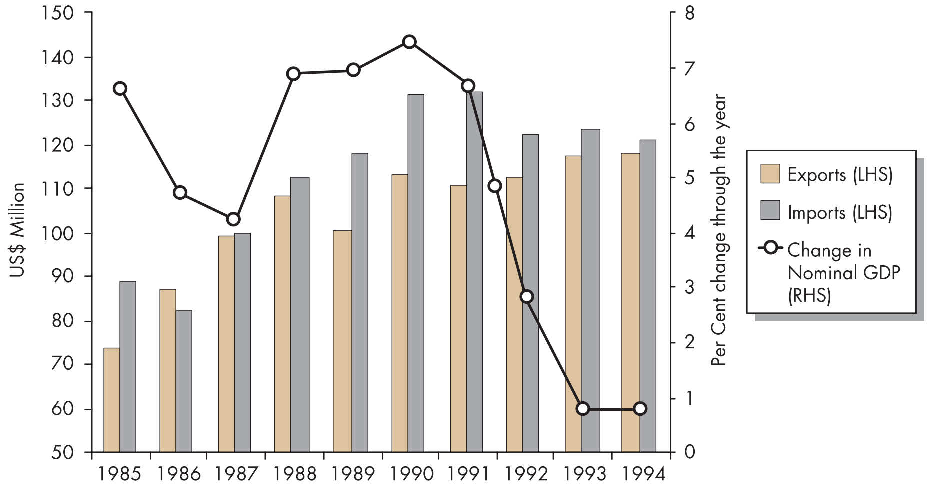
The ratio of net profit to sales, which has traditionally been low due to razor thin margins on trading house activities, has plummeted (Figure 6.15). New sources of revenue have not grown fast enough to offset the declining import-export business.

34 Of the world's 500 largest companies, based on revenue, in 1996 five Japanese traders were in the top ten: (Mitsubishi Corporation (1), Mitsui and Co. Ltd (2), Itochu Corporation (3), Sumitomo Corporation (5), Marubeni Corporation (6), with Nissho Iwai in eleventh place (*Fortune* 1996).

Figure 6.14

Trade Volumes Handled by Trading Houses Decline …

Exports and Imports of Trading Houses and Economic Activity



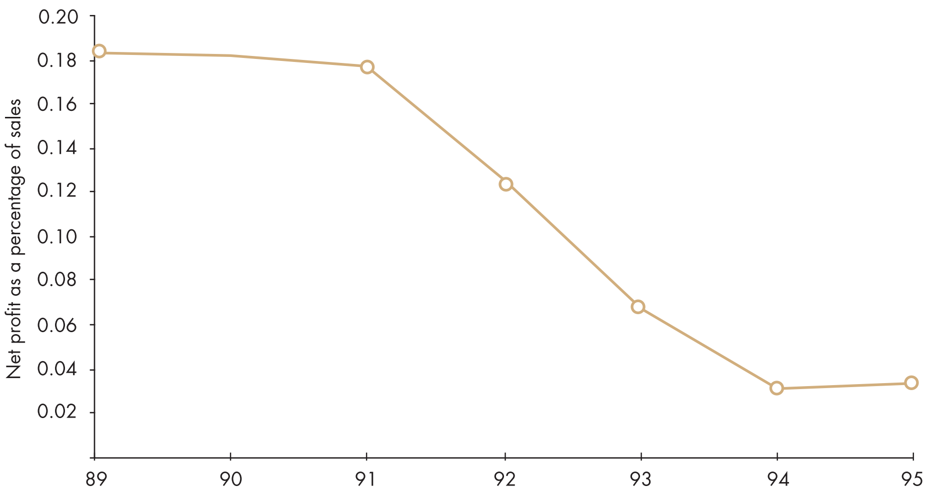
Note: These figures are for 13 companies for 1985, 17 companies for 1986-1987, and 18 companies from 1988.

Source: *Nikkei Weekly*, 1996; Organisation for Economic Cooperation and Development, 1996.

Figure 6.15

… So Does Profitability

Profitability of the Nine Major Trading Houses[a]



Note: a. The nine major trading houses are Mitsubishi, Mitsui, Itochu, Sumitomo, Marubeni, Nissho Iwai, Tomen, Nichimen and Kanematsu.

Source: Australia-Japan Economic Institute, 1996b.

WHAT FUTURE FOR TRADING HOUSES?

Despite these pressures, the outlook for trading houses is bright. Over the last decade they have reduced their dependence on trade-based activities by changing their structure and focus in Japan and expanding offshore (Figure 6.16).

Figure 6.16

Dependence on Trading is Declining

Shares of Imports and Exports in Sales: Top 9 Trading Houses

Source: Australia-Japan Economic Institute, 1996b.

The 1990s recession, falling asset prices and the slow pace of deregulation spurred a concerted effort to restructure, decrease costs, increase productivity and settle debt (Australia Japan Economic Institute, 1996b, p. 6). These efforts are ongoing and will assist trading houses as they intensify their push to diversify. The lifting of the ban on holding companies from January 1998 should advantage trading houses, providing their various business arms with greater autonomy and stronger ability to seize market opportunities. (See Chapters 7 - *Financial Markets* and 8 - *Market Access* for further details on holding companies.)

ITOCHU'S RESTRUCTURING

In April 1997, Itochu Corporation reorganised into eight in-house companies and eliminated the overall sales division. Under the new scheme, head office will allocate capital, operating funds and personnel to each of the companies, which will develop their own business plans, restructure their organisations and decide personnel matters.

The in-house companies will be involved in such activities as currency trading, securities, insurance and distribution, construction and real estate, consumer products, energy and chemicals, information and multimedia, and machinery and textiles. However, even after the holding company legislation becomes effective, whether these in-house companies will actually become in-house subsidiaries will depend on Japan moving to a consolidated tax system.

Source: *Nikkei Weekly*, 20 January 1997.

Diversification

Among the most promising growth areas in Japan are the information and telecommunications industries, in which the trading houses already have large investments (Table 6.8). Over time these investments should produce stronger earnings, higher cash flows and better capital gains (Kato, 1996). Two areas of particular promise are cable television and satellite broadcasting, which are likely to produce handsome payouts in the long term, notwithstanding some potential for competition between the two media (Kato, 1996, p. 59).

Table 6.8

Trading Houses Enjoy Communications

Investments in Domestic Communications Businesses
Yen Billion

	Itochu	Sumitomo	Mitsui	Mitsubishi	Nissho Iwai	Marubeni
Total domestic communications investments[a]	100.8	46.0	37.4	34.1	23.7	9.6
Cable TV	12.9	20.4	2.0	0.9	0.5	0.6
Satellite operations	10.5	13.8	8.5	12.6	13.8	0.4
International calls	5.5	1.8	1.8	1.8	1.2	1.2
Domestic calls	1.3	3.5	11.7	12.0	0.9	1.6
Cellular, PHS[b]	2.1	1.2	5.3	5.0	2.9	1.1
Software	4.3	2.7	1.9	0.4	1.1	0.4

Note: a. Excludes hardware sales houses and loans and guarantees, except for cable television where past restrictions on direct investment have had a large impact. b. PHS: personal handy phone service.

Source: Kato, 1996.

Trading houses are also exploiting domestic opportunities presented by deregulation of petroleum retailing and power supply and are entering the retail sector to offset the trend by retailers to import directly. (See Chapters 9 - *Distribution and 12 - Energy*.)

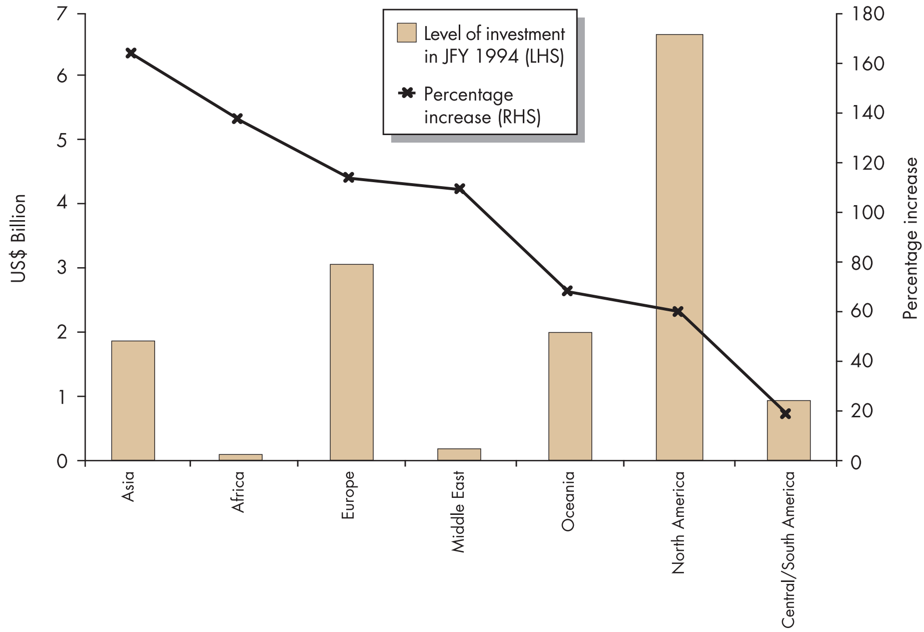
Expanding Global Involvement

The six largest trading houses have invested heavily overseas since the late 1980s and further expansion is expected (Figure 6.17). Growth will remain fastest in Asia, which will absorb 25 per cent of the overseas investment of the top five trading houses in 2000, double the level of 1994 (Kato, 1996, p. 39).

Figure 6.17

Most Investment in North America

Investment[a] by the Six Largest Trading Houses[b] by Region in JFY 1994 and Growth by Region in March 1989 to March 1995



Note: a. These figures include both direct and portfolio investment.
b. These are Itochu, Marubeni, Mitsui, Sumitomo, Mitsubishi and Nissho Iwai.

Source: Kato, 1996.

North America and Asia

North American operations have shifted from trading activities to investing in and managing local businesses. Prominent activities include processing and manufacturing food, chemicals, steel, and other industrial raw materials, as well as establishing motor vehicle dealer chains, finance and leasing companies (Kato, 1996, p. 40). Itochu and Mitsui now derive more than 60 per cent of their US profits from investments in local companies, with returns on investment as high as 20 per cent (Kato, 1996, p. 41).

Changes in Asia have also been substantial. During the 1980s and early 1990s the trading houses focused their diversification efforts on two main types of business: infrastructure projects linked to Japan's foreign aid program and the construction of manufacturing facilities and related infrastructure for Japanese and non-Japanese companies (Kato, 1996, p. 44). In addition, they continued to be heavily involved in developing resources such as liquefied natural gas.

As in the USA, the trading houses are now investing in manufacturing and processing activities, especially steel, petrochemicals and motor vehicles. Typically they provide up to 30 per cent of the total equity capital,[35] procure the raw materials, build the plants, market the final product and become involved in managing the venture after start-up.

Infrastructure Development

The World Bank forecasts that developing East Asia's demand for infrastructure will exceed US$150 billion per year in the late 1990s (*Australian Financial Review*, 18 December 1996, p. 8). The trading houses are well equipped to adapt to the demand for private sector funding being spurred by the sheer enormity of Asia's infrastructure demand. Their size and strong international connections ensure they can:

- provide finance or pull together attractive financing packages
- accept risk in infrastructure projects
- find the right international partners and suppliers with the most competitive mix of products, technology, human resources and skills
- be involved in all aspects of project design (Kato, 1996, p. 46).

The third item is of particular interest for non-Japanese companies, as the yen's appreciation and Japan's high cost structure has priced many Japanese firms out of the market. Particular areas of opportunity are engineering, heavy machinery and banking (Kato, 1996, p. 47). Trading houses are joining forces with foreign companies, as shown by Mitsui's successful bid for a build-own-operate contract for a US$2.6 billion coal-fired power station in Indonesia. Mitsui secured funds from the export-import banks of Japan and the USA, and brought in an American partner to operate the plant after start-up. Itochu also has participated in a joint venture with John Holland (an Australian engineering firm) to rehabilitate a 450-kilometre stretch of railway in the Philippines (Baldwin, 1996).

JAPANESE TRADING HOUSES IN AUSTRALIA

Trading companies have been in Australia since the nineteenth century. They are the most important conduit for Australian exports to Japan, particularly for primary commodities such as coal, iron ore, oil and gas, nonferrous metals and wool. They also export bricks and pavers, motor vehicle components, woodchips, salt and

35 According to Kato (1996), Mitsui and Marubeni are investing even more in their ventures in Malaysia and Indonesia.

processed foods. The top seven Japanese trading houses in Australia were involved in exports worth A$15.1 billion in 1995, more than our total exports to Japan and more than one fifth of Australia's total merchandise exports.[36]

Trading houses continually seek new trading opportunities in Australia. For small and medium-sized enterprises, trading houses can offer a channel for breaking into the Japanese and other export markets. They can assist in dealing with the main difficulties that SMEs have in exporting, including providing finance, market information and overseas facilities (McKinsey et al, 1993).

Investment Activities

Trading houses in Australia have traditionally invested in resources particularly coal, iron ore, and the North West Shelf gas project where trade activity is concentrated. However, the trading houses now invest heavily outside traditional areas, including in agricultural and mineral processing, highly sophisticated value-added manufacturing operations, infrastructure and services.

Joint Ventures with Australian Companies

Opportunities exist for Australian companies to form joint ventures with trading houses in third countries. In addition to the John Holland-Itochu joint venture, AWA is working with Marubeni to supply air navigation equipment to a Mongolian airport project, and Telstra is working with Itochu, Sumitomo, Nippon Telegraph and Telephone and the Indonesian Indosat on a privatised telephone network in Jakarta worth US$500 million. Barclay Mowlem Construction has an A$40 million contract from Marubeni for an overland conveyor belt for an Indonesian cement plant (*Business Review Weekly*, 27 January 1997, p. 48). Further opportunities are arising in construction, infrastructure development, mining, and livestock management.

---

36 The top seven Japanese trading houses in Australia (based on export volumes) are Mitsui and Co., Mitsubishi, Itochu, Marubeni, Sumitomo, Nissho Iwai and Kanematsu. Export figures for the trading companies are from *Business Review Weekly*, 27 January 1997, p. 54. Figures for Itochu, Marubeni and Kanematsu are for the 12 months ending March 1996. Caution is needed in interpreting these figures as trading houses may 'claim' exports on the basis of rather limited equity relationships.

SELECTED TRADING COMPANY INVESTMENTS IN AUSTRALIA, 1992 TO 1996

Manufacturing:

Sumitomo (17 per cent) and Mitsubishi (14 per cent) invested with Comalco and Yoshida in the A$900 million third potline at the Boyne Island aluminium smelter.

Nissho Iwai has a joint venture with Furakawa and possibly other trading houses and nonferrous metals companies in the A$250 million reopening and expansion of a Port Kembla copper refinery and smelter.

Mitsubishi has a joint venture with Meiji Milk Products and Murray Goulburn in an A$44 million powdered milk plant, and with BHP in an A$70 million methanol research plant.

Infrastructure:

Sumitomo and Mitsubishi have a minority partnership with Comalco, NRG Energy and Yoshida in the A$42 million Gladstone power station upgrade stage 2.

Mitsubishi has a minority partnership with BHP Australia Coal, QCT Resources, AMP and Pancontinental in the A$30 million expansion of the Hay Point coal export terminal (production starts in 1997).

Mitsui and Itochu have a joint venture with BHP Iron Ore in the A$85 million tunnel under Port Headland Harbour, infrastructure associated with a direct reduced iron project.

Mitsui and Itochu have a joint venture with BHP Iron Ore in the A$490 million infrastructure project for a hot briquetted iron plant (excludes tunnel under Port Headland harbour).

Agriculture:

Mitsui and Nippon Paper own an A$60 million eucalypt plantation near Collie (production starts in 2005).

Itochu and Oji Paper Company own a A$60 million eucalypt plantation near Albany (export of woodchips starts 10 years after planting).

Services:

Mitsui has a joint venture with Burmah Fuels and Woolworths in petrol retailing (*Australian Financial Review*, 16 October 1996, p. 1).

Itochu has a partnership with Country Road in global retailing of clothing (*The Australian*, 14-15 September 1996).

Source: Access Economics (1996), unless otherwise specified.

PROACTIVE APPROACH, GOOD BUSINESS ENVIRONMENT KEYS TO FDI GROWTH IN AUSTRALIA AND JAPAN

Japanese FDI has grown strongly since 1992, but Australia has largely missed out. Because Japanese companies employ more than 75 000 people in Australia,[37] purchase large volumes of local goods and services, and contribute heavily to exports, action is required to reverse the decline in Japanese FDI. Surveys indicate that enhancing operating conditions and the general business environment could well attract more Japanese investment. The trading houses, for example, are looking to expand and diversify their operations in Australia.

In Japan, inward FDI makes only a limited contribution to the Japanese economy. Intensified liberalisation and reform would further improve the environment for foreign, as well as domestic, investment. Australia, however, cannot be complacent. It must proactively explore investment opportunities in Japan as a way to increase value-added exports to Japan and to take advantage of emerging opportunities in a variety of sectors.

[37] This estimate of the total number of employees of Japanese companies in Australia comes from Australia-Japan Economic Institute, 1996c.

REFERENCES

Access Economics, 1996 and previous issues, *Pacific-Power Access Economics Investment Monitor*.

American Chamber of Commerce in Japan (ACCJ), 1995a, *Japan in (R)evolution: an Assessment of Investment Performance by Foreign Firms in Japan*, a joint study by the ACCJ, the Council of the European Business Community and A.T. Kearney Inc, Tokyo.

____ 1995b, 'A Wider Path Leading In: Foreign Direct Investment in Japan', *The Journal*, December, pp. 18-27.

Australia-Japan Economic Institute (AJEI), 1996a, 'Japanese Investment in Australia in Japanese Fiscal Year 1995', *Economic Bulletin*, Vol. 4, No. 6, pp. 2-6.

____ 1996b, 'Japanese General Trading Companies', *Economic Bulletin*, Vol. 4, No. 9, pp. 2-8.

____ 1996c, 'Survey of Japanese Business in Australia', *Economic Bulletin*, Vol. 4, No. 2, pp. 2-13.

Australian Bureau of Statistics data base.

Australian Financial Review, various issues.

Baldwin, R., 1996, 'A successful joint venture (John Holland Asia/Itochu)', paper presented at the Australia-Japan Economic Institute conference Australia and Japan: Business Partners in Asia, Sydney, March 21.

Bank of Japan, 1996 and previous April and November issues, *Balance of Payments Monthly*, Bank of Japan, Tokyo.

Bureau of Industry Economics (BIE), 1993, *Multinationals and Governments: Issues and Implications for Australia*, Research Report 49, Australian Government Publishing Service, Canberra.

Business Review Weekly, various issues.

Economic Planning Agency (EPA), 1995, *Economic Survey of Japan 1994-95: Toward the Revival of a Dynamic Economy in Japan*, Government of Japan, Tokyo.

____ 1994, *Economic Survey of Japan 1993-94: A Challenge to New Frontiers Beyond the Severe Adjustment Experience*, Government of Japan, Tokyo.

Economist Intelligence Unit (EIU) Australia, 1996a, 'Japan's *Keiretsu* in transition: case studies of the construction and automotive components sector', consultancy report for East Asia Analytical Unit, Sydney.

____ 1996b, *Australia's Investment Challenge: The Harsh Reality, A Foreign Investor Perspective on Australia*, EIU Australia, Sydney.

____ 1996c, *Investment, Licensing and Trading Conditions Abroad, Japan 1996*, EIU Australia, Sydney.

Encarnation, D., 1992, *Rivals Beyond Trade: America versus Japan in Global Competition*, Cornell University Press, Ithica.

Export-Import Bank of Japan, 1996, *Survey on Foreign Direct Investment*, Tokyo.

Financial Times, various issues.

Fortune, 1996, 'The Fortune Global 500', August 5 1996.

Industry Task Force on Leadership and Management Skills, 1995, *Enterprising Nation - Renewing Australia's Managers to Meet the Challenge of the Asia-Pacific Century*, Australian Government Publishing Service, Canberra.

Japan Automobile Importers Association, 1997, *Car Import News*, Tokyo.

Japan External Trade Organisation (JETRO), 1996, *JETRO White Paper on FDI 1996*, English summary, Japan External Trade Organisation, Tokyo.

____ 1995, *Investment Promotion in Japan: JETRO's Guide to Successful Investment in Japan*, Japan External Trade Organisation, Tokyo.

Kato, T., 1996, 'Reinventing the Business: Japan's Trading Companies on the Move', *NRI Quarterly,* Summer, pp. 36-59.

Kishi, N. and Russell, D., 1996, *Successful Gaijin in Japan: How Companies Are Making It in Japan*, NTC Business Books, Chicago.

Market Penetration Taskforce, 1994a, *Inside Asia: Australian Companies Becoming Local Players*, Australian Government Publishing Service, Canberra.

____ 1994b, background interview notes for Market Penetration Taskforce, unpublished.

McKinsey and Co and Australian Manufacturing Council, 1993, *Emerging Exporters: Australia's High Value Added Manufacturers*, Australian Manufacturing Council, Melbourne.

Ministry of International Trade and Industry (MITI), 1997 and previous years, *Summary of the 29th Survey of Trends in Business Activities of Foreign Affiliates in Japan*, International Business Affairs Division, Tokyo.

____ 1996a, *Summary of the 25th Survey of Trends in Overseas Business Activities of Japanese Companies*, International Business Affairs Division, Industrial Policy Bureau, Tokyo.

____ 1996b, Charts and tables related to Japanese direct investment abroad, International Business Affairs Division, MITI, Tokyo.

____ 1996c and previous years, *Survey of Trends in Overseas Business Activities of Japanese Companies*, MITI, Tokyo.

____ 1996d, Charts and tables related to foreign direct investment in Japan, International Business Affairs Division, MITI, Tokyo.

____ 1992, *A Comprehensive Survey of Foreign Investment and Overseas Activities*, MITI, Tokyo.

____ 1989, *A Comprehensive Survey of Foreign Investment and Overseas Activities*, MITI, Tokyo.

____ 1988, *A Comprehensive Survey of Foreign Investment and Overseas Activities*, MITI, Tokyo.

Nakatani, K., Hosono, K., Nakashima, H., and Moritani, Y., 1996, 'Export-Import Bank of Japan JFY 1995 Survey: The Outlook of Japanese Foreign Direct Investment', *EXIM Review*, Vol. 16 No. 1, pp. 1-68, Export-Import Bank of Japan, Tokyo.

New South Wales Department of State and Regional Development, 1996, *New South Wales Competitiveness Report*, Sydney.

Nicholas, S., Merrett, D., Whitwell G., and Purcell, W., 1996, 'Report on Japanese Foreign Investment in Australia', consultancy report prepared for East Asia Analytical Unit.

Nikkei Data base.

Nikkei Weekly, various issues.

Nikkei Weekly (ed), 1996, *Japan Economic Almanac 1996*, Nihon Keizai Shimbun, Tokyo.

Ogawa, H., 1996, 'A Japanese Trading House Perspective', paper presented at the Australia-Japan Business Outlook Conference, Sydney, March 21.

Organisation for Economic Cooperation and Development (OECD), 1996, *Quarterly National Accounts*, Organisation for Economic Cooperation and Development, Statistics Directorate, Paris.

____ 1995, *OECD Economic Surveys: Japan*, Organisation for Economic Cooperation and Development, Paris.

Okina, Y. and Kohsaka, A., 1996, 'Japanese Corporations and Industrial Upgrading: Beyond Industrial Hollowing Out', *Japan Research Quarterly*, Vol. 5, No. 2, Spring, pp. 45-91.

Rao, S., Legault, M. and Ahmad, A., 1994, 'Canadian Based Multinationals: An Analysis of Activities and Performance', in Globerman, S. (ed.), *Canadian Based Multinationals*, The University of Calgary Press, Calgary, pp. 63-123.

Pender, H. and Ross, S., 1995, *Business Taxation in Australia and Asia*, Commission Paper No. 4, Economic Planning Advisory Commission, Australian Government Publishing Service, Canberra.

Tejima, S., 1995, 'The Outlook of Japanese Foreign Direct Investment in the 1990s Based on the EXIM Japan 1994 Survey', *EXIM Review*, Vol. 15, No. 1, pp 1-107, Tokyo.

The Australian, various issues.

The Economist Conferences, 1996, 'Regional Overview: the Next Five Years', The Economist Conferences Annual Planning and Budgeting Outlook, Bangkok, 23 September.

Treasury Department, 1996, 'Policy Perspectives on Foreign Investment and the Role of the Foreign Investment Review Board', *Economic Roundup*, Spring, pp. 63-76.

United Nations, 1996a, *World Investment Report 1996: Investment, Trade and International Policy Arrangements*, United Nations Conference on Trade and Development, New York.

____ 1996b, *Trade and Development Report*, United Nations, New York.

____ 1995, *World Investment Report 1995: Transnational Corporations and Competitiveness*, United Nations, New York.

Wednesday Group, 1993, *Toward a New US-Japan Policy for the Post Cold War Era*, Congressional Policy Caucus, Washington DC.

Wood, C., 1994, *The End of Japan Inc. and How the New Japan will Look*, Simon and Schuster, New York.

Chapter 7

FINANCIAL SECTOR REFORM

Japan's financial sector, a vital link in the country's postwar economic success, has come under strong pressure since the bubble economy burst. Handicapped by heavy regulation and inefficiency, it constrains economic revitalisation. With the rapidly growing proportion of elderly in the population, a healthy financial sector is crucial to Japan's future; it is the channel through which citizens build wealth to fund their retirement and whereby savings are converted into productive investments.

While considerable liberalisation has occurred over the past two decades, further reform is essential if Japan is to preserve the living standards of its increasingly elderly population, cope with the competitive challenge of constant innovation in international financial markets and ensure its industries' competitiveness.

LIBERALISATION TRENDS IN JAPANESE FINANCIAL MARKETS

Interest rates: liberalisation of interest rates began in 1985; all interest rates were liberalised by 1994.

Corporate finance: eligibility requirements for firms wishing to issue bonds and stocks were progressively relaxed during the 1980s and early 1990s.

Relationship banking: regulations preventing banks and securities companies from entering each other's lines of business were relaxed in 1992.

Pension markets: rules restricting investment advisory companies from managing Japanese corporate pension funds were relaxed in February 1996.

Insurance markets: life and nonlife insurers were allowed to enter each other's fields from April 1996.

Holding companies: the ban on holding companies will be lifted in January 1998, making it easier for financial companies to expand into new activities.

The 'Big Bang' statement of November 1996 set out important financial market liberalisation objectives to be achieved over five years.

This chapter examines pressures on the banking, insurance and pensions sectors from bad loan problems, lack of competitiveness, globalisation of the financial services industry and the reform process. It also assesses administrative reform in the financial sector and identifies areas in which pressures will intensify. Finally it evaluates how effectively government and business are responding to these pressures, highlights reform trends and analyses the implications for foreign companies.

THE 'BIG BANG': CATALYST FOR FURTHER REFORM

The fundamental challenge for Japan's financial sector is to increase the rate of return on its assets, reduce the sector's costs and, by allocating lower cost funds to the most productive uses, improve the economy's efficiency, companies' competitiveness and society's capacity to support its ageing population. The newly elected Government of Prime Minister Ryutaro Hashimoto recognised these imperatives in November 1996, in its *Statement on Japanese Financial System Reform*.[1] The so-called 'Big Bang' statement aims to bring Japanese financial markets into line with their international counterparts by 2001. Importantly, it should act as a catalyst for further reform and when fully implemented:

- banks, securities companies and insurance companies will operate more freely in each others' main business areas
- barriers separating business undertaken by commercial, long-term credit and trust banks will be lower or nonexistent
- the foreign exchange bank system will be abandoned, enabling companies to undertake foreign exchange activities on their own account
- insurance premiums will be liberalised and commissions on stock brokerage will be deregulated
- restrictions on management of investment trusts and pension funds will be further eased.

KEY INFLUENCES ON THE BANKING SECTOR

The key factors influencing the banking sector include changing sources of corporate finance, the aftermath of the bad loan difficulties, efforts to deal with the sector's high cost structures, lack of international competitiveness and the impending passage of the holding company legislation.

Changing Patterns of Corporate Finance

Until the 1980s, Japanese capital markets were regulated heavily and credit was rationed. Banks dominated industrial finance, the stock market was fairly underdeveloped, and bond markets were inaccessible to all but public utilities, long-term credit banks and the largest, least risky firms.[2] By favouring heavily the banks and restricting alternative methods by which corporations could raise finance, the prederegulation system artificially raised the cost of capital.[3]

....

1 The Big Bang package's formal name is 'Reform of Japan's Financial System - For the Rebirth of the Tokyo Market in 2001'.

2 For comprehensive discussions of the evolution of the Japanese financial system, see Suzuki (1987) and Yoshino (1995). For an authoritative chronology of the 1980s deregulation, see Takeda and Turner (1992).

3 Calder (1993) and Bank of Japan (1993) found that in the prederegulation system, bank stocks consistently outperformed nonfinancial stocks as a result of banks earning supernormal profits on their lending.

Relaxing eligibility requirements for bond and stock issues during the 1980s and early 1990s enabled securities markets to develop rapidly. Now stock and bond issues are an important feature of corporate funding and since 1988 the commercial paper market has also been available (Table 7.1). These changes more competitively determine capital prices. Even after the collapse of the bubble economy, the primary bond market's share in GDP was double that of the early 1980s (Figure 7.1).

Table 7.1

Securities Markets Important in the 1990s

The Funding of Corporate Liabilities 1980 to 1996

Year	(1) Securities issued by corporate sector	Of which				(2) Private loans	(3) Govt loans	Trade credit
	Of which:	Bonds	Stocks	Foreign bonds	Commercial paper			
1980	8.6	2.9	5.1	0.6	0.0	48.1	5.7	37.6
1985	8.5	2.8	4.6	1.1	0.0	52.2	6.1	33.2
1988	14.6	5.2	7.1	1.9	0.4	50.7	7.3	27.4
1989	16.3	5.0	7.6	2.4	1.3	51.8	7.4	24.5
1990	18.0	4.8	8.0	3.4	1.7	51.5	7.3	23.2
1992	17.9	5.0	7.6	4.1	1.1	51.8	8.3	22.1
1994	17.3	5.9	7.5	3.0	1.0	52.1	10.0	20.5
1995	17.4	6.2	7.5	2.8	0.9	51.2	10.4	21.0
1996	17.5	6.5	7.4	2.7	0.8	50.0	10.4	22.2

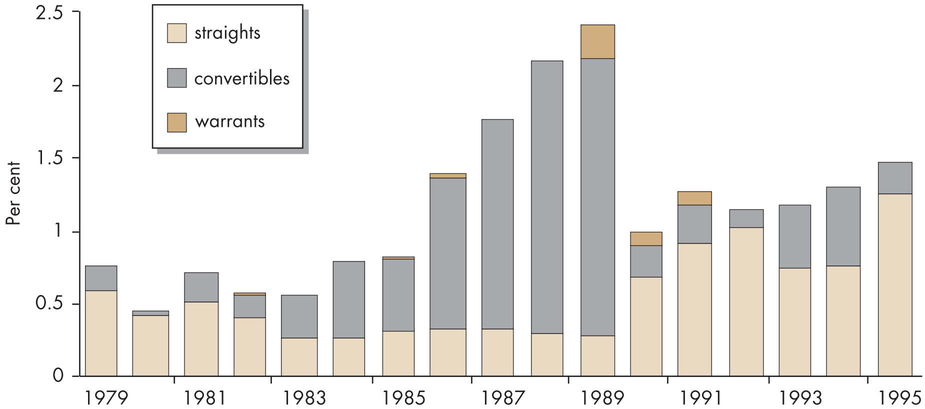
Note: 1. The sum of bonds stocks, foreign bonds and commercial paper.
2. Private loans are loans from private financial institutions.
3. Government loans are loans from government financial institutions
4. Any failure of subtotals to sum to totals is due to rounding.

Source: Adapted and updated from Yoshino (1995).

Figure 7.1

Bond Market Increasingly Important

The Primary Bond Market as a Percentage of GDP by type of bond, 1979 to 1995



Note: 1. A straight bond is a simple debt contract between an investor and a firm.

2. A warrant bond has a straight debt component but also gives the purchaser certain rights to buy up the firm's securities (usually stocks) on pre-specified terms.

3. A convertible bond is similar to a warrant bond in that it gives the purchaser the option to convert debt into equity at a certain rate and in certain conditions. However, the option to exercise rights over a firm's securities is often detachable from debt in a warrant bond and can be traded separately.

Source: Bank of Japan, 1996a.

IMPLICATIONS FOR BANKS

The increased importance of securities markets in the 1990s along with firms' stronger capacity to fund projects internally (Figure 7.2), has allowed large-scale enterprises to reduce their dependence on the banks. When stock prices collapsed in 1990, many large firms chose to switch from equity-related to straight debt (direct debt between lenders and borrowers) rather than revert to bank debt. By 1994, the largest manufacturing companies raised as much as 80 per cent of their funding directly from local and foreign capital markets (Organisation for Economic Cooperation and Development [OECD], 1996, p. 177). This decreased dependence has important implications for banks.

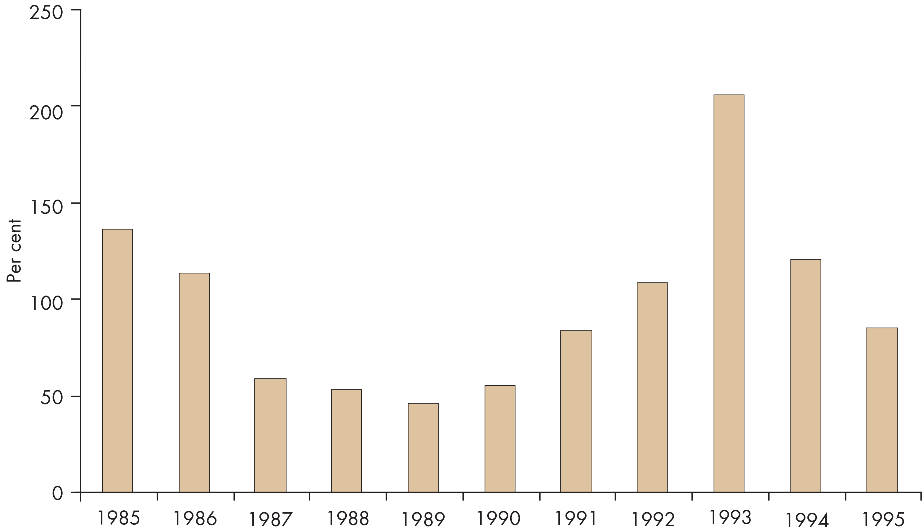
Changing Nature of 'Main Banking'

Many large firms have switched their 'main bank' affiliation. Small and medium-sized enterprises, with fewer corporate finance options, have less flexibility.

F i g u r e 7 . 2

Self-Generated Funding Strong in 1990s

Internal Funding as a Percentage of Total Physical and Financial Investment



Source: Bank of Japan, 1996c.

MAIN BANK RELATIONSHIPS

Japanese financial markets operate a system of 'main bank relationships' whereby a long-term, multifaceted relationship is forged between a firm and its 'main' bank. This system does not involve any legal mechanisms, but is understood to exist when a firm does much of its business through a single bank and when that bank has substantial shareholdings in the firm (up to a legal limit of 5 per cent of outstanding equity).[4]

Traditionally, main banks have played a major role in disciplining and controlling firms, and ensuring they are efficiently managed (often by sending in managers).

With large firms more freely switching banks, the main banks are less able to exert their former discipline. Large firms also are less willing to hold bank shares if returns are not adequate. For instance, in 1996 Hanwa Corporation, a steel trader, sold 1.6 million shares in Sumitomo Bank, its main financial backer.[5] Banks are responding by slowly selling share holdings in their customer corporations (*Asian*

....

4 In practice, there is a great deal more to main bank relationships, see Aoki et al (1994) and Sheard (1994) for more detailed discussion.

5 While no data are available for JFY1996, the share of banks in the stock holdings of listed companies only fell by 0.1 percentage point between JFY1990 and JFY1995 to 21.6 per cent (Long-Term Credit Bank, Research Institute, 1996).

Wall Street Journal, 25 July 1996, p. 1). If this trend continues, patterns of cross-ownership between banks and their clients will weaken significantly and may break down eventually. Foreign financial institutions operating in Japan see this as a positive development.

Increasing Disparities between Strong and Weak Banks

Among the large strong banks, ongoing financial sector deregulation has mitigated the effects of large firms' lower loan demand and main bank switching. These banks have expanded business through debt issues and foreign exchange transactions. Weaker banks, however, are seeking to improve efficiency by withdrawing from noncore business, making it difficult for them to expand their client relationships as their lending declines. (For further details see the section on bank restructuring.)

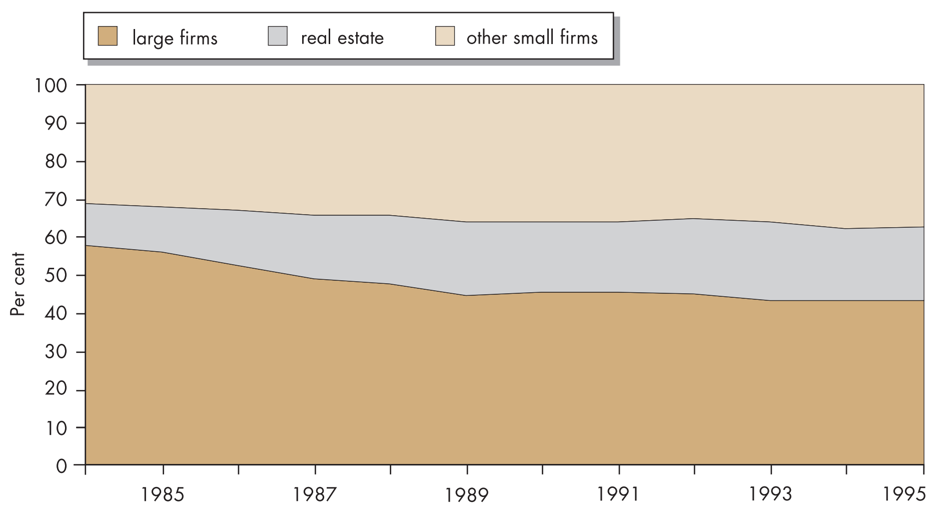
Increased Attention to Smaller Clients

Large firms' growing financial independence also encouraged the city banks to develop their clientele among smaller firms.[6] Their increased lending to real estate firms in the second half of the 1980s seriously rebounded on them when land prices collapsed in 1991. They also gradually increased their lending to other small firms, with the proportion of outstanding loans and discounts to non-real estate small firms rising by 5 percentage points between 1984 and 1995 (Figure 7.3).

Figure 7.3

More Lending to Small Firms

Composition of City Banks' Lending
1984 to 1995



Source: Bank of Japan, 1996a.

6 The ten city banks are The Daiichi-Kangyo Bank, The Sakura Bank, The Fuji Bank, The Bank of Tokyo-Mitsubishi, The Asahi Bank, The Sanwa Bank, The Sumitomo Bank, The Daiwa Bank, The Tokai Bank and the Hokkaido-Takushoku Bank. They are among Japan's largest banks.

Pressure on Margins

Until about 1988, the shift of corporate finance away from banks and progressive deregulation of deposit rates put downward pressure on bank margins.[7] However, since monetary policy easing began in 1991, the compression of average funding costs and effective lending rates has been reversed partially. This is because banks have not passed on reductions in official interest rates to their borrowers because they need to repair the bad loans damage to their balance sheets (Okina and Sakuraba, 1994). In doing so, they seem to have discriminated heavily against smaller firms. This may reflect two factors:

1. Large firms, through their access to a wide range of corporate finance instruments, have considerable power to resist banks' efforts to maintain artificially high loan rates.

2. Banks paid increasing attention to risk issues after the bad loans debacle; this led to rising risk premiums on small business lending.

Over time, as banks resolve their bad loans problems and increasingly compete for small firms' business, margins on small business loans should contract.

THE BAD LOANS ISSUE

In the mid and late 1990s, the financial system laboured under the bad loans problem which originated in the bubble economy of the late 1980s. At that time, land and stock prices rose rapidly due to an accommodating monetary policy. Banks, failing to foresee the inevitability of a correction, lent too heavily to real estate projects depending on persistent asset price inflation.

Moreover, given what they supposed was reasonable collateral (real estate), banks extended overdrafts on an unprecedented scale, with the percentage of total loans advanced as overdrafts by city banks rising from 1.9 per cent in 1980 to 17.6 per cent in 1990. This caused further problems as the uses to which overdrafts are put cannot easily be monitored.

Another strategic error that the banks made during the bubble economy years was responding to pressure on their margins by increasing turnover (Bank of Japan, 1991). This made credit screening and monitoring functions subordinate to loan promotion activities.

Impact on Financial Institutions

As a result of their imprudent lending, banks were saddled with bad loans and collateral that could be sold only on highly unprofitable terms. At the end of September 1996, the Ministry of Finance estimated total bad loans in the banking system at ¥29.2 trillion (US$266 billion), including ¥23.6 trillion (US$215 billion) in bad loans by the 20 major banks, which hold over half the nation's deposits.

7 Deposit rates were progressively deregulated between 1985 and 1994. According to Ministry of Finance (1993) data, the effect was exacerbated by a steady decline in the size of compensating balances.

Nevertheless, this estimate was a major improvement on the September 1995 bad loans estimate of ¥37 trillion (US$368 billion), due to massive loan write-offs and improved share prices.

Private sector organisations, such as the major research institutes, usually advance considerably higher bad debt estimates, with ¥50 trillion (US$446 billion) being a median estimate in late 1996. The disparity is mostly due to the Ministry of Finance figures excluding loans made by non-bank financial institutions because these overlap with bank lending to non-banks.

The ability of the banks to deal with these bad loans varies considerably. Major commercial (or city) banks are in the soundest position because although they have a substantial share of the nonperforming loans, they also have the largest reserves on which to draw. In JFY1995, the 21 leading banks wrote off an estimated ¥10 trillion (US$104 billion) in bad loans,[8] compared with only ¥4.9 trillion (US$49 billion) in the preceding year. At the end of March 1996, all city banks were above the 8 per cent capital adequacy requirement set by the Bank for International Settlements.[9]

Regional banks present a more complex picture. Many with an urban focus lent heavily in the real estate boom of the late 1980s, and now carry a heavy burden of nonperforming loans. In contrast, many regional banks that maintained their traditional lines of business emerged relatively unscathed.

Generally, the second-tier regional banks are in a more precarious position. They are widely perceived to be financially unsound, with their deposit base actually contracting slightly in 1995, despite the deposit base of regional banks growing by 8 per cent. The second-tier regional banks' precarious position is mainly due to the erosion in the 1980s of their traditional client base, small rural business, which led the banks to increase their real estate sector exposure. The erosion was caused by other financial institutions poaching business and by a structural decline in rural firms' demand for funds. The recession exacerbated these trends.

Many non-bank financial institutions, including the infamous seven failed mortgage companies, the *jusen*, are also in serious trouble, although it is difficult to gauge accurately the extent of their problems. In early 1996, Yamaichi Research Institute estimated that about 40 per cent of Japan's 19 000 non-bank financial institutions were in difficulty, with at least ¥32 trillion (US$302 billion) of their loans unrecoverable (*Nikkei Weekly*, 18 March 1996).

Agricultural cooperatives also are experiencing difficulties due to lending to the *jusen*. (See Chapter 11 - *Agrifood.)* Nevertheless, because Japan's electoral system heavily weights rural constituencies, agricultural cooperatives are likely to be supported through their current difficulties rather than reformed or abolished.[10]

....

8 There are now only 20 leading banks because of the Bank of Tokyo - Mitsubishi Bank merger.

9 The BIS ratio is the ratio of a bank's capital to risk-weighted assets. It is set at a minimum of 8 per cent under a 1988 international agreement . The ratio affects the financial leverage of banks and is designed to measure and control their solvency.

10 The use of public money for bailing out the *jusen*, to which the cooperatives lent extensively, shows the depth of political sympathy for agricultural financial institutions. However, this decision was deeply unpopular with the electorate at large.

THE COMPETITIVENESS OF BANKS

Japanese commercial banks seriously lag behind their international counterparts on most financial criteria (Table 7.2). The banks represented here often are more efficient than the smaller institutions in the Japanese financial system.

Table 7.2

Japanese Banks Lag World Standards

Principal Management Ratios for Commercial Banks of G3 Countries (Per Cent)

	Japan			USA			Germany		
Year	1990	1993	1994	1990	1993	1994	1990	1993	1994
Yield on working assets	7.7	5.0	4.6	10.8	7.7	7.7	7.8	7.6	6.7
Interest on funds raised	6.7	3.7	3.2	8.0	4.0	4.0	5.8	5.4	4.5
Profit margin	1.0	1.3	1.4	2.8	3.7	3.7	2.0	2.2	2.2
Own capital ÷ assets	3.9	4.7	4.9	6.5	7.8	7.9	8.8	7.5	7.6
Profits ÷ own capital	9.7	4.1	2.5	10.3	20.6	22.2	7.9	13.1	12.8
Expenses ÷ income	94.9	96.2	97. 6	94.1	82.0	79.8	91.9	88.3	86.9
Profits ÷ assets	0.4	0.20	0.1	0. 7	1.6	1.8	0.7	1.0	1.0
Personnel expenses ÷ assets	0. 5	0.5	0.5	1. 6	1.6	1.6	1.2	1.2	1.1

Note: Profits are current profits; the expense: income ratio is in current terms.

Source: Bank of Japan, 1996b.

In addition, banks are failing to meet international standards in sophisticated financial products and frequently fail to offer convenient and competitive services to their depositors. Foreign financial institutions have played a key role in introducing innovation and international best practice into the Japanese market. Citibank, for example, introduced 24-hour automatic teller machines, retail foreign currency bank accounts and telephone banking (*Australian Financial Review*, 28 August 1996, p. 15).

The pressures of bad loans and ongoing deregulation have intensified banks' efforts to improve their competitiveness. Mechanisms used include:

- mergers and acquisitions
- withdrawal from unprofitable lines of business
- staff reductions.

Mergers and Acquisitions

In April 1996, the Bank of Tokyo and Mitsubishi Bank merged to form the world's largest bank. Considerable rationalisation is occurring, as approximately 3 000 excess jobs are shed (*Nikkei Weekly*, 13 November 1995, p. 25). This merger unites the two banks' complementary skills. Before the merger, the Bank of Tokyo was renowned for its prowess in international financial transactions, while Mitsubishi Bank had great expertise in domestic lending.

Another important merger will take effect from April 1998 between Hokkaido Takushoku Bank (the weakest of the ten city banks) and Hokkaido Bank, a regional bank which services the same area. The combined institution will operate only in Japan (*Nikkei Weekly*, 7 April 1997, p. 1).

Increasing competition in financial markets and the persistent bad debt issue are likely to force further consolidation among banks with poor capital adequacy and profitability. Regional banks and cooperatives/credit unions are particularly strong candidates. Some of Japan's trust banks and long-term credit banks also may merge or be absorbed by the city banks. Pressures on the long-term credit banks are particularly pronounced as city banks enter large-lot commercial lending, the core business of long-term credit banks, and the large firms continue to access directly securities markets.

Restructuring

The dismantling of regulations and laws segmenting financial markets gives banks opportunities to expand their services, including establishing securities companies, managing debt issues and engaging in foreign exchange businesses. City banks, including Fuji, Dai-Ichi Kangyo and Sanwa, also are establishing subsidiaries to provide investment advice for pension funds (*Nikkei Weekly*, 16 September 1996, p. 12).

In some cases, banks are withdrawing from particular lines of business to concentrate on banking or geographic niches. Daiwa Bank, for example, is restructuring aggressively, after it lost US$1.1 billion from unauthorised trading in the USA. In April 1996, it announced a three-year plan to concentrate on its strengths: the Kansai area, the Asian market and trust business (*Asian Wall Street Journal*, 23 September 1996, p. 13). Nippon Credit Bank announced in April 1997 that it will sell all its real estate and lease it back, implement substantial staff reductions (20 per cent by March 1998), and withdraw from all overseas operations (*Nikkei Weekly*, 7 April 1997, p. 1).

The tendency for Japanese banks to withdraw from foreign operations is broadly based.[11] The trust banks reduced their overseas representative offices from a peak of 54 in March 1992 to 30 in September 1996. The regional banks, including the second-tier regionals, closed 12 overseas branches in the first nine months of 1996.

Staff Reductions

Staffing levels are being reduced across city banks, trust banks and long-term credit banks. Across the 20 major banks, employee levels will be cut by around 10 per cent over two to three years from late 1996 (*Asian Wall Street Journal*, 23 September 1996, p. 13).

11 Again Daiwa is at the forefront. It has closed all its US branches and plans to close a further 16 overseas branches by March 2000 (*Asian Wall Street Journal*, 23 September 1996, p. 13).

If carried out, this rationalisation will be significant by international standards. In Australia between 1991 and 1996 compulsory retrenchments abolished 15 000 jobs, or 10.8 per cent of bank employment (Finance Sector Union, 1997). With substantial restructuring only just starting in Japan, the banks are set to remain under strong competitive pressure, with further employment cuts likely.

IMPACT OF THE NEW HOLDING COMPANY LEGISLATION

The lifting of the ban on holding companies from January 1998 will allow entities to be established to manage shareholdings in other firms. This will affect the competitive position of banks by:

- enabling banks to expand into other sectors, such as pensions and insurance, at less cost and risk than via the present method of setting up new subsidiaries. On the other hand, this reform may facilitate the move of non-bank financial institutions into banks' main areas of business
- encouraging further mergers and acquisitions, with trust banks as particular targets
- facilitating restructuring of core business as banks transfer surplus employees to new subsidiaries. While in some cases this will let excess staff generate new income (such as venture capital businesses utilising employees with specific talents), in others it may delay necessary staff reductions.

However, two constraints must be resolved to ensure the new holding company provisions are effective:

1. without a consolidated tax system, a firm divided into subsidiaries under a holding company system may face an increased tax burden;[12] and
2. the ban on financial companies holding or acquiring more than 5 per cent of the stocks of a domestic company should be lifted.[13]

THE INSURANCE AND PENSION SECTOR

The insurance and pension sector also has experienced acute pressure, primarily due to the bursting of the bubble economy, the growing proportion of elderly in the population and deregulation.

....

12 Under the current system, each subsidiary in a corporate group is separately taxed. A system of consolidated taxation would allow tax-free dividends to the holding company to be paid and operating losses to be shared.

13 Insurance companies can acquire up to 10 per cent of stocks of domestic companies.

Life Insurance

Life insurance companies encountered four major difficulties in the 1990s:

1. Their unrealised profits on shareholdings suffered heavy falls due to the extended weak share prices.
2. As life insurers have held a fairly high proportion of their assets in foreign currency-denominated bonds over the years,[14] their failure to hedge against exchange risks proved disastrous as the yen appreciated. Moreover, with the prolonged weakness of the stock market, they have been unable to offset foreign exchange losses against unrealised capital gains on shares.
3. They are also burdened with some non-performing loans.[15]
4. The recession and low inflation have lowered average yields on assets held by life insurers.

These pressures widened the gap between the guaranteed dividend yield that insurers must pay policy holders and their average returns. In April 1996, the requirement that life insurers guarantee a minimum return of 4.5 per cent per year was lowered to 2.5 per cent per year.

Continued pressure on the life insurance sector is likely. From 1 April 1996, the door was opened for life and nonlife insurers to enter each other's fields, with 11 nonlife insurers establishing crossover subsidiaries on 1 October 1996 (*Nikkei Weekly*, 23 September 1996, p. 12). Moreover, insurance premiums will be liberalised by 2001 as part of the reform package announced on 11 November 1996.

Nonlife Insurers

Bad loan problems, low investment yields and the potential for life insurers to enter into nonlife insurance areas put pressure on nonlife insurers.[16] The agreement reached between Japan and the USA in December 1996 allowing insurers to freely set premiums on car insurance is another potential source of pressure. This will stimulate price competition in the car insurance market, almost half of the nonlife insurance sector. The 'confirmation' in October 1996 that car insurance can be sold

14 They did this because they were legally required to pay returns based only on interest income. As foreign bonds offered a higher yield, insurers held onto them, ignoring the exchange rate risk. Recent changes to this law have enabled life insurers to pay returns on the basis of capital gains as well.

15 In JFY1995, the big eight life insurance companies (Nippon, Dai-ichi, Sumitomo, Meiji, Asahi, Mitsui, Yasuda and Chiyoda) had ¥474 billion (US$4.9 billion) in disclosed bad loans and ¥1.2 trillion (US$12 billion) in restructured loans (*Nikkei Weekly*, 1996).

16 Bad loan provisions among the big five nonlife insurers (Tokkio Marine and Fire, Yasuda Fire and Marine, Mitsui Marine and Fire, Sumitomo Marine and Fire, and Nippon Fire and Marine) totalled ¥81.1 billion (US$841 million), with an average investment yield of 3.71 per cent (*Nikkei Weekly*, 27 May 1996, p.15). Six of the eight major Japanese life insurers have established nonlife subsidiaries while the other two linked up with existing nonlife insurers (*Nikkei Weekly*, 8 July 1996, p. 12).

by mail order will also stimulate competition.[17] These developments should benefit foreign insurance companies because:

- they have a better capacity to price risk than Japanese companies who have been used to heavy regulation
- their costs are lower because, unlike Japanese companies, they do not employ huge numbers of sales people.[18]

As a result, foreign companies, who sold just ¥134 billion (US$1.4 billion) of the ¥6.32 trillion (US$67 billion) in nonlife insurance premiums in 1995, are likely to increase their market share (*The Economist,* 21 December 1996, p. 108).

Pension Markets

The fundamental challenge facing Japan's pension system is coping with the rapidly growing proportion of elderly in the population. In recent years, falling returns on assets have compounded this challenge. For instance, since 1991, the average return on assets in Japan's corporate pension scheme has been between 3.5 and 4.5 per cent, well short of the 5.5 per cent rate of return necessary to fund future liabilities.

One important change that has been instituted to cope with these pressures is raising the 'mandatory' retirement age from 55 to 60 from 1998. (See Chapter 2 - *Socioeconomic Evolution*.) Moreover, from April 1997 pension schemes will be required to value assets and investment returns on market, rather than book, value. This will bring any hidden losses into the open and allow equity managers' performance to be assessed more easily.

Deregulation also is being used to improve returns. Laws governing the asset management of private pension funds have changed significantly, with further change likely. In particular:

- the limitation that no more than one-third of assets may be placed with investment advisory companies was eased from April 1996 to one-half of assets, and will be abolished by April 1999
- constraints on where funds may be invested will be eased significantly, with a 50 per cent reduction in the percentage of funds that must go to government bonds and other safe assets.

The first of these changes will make it easier for pension funds to select fund managers according to performance and will result in investment advisory firms, many of which are foreign owned, having full access to the market. This increased role for investment advisory firms will come at the expense of trust banks and life

17 No actual rule prevented direct sales of car insurance by nonlife insurers; a Ministry of Finance official was reported as saying that the announcement on car insurance was made to 'confirm that there is room for mail-order sales of auto insurance in the Japanese market' (*Nikkei Weekly*, 7 October 1996, p. 12).

18 The big five Japanese nonlife insurance companies employ 270 000 sales people (*The Economist*, 21 December 1996, p. 108).

insurers who dominate management of private pension funds[19] and offer little variety in returns, risk or portfolio structures. Life insurers are likely to be particularly hard hit as a result of the reduced guaranteed return that they offered in April 1996.

The second change may increase investment in foreign securities and domestic equities and lead to greater variation in fund managers' performance.

In the public pension system, which accounts for around 70 per cent of total assets managed in Japan's pension schemes (Takahara and Tanaka, 1996, p 61), deregulation has been much more limited. The Ministry of Health and Welfare now allocates a tiny proportion of assets to specialist fund managers.

THE FUTURE OF TOKYO'S FINANCIAL MARKET

Japan is central to development in the Asia-Pacific region and home to some of the world's largest corporations; this will sustain Tokyo's status as an important financial centre. Its well developed communications networks, well populated capital and money markets, vigorous corporate finance activity and strong demand for sophisticated financial management will underpin the Tokyo financial market's continued development. However, 'financial hollowing out', moving financial transactions normally carried out domestically to overseas markets, could reduce Tokyo's prominence as a financial centre. A major motivation of the November 1996 'Big Bang' reform package was concern that Tokyo's financial market could not compete with New York or London and that Hong Kong and Singapore were increasingly challenging Tokyo for business.[20]

According to the Economic Planning Agency (1995, p. 253), frequently quoted examples of hollowing out in Japanese financial markets are:

- rising trade in Japanese stock on the London market
- rising trade in Nikkei 225 futures on the Singapore International Monetary Exchange
- falling volume of exchange rate transactions on Tokyo markets
- withdrawing of foreign stockbrokers from Tokyo markets
- fewer foreign firms listed on the Tokyo Stock Exchange
- shifting by nonresidents from samurai bonds (yen bonds issued in Japan) to Euro-yen bonds (issued offshore).

The combination of weak Japanese economic growth relative to Asian and other OECD countries and structural problems have driven these trends. Although rents and other operating costs have fallen since the bursting of the bubble economy, Tokyo remains very expensive, particularly as transaction volumes are declining.

[19] In JFY1995, trust banks and life insurers had shares of 56 per cent and 39 per cent, respectively, of employee pension fund assets. Investment managers held the remaining 5 per cent (Organisation for Economic Cooperation and Development, 1996, p. 181).

[20] See for instance Dr Alan Greenspan's comments as reported in the *Australian Financial Review*, 20 November 1996, p. 1 and *Sydney Morning Herald*, 13 November 1996, p. 30.

Taxes also hinder financial transactions in Tokyo. For instance, the higher tax rate on domestically issued bonds and the comparatively high commissions and fees in Tokyo encourage offshore issues, contributing to financial hollowing out.

Other factors driving financial hollowing out include:

- the system of fixed brokerage commissions
- the antiquated settlements system for some financial instruments and disparities between domestic and international accounting standards
- bureaucratic conservatism, particularly the resistance to developing new and sophisticated financial products
- lack of transparency in the regulatory regime, due to Ministry of Finance intervention.

Successfully implementing the 11 November 1996 reform package designed to bring the regulatory structure of Tokyo's financial markets into line with other major financial markets by 2001 should address many of these factors. The package will continue the move away from the administered, discretionary environment that has characterised Japan's financial markets, deregulate commissions on stock brokerage and ensure that Japanese accounting practices correspond with those in most other OECD countries.

IMPLICATIONS FOR AUSTRALIAN FINANCIAL INSTITUTIONS

The need for a financial institution to be physically represented where it trades has diminished over time and consequently many foreign firms have reduced their Tokyo operations. However, new opportunities are opening up in the pension and insurance markets and in the banking sector.

Pension and Insurance Markets

Foreign firms' access to Japan's pension and insurance markets has improved. As discussed previously, opportunities to manage pension funds and provide nonlife insurance are expanding steadily. Foreign firms usually have lower costs, a better capacity to price risk and strong money management skills. As the process of liberalising Japanese insurance premiums continues, these opportunities should spread to life insurance. One option for foreign firms is to acquire a small to midsize Japanese company through the share market.[21]

As part of the reform of the insurance industry, large Japanese life and nonlife insurance companies will be allowed to enter the so-called 'third sector' of Japanese insurance, covering products like personal accident, nursing and cancer insurance. This will increase pressure on foreign operators as they currently have a 35 per cent share in such segments (*The Economist*, June 15 1996, p. 79).

....

21 Allianz Fire and Marine Insurance Japan Ltd, a subsidiary of Germany's Allianz Group, is reportedly considering this option (*Nikkei Weekly*, 3 February 1997).

GIO JAPAN SMALL YET VIABLE

Australia has a minimal presence in the Japanese nonlife insurance sector. However, GIO Reinsurance is one Australian company that has carved out a market niche and challenged the myth that the only way to enter the Japanese market is on a large scale.

GIO's presence in Japan began in 1986. Its Japan office has one Australian representative and a Japanese secretary. GIO's clients are the 21 Japanese nonlife insurers, but after the recent deregulation in the Japanese insurance market, six potential new clients have emerged. This fairly limited market and GIO's focus on nonlife reinsurance have helped make its operation feasible, despite its very small size.

The yen appreciation in recent years led GIO to reduce the number of contracts it wrote in Japan, as ultimately its exposure to risk is in Australian dollars. Premium income peaked at A$40 million for a few years, then fell to around A$30 million, causing some tensions with clients.

GIO considers Japan a difficult market. The key lessons of its experience include:

- recognising the importance of doing things the way they are done in Japan, rather than the way they usually are done at home
- being aware of the importance of long-term relationships with customers.

GIO considers it an important advantage that its representative is highly knowledgable about and immersed in the society in which he works. It is also important to have a representative who understands Australian practices and can speak clearly on Australia's market deregulation experience.

Source: EAAU interview.

Banking

In recent years, opportunities for foreign firms in Japanese banking have not received the same high-profile coverage as those in the pension and insurance markets. Much of the demand for foreign banks in Tokyo stems from Japanese banks' lack of expertise in sophisticated financial products. Derivatives markets are a prime example. The low level of derivatives trading in Japan suggests that Japanese financial institutions do not fully meet the needs of their clients for derivatives and that opportunities exist for capable foreign firms.[22] For instance, a number of foreign banks currently provide Japanese oil refineries and chemical companies with

[22] At the end of 1993, Japan accounted for about 34 per cent of the value of stocks and bonds traded in the USA, Japan and Europe, yet it accounted for a mere 9.6 per cent of the derivatives associated with those instruments (Economic Planning Agency, 1995). Japanese commercial banks still make over 80 per cent of their income through interest receipts. US banks present a stark contrast; reflecting the much broader range of transactions in which they engage, they make only about half of their income this way (Economic Planning Agency, 1995).

commodity swaps. Japanese banks have not provided swaps because they believed the Banking Law's prohibition on banks dealing in commodities also applied to these instruments. Although the Ministry of Finance recently ruled out this interpretation, Japanese banks have yet to develop expertise in commodity swaps.

Another example is in foreign exchange. Foreign banks tend to be more skilled in settlement and risk participation, and are highly price competitive. Consequently, foreign banks' business is likely to expand from April 1998 when revisions to the Foreign Exchange and Foreign Trade Control Law take effect.[23]

Foreign banks also have expanded their standard lending activities, with loans and discounts growing by 9.0 per cent in 1995 and by a further 11.6 per cent in 1996, to their highest level since 1992. This growth is driven by Japanese banks' financial difficulties and, in particular, the premium they pay on borrowings in international capital markets.[24] Penetration is still extremely low, with these loans and discounts comprising only 1.6 per cent of the total loans and discounts of domestically licensed banks (Bank of Japan, 1996a). However, over the long term, further growth is likely as main bank relationships continue to weaken. If foreign banks improve their effective penetration of the market by expanding their automatic telling and computer banking networks or developing links with domestic banks, growth could be even stronger. The agreement between Citibank and the Ministry of Post and Telecommunications is an interesting development, securing Citibank access to 23 000 Post Office ATM machines (*Nikkei Weekly*, November 25 1996, p. 1).

ADMINISTRATIVE REFORM IN THE FINANCIAL SECTOR

In addition to the ongoing deregulation of Japan's financial markets, administrative reform in the financial sector is underway. This important process will affect the Ministry of Finance's powers, the oversight of bank and non-bank financial intermediaries and the role of state financial institutions.

The Ministry of Finance's perceived failure to foresee and prevent the *jusen* problem, and its general inability to control the financial sector's risk exposure during the late 1980s, generated intense debate about the supervision of financial institutions in general and the Ministry of Finance's role in particular.

23 See *Nikkei Weekly* (3 March 1997, p. 1) for further details.

24 This is the so called 'Japan premium' which reached a level of more than half a percentage point on three-month Euro-Yen loans in the wake of the Daiwa Bank scandal in the USA (*The Asian Wall Street Journal*, 23 September 1996, p. 13).

ANZ'S OPERATION IN JAPAN

All four major Australian banks are in Japan. With branches in Tokyo and Osaka and 89 employees, ANZ is the largest. ANZ has three main lines of business in Japan.

Important aspects of this business include providing bid and performance bonds for Japanese companies undertaking projects, predominantly in Asia; and letters of credit and other trade services.

In bid bonds, ANZ guarantees companies can meet their contractual obligations for a project when they are at the bidding stage. In performance bonds, ANZ guarantees that obligations can be met once the contract has been awarded.

Personal Banking

This line of business includes providing:

- foreign currency deposits (largely in Australian and New Zealand dollars)
- property loans for purchases of Australian property by Japanese citizens and Australian expatriates
- remittances from Japan to countries such as the Philippines, India and Pakistan
- banking for Japanese students studying overseas.

Providing foreign currency deposits has grown rapidly in recent years as Japanese citizens take advantage of higher yields offshore and seek profits by holding assets in appreciating currencies. One rationale for ANZ's involvement with student banking is to establish a long-term client base among future high net worth individuals.

Treasury Business

This includes: wholesale foreign exchange activities on both the spot and forward markets, largely in Australian and New Zealand dollars, and yen; and money market services.

Overall, ANZ's operation in Japan is regarded as quite profitable, compared to other foreign banks. However, the operating environment is tough, with high operating costs and taxes. Focusing on niches where ANZ's competitiveness is strong is a key ingredient of its success. For example, ANZ's extensive network in Asia allows it to provide competitive exchange rates and other services to facilitate crossborder business, while its Australian base is an advantage in providing competitively priced foreign currency deposits in high-yielding Australian and New Zealand dollars.

ANZ is closely monitoring Japan's ongoing financial sector deregulation. Its growth strategy in an increasingly deregulated environment includes moving into investment banking activities and integrating a securities presence into its Treasury business.

Source: EAAU interview.

Progress

One area where the new arrangements have become clear is prudential supervision. The Government has announced that a new agency, tentatively called the Financial Supervision and Inspection Agency, will be established under the auspices of the Prime Minister's Office. It will assume the Ministry of Finance's responsibility for overseeing bank and non-bank financial intermediaries and securities markets from the end of March 1998. The new agency will be responsible for resolving institutional failures and other difficulties, consulting with the Ministry of Finance where public funds are required.

While the agency will oversee non-bank financial institutions, it will, in line with present practice, share this responsibility with the Ministry of Agriculture, the Ministry of International Trade and Industry, and other agencies for agricultural cooperatives, labour cooperatives and leasing companies. This is a disappointing outcome as it continues the lack of clarity in regulatory responsibility for regional non-bank financial institutions; this significantly contributed to the failure of the regulatory system in relation to the *jusen*.

The Ministry of Finance also established a three-stage process for handling troubled financial institutions which the new agency would ultimately be expected to adopt.

1. Stage 1 would require institutions to develop a financial recovery plan that would satisfy regulators. It would be triggered if an international institution's capital-to-assets ratio fell below 8 per cent, or 4 per cent for institutions operating domestically.
2. Stage 2 would entail direct intervention such as closing branches, reducing asset/loan portfolios and ending dividend payments. This would be triggered if capital-to-asset ratios fell below 4 per cent for international institutions and 2 per cent for domestic entities.
3. Stage 3 would be triggered by institutional insolvency, when an institution would be closed.

However, concerns remain that the consultative requirements in such events among the new agency, the Ministry of Finance and the Cabinet are not sufficiently transparent.

Another issue which is part of the administrative reform process and which has important implications for the smaller regional financial institutions, is the practice of retiring Ministry of Finance bureaucrats into positions in private banks, generally the smaller regional banks, cooperatives and credit unions. Once regarded as a way of maintaining communication between the Ministry and the banks, the practice is now suspected of breeding incestuous relations between the regulatory Ministry and banks whose conduct it must regulate.

A key strand of the administrative reform process is to reassess the appropriate role of government within the economy. Within the financial sector, the efficiency and desired profile of Japan's state financial institutions is a key issue. Currently 13 state financial institutions are controlled by nine government instrumentalities. The increase in significance of government loans for corporate finance suggests that state financial institutions are crowding out private sector lending activity (Table 7.1). If the Japanese financial system is to become 'free' and 'fair' as Prime Minister

Hashimoto's November 1996 statement envisages, then this preponderance of state financial institutions needs urgent attention.

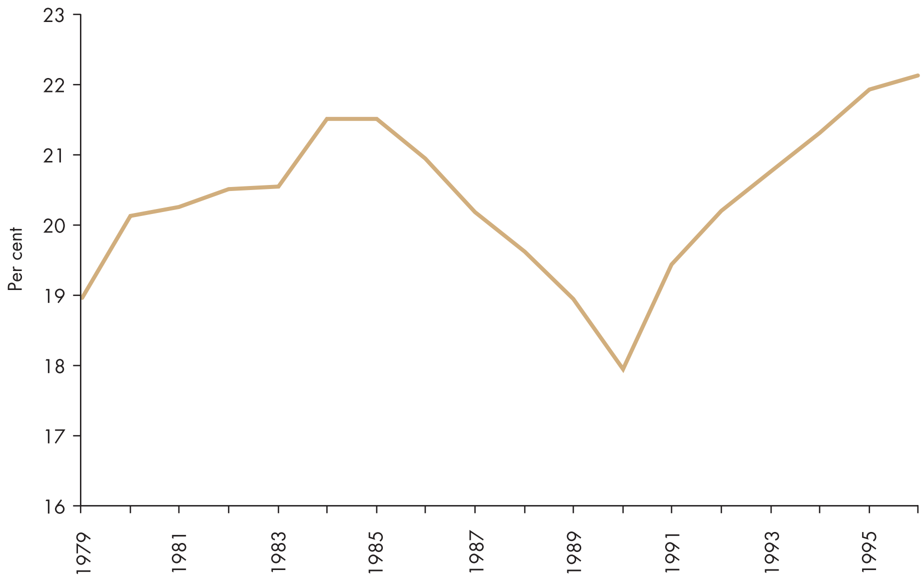
THE POSTAL SAVINGS SYSTEM

Probably the highest priority area for reform is Japan's postal savings system. Japan's postal savings system is the largest savings institution in the world. Its importance relative to total personal savings in Japan declined steadily throughout most of the 1980s, but rebounded in the 1990s (Figure 7.4). This is largely due to the system's safe haven status in periods of private bank crisis.

Figure 7.4

Postal Savings Still Very Important

Postal Savings as a Proportion of Total Personal Savings 1979 to 1996[a]



Note: a. 1996 figures are provisional.

Source: Bank of Japan, 1996a, 1996c.

In coming years, the proportion of total personal savings in postal savings is expected to fall, although postal savings will remain very substantial in absolute terms. The main factors affecting postal savings will be:

- growing confidence in private banks as their bad loans problems are resolved
- the spread of automatic telling which will enlarge the private banks' branch network
- the continued emergence of new savings instruments.

Priorities for Reform

Most postal savings system funds go to government bonds, housing loans, loans to public corporations, like the National Highway Authority, and local government investment projects, rather than their best available use by the market. As Japan's savings rate continues to fall, it is imperative that this vast pool of savings be allocated more efficiently with a greatly strengthened role for market forces. Indeed, postal savings are so important to Japan's total savings that privatisation of the postal system, including the postal savings system, should be considered as Minister for Health and Welfare Koizumi advocates.

Another problem is that the postal savings system is exempt from various fees and taxes that apply to other financial institutions, including deposit insurance.[25] This creates an unequal regulatory environment in the savings market.

FUTURE PROSPECTS

Since the early 1980s, Japan's financial markets have undergone profound regulatory changes, accentuated by new methods of corporate financing, the bad loans problem, lack of competitiveness, poor return on assets and population ageing. These factors have altered bank-client relationships, particularly among large firms, widened gaps between strong and weak banks, and opened up significant opportunities for foreign firms, particularly in pension and insurance markets.

Looking forward, three key factors have the capacity to improve the health of the Japanese financial sector:

1. implementing completely the financial sector reform package announced by Prime Minister Hashimoto in November 1996 (vested interests opposing liberalisation include the weaker banks,[26] the 230 securities firms that earn commissions on share trading and from selling mutual funds, and the many insurance salespeople).
2. removing the public sector from the provision of financial services by reforming and rationalising the large number of government financial institutions (removing concessions for the postal savings system and increasing its commercial orientation is particularly urgent, given its importance in absorbing and investing Japanese savings).
3. strengthening the regulatory regime for bank and non-bank financial institutions, by removing overlapping administrative jurisdictions.

25 Government guarantees on the security of postal savings mean that taxpayers provide implicit deposit insurance for postal savings.

26 One disturbing development is the decision to mount a A$170 billion rescue of Nippon Credit Bank, the weakest and smallest of Japan's three long-term credit banks, with funds from the central bank, the Bank of Japan, private banks and insurers (*Australian Financial Review*, 8 April 1997, p. 10).

REFERENCES

Aoki, M., Patrick, H. and Sheard, P., 1994, 'The Japanese Main Bank System: An Introductory Overview', *EDI Working Papers 94-2*, Economic Development Institute of the World Bank, Washington DC, pp. 94-92.

Asian Wall Street Journal, various issues.

Australian Financial Review, various issues.

Bank of Japan, 1996a and previous issues, *Economic Statistics Monthly*, Bank of Japan, Tokyo.

____ 1996b and previous issues, *Comparative Economic and Financial Statistics, Japan and Other Major Countries*, International Department, Bank of Japan, Tokyo.

____ 1996c and previous issues, *Economic Statistics Annual*, Tokyo.

____ 1993, 'Japanese Banks' Capital Ratio and Their Earnings Trend: An ROE analysis', *Special Paper No. 230*, Bank of Japan, Tokyo.

____ 1991, 'Recent Developments in Lending Rates: Changing Behaviour of Banks under Interest Rate Liberalization' *Special Paper No. 206*, Bank of Japan, Tokyo.

Calder, K., 1993, *Strategic Capitalism: Private Business and Public Purpose in Japanese Industrial Finance*, Princeton University Press, New Jersey.

Economic Planning Agency (EPA), 1995, *Economic Survey of Japan 1994*-95*: Toward the Revival of a Dynamic Economy in Japan*, Government of Japan, Tokyo.

Finance Sector Union, 1997, The Finance Sector Union: Second Submission to the Wallis Enquiry: Response to Financial System Inquiry Discussion Paper, Submission Number 000104, Canberra.

Long-Term Credit Bank Research Institute, 1996, 'Corporate Finance - Japan Enters a New Phase', *LTCBR Monthly*, No. 15, December.

Ministry of Finance, 1993, *Financial Statistics Monthly*, Vol. 467, Tokyo.

Nikkei Weekly, various issues.

Organisation for Economic Cooperation and Development (OECD), 1996, *Economic Surveys: Japan 1996*, Organisation for Economic Cooperation and Development, Paris.

Okina, K. and Sakuraba, C., 1994, 'Bank Balance Sheet Adjustments and Interest Rate Policy in Japan', in *National Differences in Interest Rate Transmission*, Monetary and Economic Department, Bank for International Settlements, Basle.

Sheard, P., 1994, 'Main Banks and the Governance of Financial Distress', *EDI Working Papers 94-7*, Economic Development Institute of the World Bank, Washington DC, pp. 94-97.

Suzuki, Y. (ed.), 1987, *The Japanese Financial System*, Clarendon Press, Oxford.

Sydney Morning Herald, various issues.

Takahara, N. and Tanaka, H., 1996, 'Improving Japan's Corporate Pension Plan System', *Nomura Research Institute Quarterly*, Vol. 5, No. 2, pp. 60-79.

Takeda, M. and Turner, P., 1992, 'The Liberalisation of Japan's Financial Markets: Some Major Themes', *BIS Economic Papers No*. 34, Bank for International Settlements, Basle.

The Economist, various issues.

Yoshino, N., 1995, 'Changing Behaviour of Private Banks and Corporations and Monetary Policy in Japan' in Sawamoto, Nakajima and Taguchi (eds), *Financial Stability in a Changing Environment*, Bank of Japan and St Martins Press, Tokyo.

Chapter 8

HOW OPEN IS THE JAPANESE MARKET?

Japan is perceived as a difficult and complex market, closed and unique. While official tariff and core nontariff barriers appear no more prohibitive in Japan than in the EU or USA, excessive regulation, widespread lack of transparency and abuse of bureaucratic discretionary power impede new market entrants. Yet increasingly, foreign companies have been successful in Japan.

The import-driven market opening begun in the early 1990s may represent the last phase of Japan's progression to a mature, high income economy. The spread of this phenomenon to non-export oriented sectors, which were protected from international competition, is not only inevitable, but desirable.

This chapter examines the many impediments to doing business with Japan and the ongoing deregulation and market-opening process. It also discusses the factors that influence Japan's market and evaluates how they might shape the market over the next decade.

TRADE AND THE JAPANESE ECONOMY

Although Japan is the world's third biggest trading nation, exports and imports do not represent significant proportions of Japan's GDP compared to other member countries of the Organisation for Economic Cooperation and Development (OECD). Exports contributed just 12 per cent to Japan's GDP in 1995, the second lowest among G7 countries (Figure 8.1).[1] Moreover, the importance of exports to Japan's GDP has remained relatively unchanged over the last decade, hovering at 10 to 12 per cent (Figure 8.2). Despite a heavy reliance on foreign sources of mineral and agricultural products, Japan's imports are also relatively small compared to its GDP (Figure 8.1).

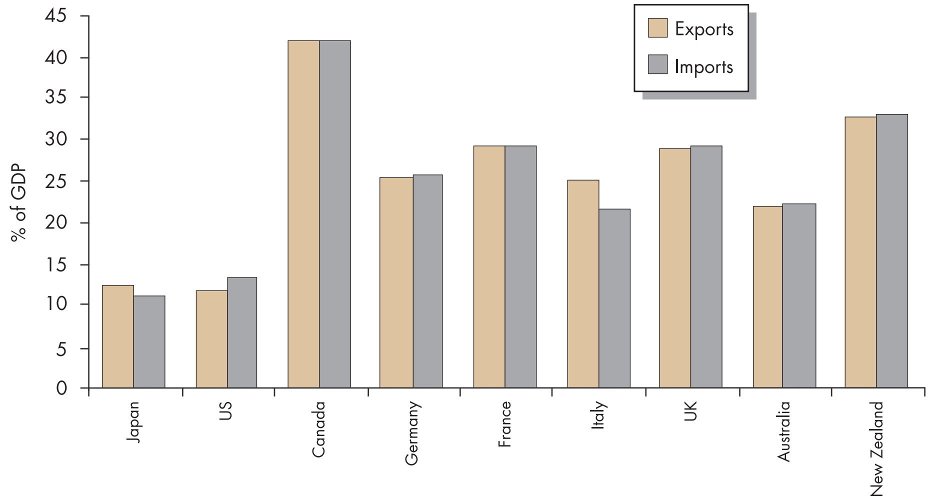
Trade's small role in overall economic activity and the virtual segmentation of export-oriented and domestically oriented sectors contribute to the relatively inward-looking nature of the Japanese economy and the difficulty foreign firms experience when they seek to establish a presence in Japan. Until the early 1990s recession revealed major structural weaknesses in the economy, Japan had relatively few domestic imperatives to encourage greater internationalisation. (See Chapters 6 - *Internationalisation* and 9 - *Distribution*.) However, the constantly appreciating yen threatened the viability of the strong export-oriented sectors, and as the 1990s progressed, increased import penetration meant the nontraded sectors needed to become more internationally competitive. The rapid development of Japan's Asian neighbours, especially China, and their potential to become serious competitors, also has driven this change.

1 G7 countries are Japan, the UK, USA, France, Italy, Germany and Canada. The USA had the lowest figure, with exports contributing 11.8 per cent to GDP (Figure 8.1).

Figure 8.1

Japan Has Relatively Low Trade Dependency

Exports and Imports Expressed as a Percentage of GDP (1995)



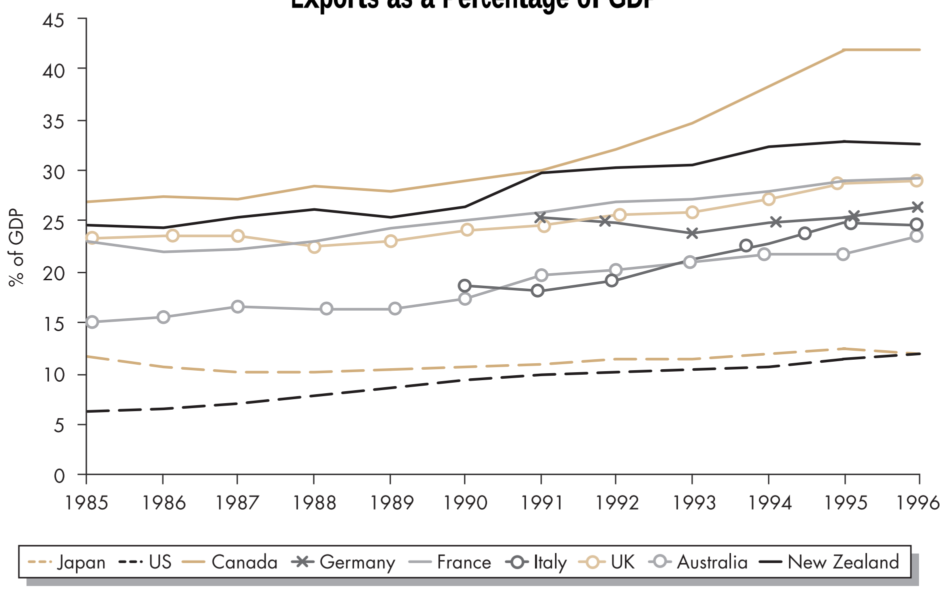
Note: Constant prices.

Source: Organisation for Economic Cooperation and Development, 1996d.

Figure 8.2

Exports a Relatively Small Proportion of Japan's GDP

Exports as a Percentage of GDP



Note: Constant prices; 1996 figures are first quarter only.

Source: Organisation for Economic Cooperation and Development, 1996d.

Over the past decade, Japan's trade structure has altered dramatically and this trend should continue. (See Chapter 5 - *Trade*.) In particular, imports grew strongly in 1994 and 1995, in the midst of recession. Although weaker, the 6 per cent growth rate projected for 1997 and 1998, still represents US$19 billion in extra imports annually.

ARE FOREIGN COMPANIES LOCKED OUT OF JAPAN?

Sales for the top 100 foreign-owned companies in Japan are US$155 billion; equivalent to the GDP of Thailand or Indonesia. Foreign manufacturers and marketers have positions in nearly all sectors of the Japanese economy. More than 40 have over US$1 billion each in annual sales. Thirteen countries are in the top 100 companies list. While the USA dominates the list, one third of the companies are from Europe and 11 from Asia - including eight from the Republic of Korea.

IBM is Japan's largest foreign-owned company, with sales of over US$14 billion and majority interests in 31 enterprises. Indeed, foreign companies stand out in the high technology sector. Phillips, Texas Instruments, Motorola, Apple Computer, Hewlett Packard, Unisys, Samsung Electronics, Intel and Digital Equipment all have sales over US$1 billion. Ford is the second largest foreign-owned company in Japan. It had equity in seven Japanese companies and sales of over US$28 billion in 1994.

Successful medium to large foreign companies have learned that:

- technology is important; it should be effectively used as an entry mechanism and not sold off to the highest bidder
- management control is critical to competitive success and should not to be shared or diluted
- success will usually require patience although sometimes it can be relatively quick. Amway, for example, became the 28th largest foreign company in Japan in just 15 years.

Source: *Asian Wall Street Journal*, 4 March 1996, p. 10.

BARRIERS AT THE BORDER - TARIFFS

Japan's trade-weighted industrial tariffs are among the lowest in the developed world.[2] However, tariff barriers in agriculture, processed food, textiles and apparel remain relatively high. (See Chapter 11 - *Agrifood*.) Under Uruguay Round reductions, the simple average tariff on industrial products is estimated to fall to 4.6 per cent; on an import-weighted basis, the average will decline from 3.9 per cent to 1.7 per cent. Tariff and nontariff measures will be eliminated on a most favoured

....

2 This section benefits from using a report (OECD, 1996b) on the patterns and pervasiveness of tariff and nontariff barriers. Two major reasons for relying on this report are: it compared all OECD countries, thus making it possible to include Australia in the discussion; and it covered core nontariff barriers and their effects.

nation (MFN) basis on all pharmaceuticals, construction and medical equipment and beer. With some exceptions, tariffs will also be eliminated on steel, distilled spirits, furniture, agricultural equipment, paper and pulp, and toys. Agreement was reached to 'work' towards tariff cuts of up to 50 per cent on ceramics, glass, textiles and clothing (General Agreement on Tariffs and Trade [GATT], 1995).

Japan's tariff structure is no more prohibitive or distorting than that of the EU, USA or Australia (Table 8.1).

- Most tariff lines[3] in Japan, the EU and USA are bound[4] by an upper limit which they cannot legally exceed (*Indicator 1*).
- Australia and Japan have more tariff lines where the tariff is zero than the EU and USA *(Indicator 2*).
- The USA has the highest proportion of specific and compound tariffs, which tend to disguise very high *ad valorem* equivalents and distort domestic production patterns more than *ad valorem* tariffs.[5] Japan's proportion is less than half the US proportion *(Indicator 3*).
- Australia has the highest simple average bound tariff rate, followed by Japan. However, Japan and the USA have the lowest simple average applied tariff rate *(Indicators 6 and 7*).
- Japan has the lowest import-weighted and production-weighted tariff rates[6] followed closely by the USA (*Indicators 8 and 9*).
- Australia has the highest incidence of highly distorting tariff spikes[7] followed closely by Japan *(Indicator 10*).
- The dispersal of tariff rates[8] for Japan, Australia, the USA and EU varies by less than 2 percentage points, suggesting that the distorting effects of tariff dispersion are similar in each country *(Indicator 11)*.

....

3 A tariff line, or tariff classification, is a heading or subheading that is not further subdivided and which has a rate of duty set for it. A tariff schedule is part of a Tariff Act - there can be many schedules in an Act. A tariff chapter groups together similar products identified with a particular industry.

4 During the GATT/WTO process, nontariff barriers are converted to an equivalent tariff, which is then 'bound'. When tariffs are bound for a particular product, they cannot be raised above the specified rate. Bound rates are often higher than the tariff which is actually used (the 'applied' rate). For example, while the bound tariff for Japan's beef imports is 50 per cent, in April 1997 the applied rate was 44.3 per cent.

5 A specific tariff is a specific charge on the particular item to be imported, regardless of its value, while an ad valorem tariff is levied as a percentage of the value of the goods to be imported. A compound tariff consists of two parts: ad valorem and specific.

6 Weighted average tariff levels take account of the relative importance of each product in a country's trade. However, weighting by import volumes assigns a small weight to highly protected products, thus underestimating the degree of protection. For example, no weight at all is given to prohibitive tariffs. By contrast, the use of domestic production as a weight overrepresents highly protected products.

7 A tariff spike is when a tariff for a product is three times higher than the national average MFN tariff rate for all products. Tariff spikes have a highly distorting effect on domestic production decisions by attracting a relatively high proportion of resources of one sector of the economy into a particular industry.

8 This is measured by the standard deviation of tariff rates across products. If products within a given group face widely different tariff rates (that is, have a large standard deviation) this can result in large changes in relative prices and seriously distort domestic consumption and production patterns. The larger the standard deviation, the less reliable the results are.

Table 8.1

Japan's Tariffs Less Distorting Than Other Countries

Structure of Tariffs[a] in Selected OECD Countries (1993, Per Cent)

Indicators	USA 1989	USA 1993	EU[b] 1988	EU[b] 1993	Japan 1988	Japan 1993	Australia[c] 1988	Australia[c] 1993
1. Bound tariff lines	98.1	98.1	91.8	92.7	89.8	90.5	18.4	21.7
2. Duty-free tariff lines	17.4	14.4	10.5	10.9	21.8	35.1	8.7	42.9
3. Specific and compound tariffs/ all tariffs	17.6	17.0	10.6	11.1	7.4	8.8	12.3	2.1
4. Tariff quotas/all tariffs	0.1	0.2	1.0	2.4	1.0	1.2	7.6	0.2
5. Tariffs with no *ad valorem* equivalent	1.3	1.6	8.4	8.1	1.0	1.2	11.6	1.0
6. Simple average bound tariff rate	6.3	6.5	7.5	7.6	8.2	8.2	14.3	10.0
7. Simple average applied tariff rate	6.2	6.4	7.4	7.6	6.9	6.5	14.2	8.2
8. Import-weighted average tariff rate[d]	4.0	4.0	6.0	6.2	4.1	3.9	13.7	6.4
9. Production-weighted average tariff rate[e]	4.7	4.9	7.3	7.7	4.0	3.3	14.4	6.9
10. Domestic tariff 'spikes'	4.5	4.0	2.2	2.3	5.4	7.0	3.1	8.4
11. Overall standard deviation	7.7	8.6	6.1	6.1	8.8	9.3	14.3	10.1

Notes: Technical terms are defined in footnotes and the glossary. a. Applied MFN tariffs; b. Indicators encompass sliding charges; c. Indicators encompass auction premiums for quantitative restrictions; d. Constant OECD import weights; e. For the EU, German weights are used.

Source: Organisation for Economic Cooperation and Development, 1996b.

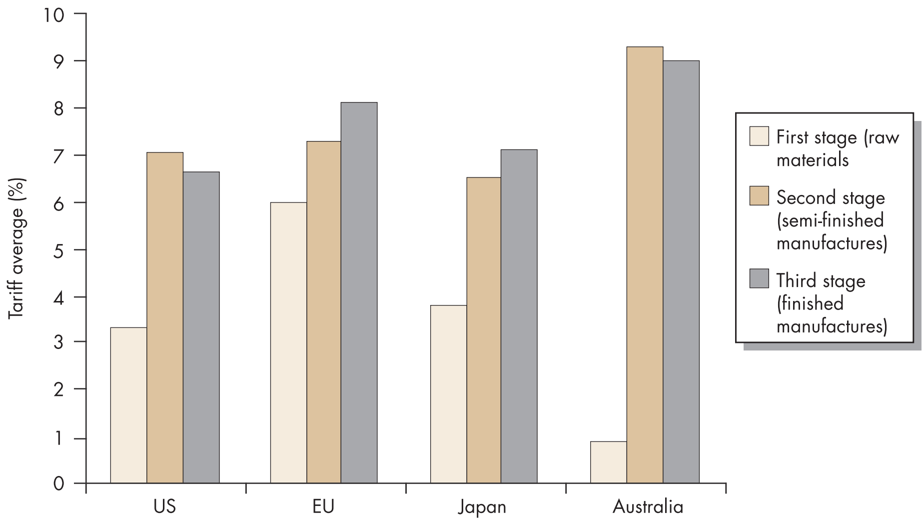
In Japan, the USA, Australia and the EU, the rate of tariff escalation[9] between the second and final stage of processing is small (and even negative in the USA and Australia), but between the first and second stages of processing it is dramatic (Figure 8.3). This tariff structure facilitates imports of raw materials and finished products, but protects domestic producers of semi-finished products. While the EU's tariffs are generally higher than those of either the USA or Japan, the increase in tariffs between each level of processing is smaller, creating less bias towards domestic production in any stage of processing. Japan and the USA have much lower tariffs than the EU in agriculture, forestry and fishing and manufacturing (Figure 8.4).

9 Tariff escalation occurs when tariffs are higher for more transformed products. Tariff escalation creates a bias in favour of domestic industry involved in higher stages of processing and value adding.

Figure: 8.3

Semiprocessed Products Most Protected

Comparative Tariff Escalation (1993)

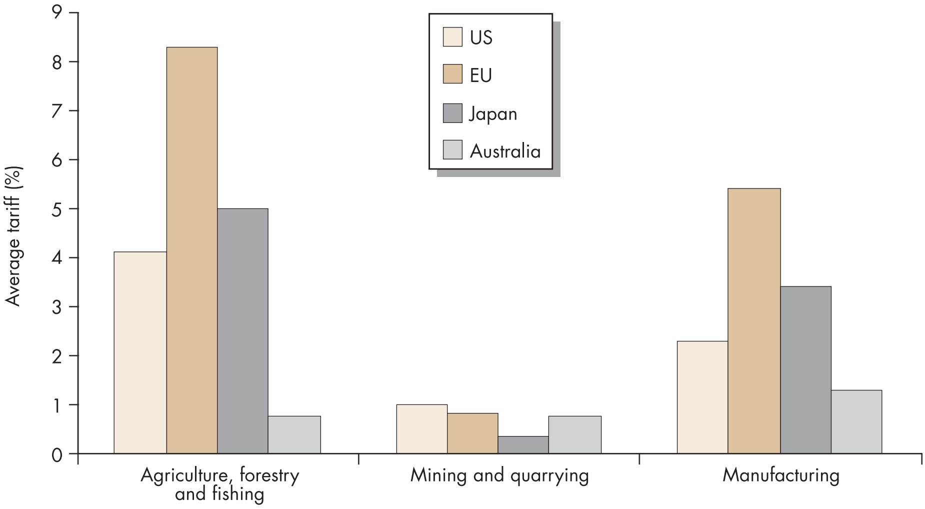


Source: Organisation for Economic Cooperation and Development, 1996b.

Figure 8.4

Tariffs Impede Agricultural Raw Material Imports

1993 Tariff Barriers in the First Stage of Processing (Raw Materials)



Note: In the first stage of processing, manufacturing refers to lightly manufactured products used as inputs for the second and third stages of processing.

Source: Organisation for Economic Cooperation and Development, 1996b.

NONTARIFF BARRIERS

Not only are Japan's tariffs generally lower and less distorting than those of the EU and the USA (Figures 8.3 and 8.4 and Table 8.1), but Japan also has fewer core nontariff barriers (NTBs).[10] While in OECD countries about 34 per cent of tariff lines are subject to core NTBs, in Japan it is 38 per cent, in the EU 59 per cent, and in the USA 70 per cent (OECD, 1996b, p. 19). Japan also has less dramatic and therefore less distorting NTB escalation between the first and second stages of processing (Figure 8.5).[11] In the USA, in the second stage of processing, core NTBs are about seven times more prevalent than in the first stage of processing; in Japan, they are four times more prevalent.

Resort to both price control measures and quantitative restrictions is less common in Japan than the EU or USA (Figure 8.6). Quantitative restrictions are the most common core NTBs, except in Australia where they have been eliminated entirely. In Japan, the most common form of quantitative restrictions is nonautomatic licensing (Table 8.2), while in the EU and the USA, voluntary export restraints are most common. The EU and USA also use price control measures relatively often.

Table 8.2

Nonautomatic Licensing an Impediment in Japan

Incidence of Core NTBs in Japan (1993)

NTB categories	Frequency ratio		Import coverage ratio	
	1988	1993	1988	1993
Quantitative restrictions (QRs)	7.3	6.7	6.5	2.8
- Export restraints	0.3	0.3	0.2	0.2
- Nonautomatic licensing	5.7	5.7	1.0	1.0
- Other QRs	1.6	1.0	5.5	1.8
Price control measures (PCMs)	0.3	0.3	0.7	0.8
- Variable charges	0.3	0.3	0.7	0.8
- AD/CV[a] actions and VEPRs	0.0	0.0	0.0	0.0
- Other PCMs	0.0	0.0	0.0	0.0

Note: VEPR: Voluntary Export Price Restraints. a. AD: Antidumping actions; CV: Countervailing actions; AD/CV involve the imposition of duties or some form of price undertaking. As it is difficult to determine which AD/CV actions are legitimate and which are not, they are all included.

Source: Organisation for Economic Cooperation and Development, 1996b.

....

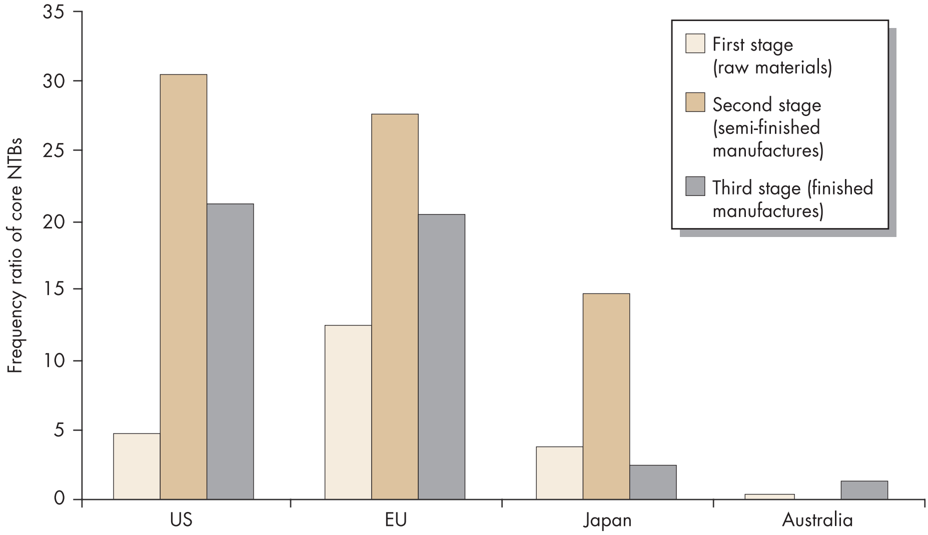
10 Nontariff barriers include price control measures and quantitative restrictions. Price control measures include voluntary export restraints, variable charges, anti dumping and countervailing duties, and administrative pricing, including minimum or reference import prices. Quantitative restrictions include nonautomatic licensing, export restraints, quotas and prohibitions.

11 The prevalence of NTBs is measured using frequency ratios, which indicate the proportion of national tariff lines that are affected by core NTBs, irrespective of whether the products are actually imported.

Figure 8.5

Incidence of Japan's NTBs Relatively Low

NTB Escalation (1993)

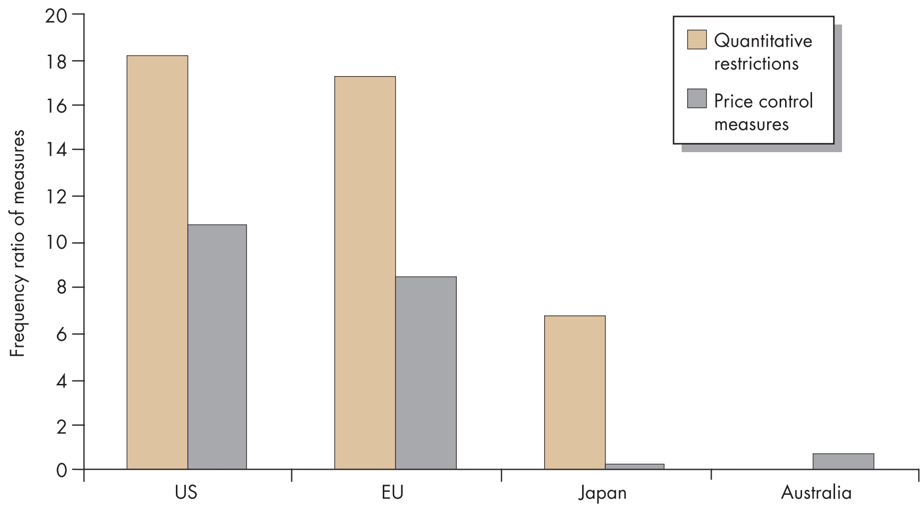


Source: Organisation for Economic Cooperation and Development, 1996b.

Figure 8.6

Use of Core NTBs Much Higher in the EU and USA

Incidence of Core NTBs (1993)



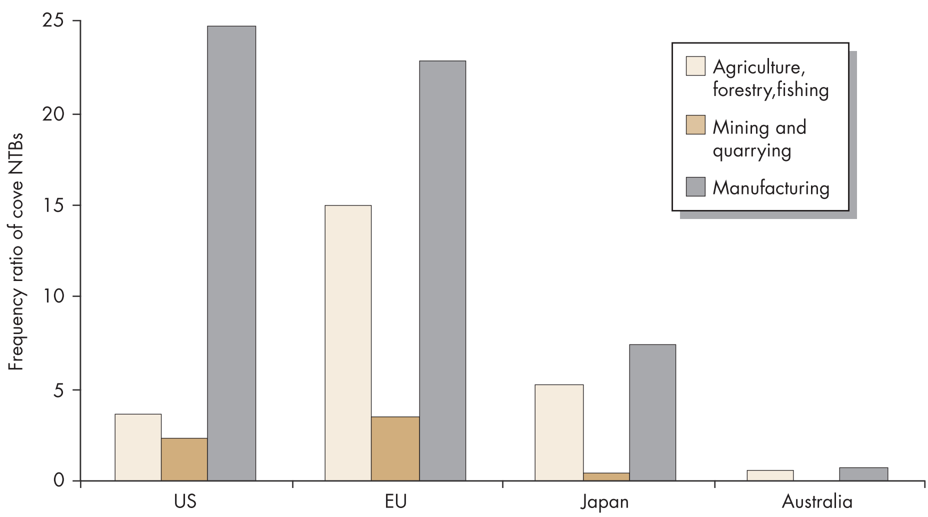
Source: Organisation for Economic Cooperation and Development, 1996b.

While core NTB frequency in all sectors is much lower in Japan than in the EU or USA, the pattern of their occurrence is similar: they are highest in manufacturing, then agriculture, forestry and fishing, and have a relatively low incidence in mining and quarrying (Figure 8.7). Japan's core NTBs are most frequent in textiles and footwear; food, beverages and tobacco; and agriculture, forestry and fishing (Table 8.3).

Figure 8.7

High Core NTBs in the EU and US Manufacturing Sector

Incidence of Core NTBs Across Sectors (1993)



Source: Organisation for Economic Cooperation and Development, 1996b.

Japan's average incidence of tariffs and core NTBs is therefore much lower than in the EU and USA. Only in the case of simple average bound tariffs and domestic tariff spikes does protection in Japan (and Australia) exceed that of the EU and USA. This contrasts sharply with the popular view that Japan's market is more closed than those of the EU or USA. In a *Nikkei Weekly* survey of foreign-affiliated companies in Japan, for example, 62 per cent of respondents reported that the Japanese market is less open than the US or EU markets.[12] If the Japanese market is especially difficult for foreigners to enter, then this does not appear to be due to formal protection measures. Rather, other factors must create this problem. The rest of this chapter analyses these factors and how they shape the Japanese market and influence its accessibility.

12 The results of this survey are consistent with other surveys. The survey was conducted during November and December 1996 and reported in the *Nikkei Weekly*, 13 January 1997, p. 1. Questionnaires were sent to 550 companies, of which 94 responded; of these, 67 have been in Japan more than ten years.

Table 8.3

Major Core NTBs Are in Processed Foods and Textiles

Pervasiveness of Core NTBs Across Sectors in Japan

Sector	Frequency ratio		Production-weighted frequency ratio	
	1988	1993	1988	1993
Quantitative restrictions (QRs)	7.3	6.7	6.5	2.8
Agriculture, forestry, fishing	5.9	5.2	na	na
Mining and quarrying	3.1	0.4	na	na
- Coal Mining	na	na	na	na
- Crude petroleum	na	na	na	na
- Metal ore mining	na	na	na	na
- Other mining	na	na	na	na
Manufacturing	7.9	7.4	2.1	1.8
- Food beverages and tobacco	11.2	6.7	10.8	7.9
- Textiles and apparel	21.3	21.4	20.1	20.1
- Wood and wood products	0.0	0.0	0.0	0.0
- Paper and paper products	0.0	0.0	0.0	0.0
- Chemicals, petroleum products	0.8	0.7	1.0	0.8
- Nonmetallic mineral products	0.0	0.0	0.0	0.0
- Basic metal industries	0.9	0.9	0.5	0.6
- Fabricated metal products	0.0	0.0	0.0	0.0
- Other manufacturing	0.0	0.0	0.0	0.0
All products	7.7	7.1	2.1	1.8

Note: na: not available.

Source: Organisation for Economic Cooperation and Development, 1996b.

GOVERNMENT REGULATIONS

One of the most common complaints from foreign and domestic companies in Japan is excessive regulation (Figure 8.8).[13] In the *Nikkei Weekly* survey mentioned above, foreign-affiliated companies listed official regulations as the second biggest hurdle in the Japanese market after unofficial restrictions and business practices. Companies believe official Japanese regulations are:

- not transparent (43 of the 94 respondents)
- too numerous (39)

....

13 Regulations are often introduced on the grounds that, left to themselves, unregulated economies could produce undesirable outcomes, not least due to market failures. The three main reasons for deregulation are: some regulations produce undesirable side effects or fail to achieve objectives, known as ‘regulatory failure’; technological developments sometimes make previously useful regulations obsolete; and regulation may prevent economies from reaping the benefits of increased globalisation. Ambitious and well planned regulatory reform can raise living standards and improve consumer choice (OECD, 1996a; Shigehara, 1996).

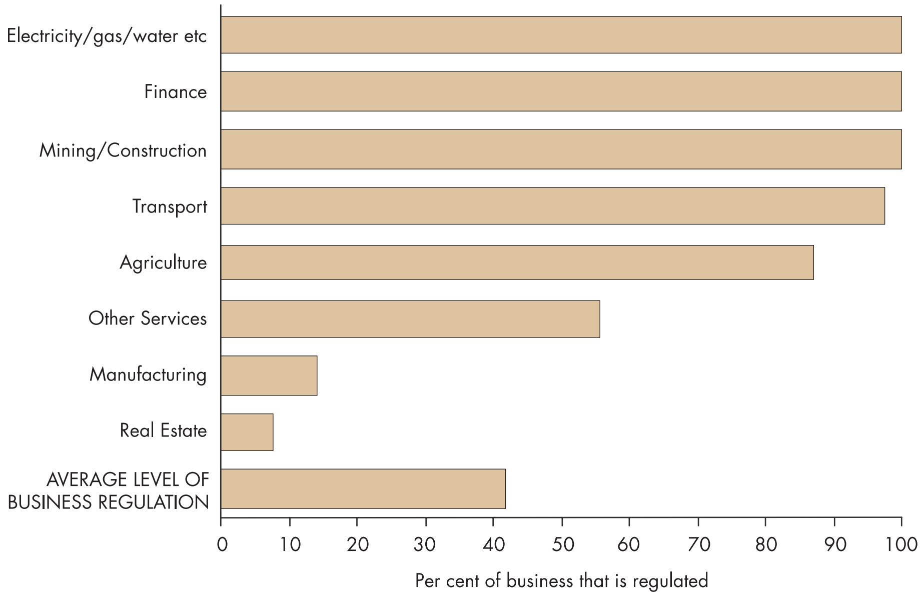
- too lengthy in the approval process (38)
- biased towards Japanese firms (25).

While these factors often restrict new domestic entrants, some mainly affect foreign firms. According to Yoshisuke Ishiuchi, Director, Compaq KK, Japan takes a long time to authorise the use of technologies which are industry standards elsewhere. A German electronics maker reported that product approvals from the Ministry of International Trade and Industry and the Health Ministry require more paperwork and visits than anywhere else in the world (*Nikkei Weekly*, 13 January 1997).

Figure 8.8

Much Room for Deregulation

Business Regulation in Japan



Source: Financial Times, 20 August 1996, p. 11 (based on Economic Planning Agency data).

Deregulation Progress

While deregulation has been espoused by Japanese leaders for more than a decade, achievements have generally fallen far short of the rhetoric. (See Appendix 8.1.) Despite some important progress, deregulation has been slow and often confined to incremental change on relatively minor technical issues. Foreign and domestic analysts agree that a more radical approach is needed if Japan is to achieve its objective of ‘freedom in principle with regulation as the exception’.

The Hashimoto Government, elected in 1996 on a platform of deregulation and economic and administrative reform, has the opportunity to achieve more than past governments, because:

- languishing domestic economic activity and increasingly competitive world trade mean that Japan cannot afford to be complacent in deregulating

- domestic pressure for deregulation, particularly from export-oriented sectors which can no longer bear the cost of cosseted domestic sectors, is much stronger than in the past, complementing international efforts for faster progress.

The most recent major reform package is the three-year Deregulation Action Plan, announced in 1995 and reviewed in 1996 and 1997 (Appendix 8.1). While by 1997, all sectors of the economy were included in the Deregulation Action Plan, originally priority was given to:

- housing and land
- distribution
- standards, certification, imports
- energy
- pollution, waste
- information and telecommunications
- transportation
- finance, securities and insurance
- employment and labour
- dangerous articles.

During the Deregulation Action Plan review, countries were invited to submit requests for deregulation and regulatory reform. In 1997, approximately half of Australia's requests met with a positive response (Table 8.4). These requests were formulated by the Australian government in close consultation with Australian business. The Australian Embassy in Tokyo then liaised with the relevant Japanese government agencies in order to ensure that Australia's requests were given due consideration.

Since the Japanese economy is heavily regulated, deregulation benefits are likely to be substantial (Table 8.5). Further deregulation could increase labour productivity by 20 per cent and decrease output prices by 10 to 20 per cent (OECD, 1996a).

Table 8.4

Half of Australia's Requests Receive Positive Response

1997 Deregulation Action Plan: Responses to Australian Requests

Industry	Deregulation Action Plan Response
Housing and construction	MITI will harmonise Japanese standards for wood products with international standards, once these standards are developed.
	MOC will submit a revised version of the Building Standards Law to the regular Diet session in 1998 to allow the current prescriptive standards to be replaced by performance-based standards.
	MOC agreed to eliminate, in principle, government housing loan corporation construction standards which the Building Standards Law has made redundant.
	Procedures applying to construction standards are to be simplified to eliminate requirements duplicated under the Construction Business Act. Relevant regulations will be examined in JFY1998.
	MOC will examine the implementation of performance-based standards for wood products and wood product construction methods.
	The approval process for water supply equipment will be eliminated and replaced by performance-based criteria, with independent third party certification, by October 1997.
	MITI affirmed that Japan will play an active role in developing International Standards Organisation building standards.
Agricultural products	MAFF will streamline and speed-up current animal and plant import quarantine procedures by computerising current processes and establishing an electronic link with customs clearance procedures. This is to be fully implemented in JFY1997.
	MHW will allow use of 'date of packing' rather than 'use-by date' on bulk dairy products over 10 kilograms, provided the items are raw materials for processed food and not for direct consumption.
	MHW amended relevant laws to replace paper certificates with electronically transferred government health certificates for products such as meat. This is to be trialed mid-1997.
Legal services	MOJ intends to finalise within JFY1997 its response to the 1996 review of work experience qualifications of registered foreign lawyers.
Racehorses	The Japan Racehorse Association will conclude a study in JFY1997 to develop a method to allow foreigners not living in Japan to own and race horses in Japan.
Information and telecommunications	The request to abolish the need for Type 1 carriers[a] to seek authorisation of accounting rates for trade in telecommunications services for markets where both sides of the transaction are competitively supplied, was 'too difficult to implement'.
Transport[b]	MOT announced that it will examine its requirement for inspection of vehicle repairs done by an unlicensed individual. This is tentatively scheduled to conclude in June 1997. No decision was made to remove brake systems from products covered by disassembling repair inspection.

Note: a. Japan has Type I and Type II carriers. Type I provide telecommunications services by establishing infrastructure. Type II supply all other telecommunications. Type I carriers must obtain Ministry of Posts and Telecommunications authorisation for tariffs, access charges and accounting rates. Type II set charges at their own discretion

b. Not subject to a specific Australian request but of interest to Australia.

JFY: Japan Financial Year (April to March); MITI: Ministry of International Trade and Industry; MOC: Ministry of Construction; MAFF: Ministry of Agriculture, Forestry and Fisheries; MHW: Ministry of Health and Welfare; MOJ: Ministry of Justice; MOT: Ministry of Transport.

Source: Department of Foreign Affairs and Trade, 1997.

Table 8.5

Services Sector to Benefit from Deregulation

A Snapshot of Some Important Areas of Deregulation

Area	Where Important Progress Has Been Made	Potential Gains from Further Deregulation
Distribution (Chapters 9, 11)	Gradual relaxation of regulations governing large retail stores, resulting in more large retail stores. Relaxation of regulations surrounding rice distribution, resulting in more rice retailers.	Labour productivity could be increased by 20 per cent. Output prices could be reduced by 10 to 20 per cent, stimulating demand for goods and services. Further deregulation will give stores flexibility to move towards high-value-added operations and customers more choice of when and where to shop. Improved procurement practices could reduce input costs. Need to eliminate inefficient zoning regulations.
Telecommuni-cations (Chapter 14)	Mobile phones: divestiture of NTT's mobile phone service from NTT resulted in subscription fees falling by 92 per cent (1985-1996); elimination of regulation preventing people from owning, rather than renting, portable phones resulted in subscribers increasing from 40 000 (1985) to to 12 million (1996).	Labour productivity could be increased by 20 per cent. Output prices could be reduced by 10 to 20 per cent. International service costs could be reduced. Further deregulation could include: abolishing price control and entry restrictions; breaking up NTT; and clarifying costs and conditions for third party access to NTT's network.
Electricity (Chapter 12)	Imports of refined petroleum products were liberalised in 1996.	Labour productivity could be increased by 10 per cent. Output prices could be reduced by 10 to 15 per cent. Entry restrictions could be relaxed, regional monopolies dismantled and rate of return control reduced so as to increase competition.
Air and road transport (Chapter 13)	Airlines: controls on ticket discounting liberalised, with new groups applying for domestic routes. Road freight: pricing and entry regulations relaxed in 1990.	Labour productivity could be increased by more than 20 per cent. Output prices could be reduced by 10 to 20 per cent. Airlines need to reduce restrictions on entry, fares and labour use. Road freight needs to reduce restrictions on licences, especially practices forcing trucks returning empty after delivering freight.
Financial (Chapter 7)	Domestic and foreign investment advisory firms allowed to manage pension funds. Announcement of Tokyo financial market 'Big Bang' reforms.	

Notes: Productivity and output gains are based on OECD calculations using 1985 input-output table on the Japanese economy.

Source: Shigehara, 1996; Organisation for Economic Cooperation and Development, 1996a.

The general consensus is that deregulation is becoming more firmly entrenched in Japan. With the benefits from early deregulation becoming more widely evident and understood, public support seems to be growing. The major issues now are pace and substance. It is also important that increased administrative guidance, which lacks transparency, and other new barriers not be substituted for the abolished regulations. Fully utilising the 1994 Administrative Procedures Law, which was designed to increase transparency of bureaucratic decision-making and to impose uniform rules on application processing, dispute handling and use of administrative guidance, could counter any tendencies toward reregulation.

NOT ALWAYS MARKET BARRIERS THAT LEAD TO FAILURE

The American beverage, Snapple, was launched in Japan in May 1994, when natural soft drinks and iced teas were increasing in popularity. Snapple also had a powerful ally in Seven-Eleven Japan, a major convenience store chain. (See Chapter 9 - *Distribution*.)

However, many traits that made Snapple popular in the USA made it unpopular in Japan. Consumers were attracted to trying the drink, but they were not repeat buyers. When confronted with this, Quaker Oats, the firm that acquired Snapple Beverages in 1994, did nothing. Hisao Takeda, a Tokyo marketing consultant who represented Snapple in Japan, indicated that Quaker refused to do anything to change its drinks and skimped on marketing. In a market where 1 000 new soft drinks are launched each year, and companies routinely spend several billion yen to advertise a new drink, Quaker spent just ¥200 million on marketing Snapple's name. Quaker's two Japanese partners, Calpis Food Industry and Itochu, also tried in vain to convince Quaker to modify its Japan strategy for Snapple.

Consequently, Snapple sales plunged from 2.4 million bottles per month in early 1995 to 120 000 bottles per month in April 1996, and were expected to decline to nothing. Marketing experts believe that Snapple will not get another chance in Japan.

Source: *Asian Wall Street Journal*, 12-13 April 1996, p. 10.

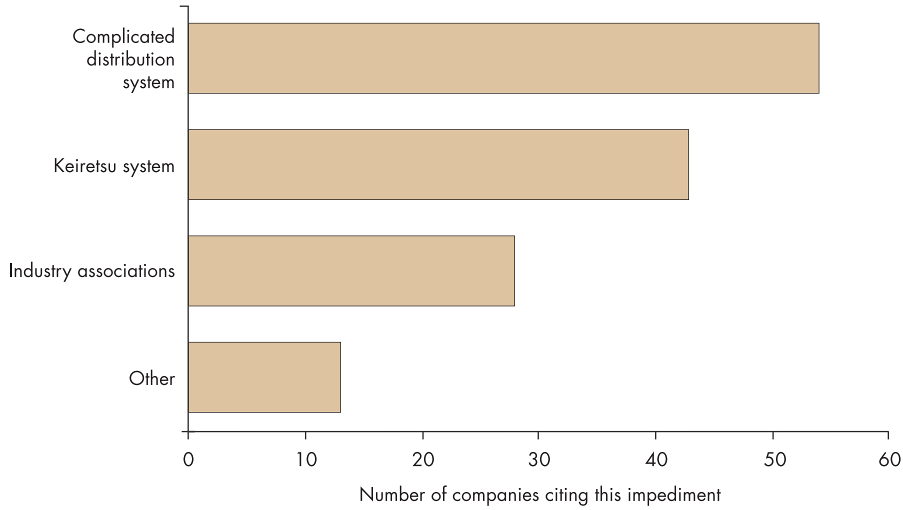
JAPANESE BUSINESS PRACTICES

Japanese business practices are commonly cited as a major barrier to entry into the market. The distribution system is the most frequently cited problem (see Chapter 9 - *Distribution*), followed by *keiretsu* and industry associations (Figure 8.9). Industry associations, which provide access to people, market data and industry information, are notoriously difficult for non-Japanese companies to enter. Furthermore, the distinction between industry association and cartel can be indistinct. (See Box - *Industry Association or Cartel?*) Whether Japanese business practices are competitive or anticompetitive is a contentious issue. However, new entrants, foreign and domestic, do find it difficult to establish themselves in Japan.

Figure 8.9

A Difficult Market to Break Into

Unofficial Barriers to Doing Business in Japan



Source: *Nikkei Weekly*, 13 January 1996, p. 3 (survey of foreign companies in Japan).

Keiretsu

The term *keiretsu* is widely used, just as widely interpreted, and not surprisingly, a matter of ongoing contention.[14] Generally, *keiretsu* refers to various forms of interfirm relationships. The three main - often overlapping - *keiretsu* relationships are: financial *keiretsu* (company links through major banks, trading companies and cross-shareholdings), and vertical and distribution *keiretsu* (vertical integration of companies engaged in production and distribution activities).

The commonly cited criticisms of *keiretsu* relationships are that:

- they shut out new foreign and domestic suppliers from intermediate product markets
- the long-term nature of contractual relationships is exclusive and impedes competition

....

[14] *Keiretsu* are contentious due to their perceived relationship to *zaibatsu*, the prewar conglomerates which derived power from owning huge trading companies and major banks, and which were broken up and banned during the US occupation due to their supposed contribution to Japan's war machine. Some of the *zaibatsu* were the forerunners to today's *keiretsu* groups such as Mitsubishi, Mitsui and Sumitomo, three of the world's largest companies. The term '*keiretsu*' was originally coined by the foreign media and used to loosely describe unofficial trade barriers arising from Japanese business practices. It has since become the subject of ongoing academic debate (see, for example, Drysdale 1995 versus Lawrence 1993). The main issue of contention is whether the inherent nature of *keiretsu* relationships is horizontal, and therefore anticompetitive, or vertical, and therefore competitive. Research undertaken for this study led to the conclusion that *keiretsu* relationships are vertical in nature.

- they produce a unique form of corporate governance, leading to a higher degree of corporate stability and facilitating the pursuit of longer-term objectives, thereby giving Japanese firms a market advantage.[15]

THREE TYPES OF KEIRETSU

Financial *keiretsu* involve companies linked by a common relationship with one or more of the major banks (known as 'main banks'), a trading company and usually some cross-shareholdings. Cross-shareholding is limited by law to 5 per cent, and group-based business usually accounts for only 15 to 20 per cent of turnover. Mutual financing, a conference of senior company presidents, shared research and some mutual assignment of senior corporate officers are the main forms of cooperation. Financial *keiretsu* often comprise companies actively competing against each other for business. In their outer periphery, apart from a preferred relationship with a particular bank, they function with complete autonomy.

Vertical and distribution *keiretsu* tend to have a core industrial company with relatively high levels of equity in a core group of upstream suppliers and/ or downstream activities, typically 20 to 50 per cent. The level of group-based business tends to be high, 50 to 90 per cent of turnover. Although group members often have unrelated side businesses, companies all contribute to a common final product. Intercompany cooperation tends to be based on closely coordinating research and development, production scheduling and quality control. As the core company usually has several sources of supply for key components, there is a mixture of competition and collaboration. While most companies supply to nonmembers, they usually have an unspoken agreement regarding 'acceptable' and 'unacceptable' competitors.

Source: Sheard 1994, 1996; Economist Intelligence Unit, 1996.

None of the above factors in themselves make *keiretsu* relationships anticompetitive. For example, while contractual relationships in the market for inputs may tie firms so closely that they resemble different parts of one firm, such relationships will work only if they are mutually beneficial and competitive in the marketplace. The post-bubble recession and import-induced competition weakened or destroyed many longstanding business relationships in Japan, providing an entry point for more competitive domestic and foreign suppliers.

....

15 Corporate governance refers to the process by which the capital market monitors the actions of corporate management and holds management accountable for its decisions. Some of the features of corporate governance resulting from *keiretsu* relationships are that main banks provide a type of a contingent governance structure reducing the risk of bankruptcy; capital costs are reduced through heavy reliance on bank finance; and risk of indirect control by takeovers or mergers and acquisitions is limited. (See OECD, 1996c for a detailed analysis of Japanese corporate governance.)

The nature of *keiretsu* relationships is not unique to Japan[16] (Ishiguro, 1996).

- Some German banks have more powerful corporate ties than Japan's financial *keiretsu*.
- US firms are more vertically integrated for auto parts distribution than their Japanese counterparts. General Motors and Ford have both internalised their auto parts markets whereas Toyota, for example, sources its auto parts by contracting suppliers.
- Despite concerted efforts to increase its share of the US colour film market, Fuji Film's share has fluctuated between 9 and 13 per cent, while Kodak's share is around 70 per cent - which is similar to the reverse situation in Japan.[17]

COMPETITIVE BENEFITS OF KEIRETSU

Reduced internal management costs: internal production involves a larger workforce and therefore a larger internal management burden. Very large corporations are often inefficient due to limited mutual understanding and slow decision-making processes. The keiretsu system of dividing production provides more flexibility and may be more efficient. For example, in 1990 while both General Motors and Toyota made the same number of cars, General Motors had 750 000 workers, while Toyota had 65 000 workers. The reason for this difference is that General Motors produces most of its own components internally, while Toyota purchases its externally.

Joint development: production of a range of goods, product differentiation and short lead times are keys to competitive strategy. Sharing technical, market and management information allows assemblers and suppliers to speedily undertake joint development, and increases the keiretsu's competitive strength.

Multiple ordering: an assembler simultaneously orders identical parts from several suppliers. This invokes competition among suppliers, keeping costs down.

Incentives and penalties: the incentives for the assembler in a keiretsu is that it has reliable, high-quality and speedy transactions with reduced internal management costs. The market imposes penalties if the assembler does not bring the suppliers up to standard. For the supplier, the incentives are technical instruction, financial security and human resource assistance from the assembler. On the other hand, if quality and deadline criteria are not met, the supply quota may be reduced or the relationship suspended.

Source: Tokyo Chamber of Commerce and Industry, 1993.

....

[16] For further discussion on similarities between Japanese, US and EU business practices (and government policies) see Oppenheim, 1992.

[17] In 1996 the USA took Japan to the WTO over what it alleges are unfair practices that keep Kodak's share of the Japanese market below 10 per cent.

The 'Iron Triangle': Business, Bureaucrats, Government

The interaction between politicians, the bureaucracy and large companies, often referred to as the 'iron triangle' or 'Japan Inc', has been an important feature of Japanese economic life.[18] Many analysts believe strong intervention by the Ministry of International Trade and Industry (MITI) and the Ministry of Finance (MOF) contributed to the Japanese 'economic miracle'. Big business has actively participated in formulating policy; the bureaucracy has been the highly respected and trusted adviser; and ministries have heavily utilised 'administrative guidance.' (See Chapters 1 - *Overview* and 3 - *Politics*.) However, foreign companies frequently cite this triangular relationship as a barrier to fair competition in Japan.

Today, this system is being challenged. A series of scandals exposing corruption and mismanagement have cost bureaucrats their traditional high standing, heightened the electorate's disillusion with politics and damaged the image of some leading corporations. The bureaucracy is increasingly seen as impeding the change that business, consumers and even some politicians demand.

Recognising these developments, the Hashimoto Government has prioritised administrative reform, known as the '*Kasumigaseki* reform'.[19] (See Chapter 3 - *Politics*.) Proposals for administrative reform include downsizing and redefining bureaucratic functions, moving all but the core ministries out of Tokyo, and establishing a new capital. While the bureaucracy vigorously opposes the relocation, some observers suggest that the threat of relocation could be used as a bargaining chip to force ministries to reform and restructure. For example, while MITI has been the strongest proponent of deregulation and market opening, it is reluctant to relinquish its own regulatory powers in industries like energy. At a time when other ministries were required to downsize, MITI sought to increase its 1996-97 budget, mainly to continue initiatives to help industries in distress. (See Chapter 10 - *Regions*.) Other ministries, like Labour, Education, Agriculture, Transport, Construction, and Posts and Telecommunications are even more reluctant to relinquish their regulatory roles.

Amakudari

A tradition which has sustained strong links between large companies and the bureaucracy is *amakudari*, or 'descent from heaven'. Through this practice, retiring senior bureaucrats assume senior positions in companies they formerly regulated, while maintaining close ties with the bureaucracy. *Amakudari* can lead to serious conflicts of interest and impede the progress of deregulation. As such, it has attracted increasing levels of public criticism. Recently Prime Minister Hashimoto targetted it as a practice to be abolished.

With private firms increasingly reluctant to accept bureaucratic retirees, *amakudari* may already be weakening. In 1995, 189 former senior bureaucrats (about half as many as at the peak of *amakudari* in 1985), moved directly into private sector jobs.[20]

....

18 For a detailed analysis, see Johnson, 1982; Murakami and Patrick, 1987; and Tabb, 1995.

19 Kasumigaseki is the district where many government offices and ministries are located in Tokyo.

20 This requires waiving a law whereby retirees must wait two years before making such a move.

Due to fewer jobs in the manufacturing sector in 1995, financial institutions, for the first time, were the largest employers of amakudari retirees. However, it is unclear whether the decline in *amakudari* reflects reduced job prospects due to the recession, a response to public criticism or weakening of the iron triangle.

COMPETITION POLICY

Japan's competition policy is founded on the provisions of the Antimonopoly Act, which aims to prevent private monopolies, 'unreasonable' restraints on trade (especially through horizontal cartels) and unfair trade practices. Weak enforcement and past proliferation of officially sanctioned cartels attracted considerable foreign criticism. Furthermore, the scope of the Antimonopoly Act is limited by exemptions provided either in the Act or by specific laws (GATT 1995, p. 85). Statutory exemptions include:

- 'natural monopolies' such as railways, electricity and gas
- resale price maintenance[21] for designated commodities and literary works
- cartels introduced to help depressed industries
- cartels introduced to assist firms during economic restructuring
- cartels maintained by small to medium-sized enterprises (SMEs) under the SME Organisation Act
- cartels under the Environmental Sanitation Act (for example, to prevent 'excessive' competition and deterioration of health standards in hairdressing and beautician businesses)
- export and import cartels authorised under the Export and Import Transaction Law (for example, to import silk products from China).

The number of cartels exempt from antimonopoly restrictions fell from over 800 in 1970 to 47 in 1996; reforms announced in 1996 promise to abolish remaining cartels by 1999. Furthermore, despite the recent recession, the Government has not introduced new cartels to bolster depressed industries over the last decade. Instead, cartel-type arrangements have come under pressure from the recession and foreign competition. However, according to Ushio Chujo, a Keio University economist, cartels are a cultural tradition dating back to the 1600s; therefore, many Japanese people do not necessarily disapprove of them (*Asian Wall Street Journal*, 5 December 1995, p. 1).

Fair Trade Commission

The Fair Trade Commission (FTC), which reports directly to the Prime Minister, is Japan's sole fair competition body. Its authority is limited to matters related to the Antimonopoly Act. Its major target areas are:

- price cartels (especially bid rigging where it affects taxpayers)

21 Regulations that govern the resale price of specific products so as to protect their value.

- import restrictions
- activities of deregulated bodies.

The FTC has been considerably strengthened in recent years, especially its investigative sections. Under the 1995 Deregulation Action Plan, for example, the number of investigators increased to 220 from 191 in 1990.

Companies may soon benefit from FTC action on import constraints and obstruction of parallel imports. The FTC will examine whether government-regulated quality inspection procedures impede free competition by restricting market entry. Reports indicate that the FTC believes some inspection procedures are so arbitrary that only a handful of firms with special ties to inspection bodies receive authorisation for their products, thereby allowing them to monopolise markets. Even when such approvals are not legally required, they are often *de facto* requirements, again impeding competition. The FTC has already determined that inspection procedures governing hospital catering and linen have prevented free competition. Other areas of focus are electrical appliances, telecommunications devices, transport equipment and medical instruments (*Nikkei Weekly*, 20 January 1997, p. 3).

INDUSTRY ASSOCIATION OR CARTEL?

While wood-burning stoves constitute a relatively new industry in Japan, old 'bad habits' remain. In 1993 the presidents of the largest companies in the industry established the Japan Fireplace and Stove Association (JFSA) to lobby the government, especially over outdated regulations, and to meet monthly for informal business discussions.

Wood-burning stoves are about four times more expensive in Japan than in the USA. Paul Kastner, a founding member of the JFSA and President of Fireside Stoves is quoted as saying 'Every once in a while someone says, "I don't want to cut prices, so you don't either". It's kind of understood, so we don't need to talk about it … Nobody wants to cut prices. When the yen was strong, nobody made the first move to cut prices, so they stayed the same.' Yet he insists that the JFSA is not a cartel. Reportedly, the Fair Trade Commission said it would be impossible to prosecute an industry group for an unspoken agreement arising in this way - an explicit agreement to raise prices would need to be found for prosecution. Parallel importers, who undercut prices, are kept out of the JFSA.

A representative from Asuka International, the largest importer not belonging to the JFSA, said it was easy to undercut JFSA members. However, they did not undercut too much as they did not want to 'get into a fight' with the JFSA.

Source: *Nikkei Weekly*, 13 November 1995.

Japan to Allow Holding Companies

From January 1998, the longstanding ban on holding companies will be lifted.[22] Critics believe holding companies will stifle competition and increase the power of business groups such as the *keiretsu*. Foreigners are concerned that holding companies will restrict market access. Proponents of holding companies, such as major corporations and the LDP, argue that they will help Japanese companies compete globally by enhancing corporate flexibility and strengthening Japan's weak venture capital sector.

The changes required to the antimonopoly law to facilitate the legal establishment of holding companies also protect against holding companies stifling competition. The main revisions to the law are to:

- lift the general ban on holding companies
- ban holding companies that would result in an over-concentration of power
- notify the FTC when assets exceed ¥300 billion
- clarify legal provisions and limit bureaucratic discretion
- provide for FTC to take action against violations
- maintain restrictions on stockholdings of financial institutions
- maintain restrictions, at least temporarily, on stockholdings of large nonfinancial companies.

Preliminary indications suggest that some Japanese companies, especially large trading houses, already are restructuring to take advantage of these changes. However, taxation reform will also be necessary to make holding companies attractive options. (See Chapter 6 - *Internationalisation* and 7 - *Finance*.)

MARKET REFORM INFLUENCES

In the past, much economic reform has occurred as a result of g*aiatsu*, or foreign pressure. While domestic pressure for reform has strengthened considerably over the past few years, participation in multilateral and regional fora such as the World Trade Organisation (WTO) and Asia-Pacific Economic Cooperation (APEC), and direct bilateral discussions will continue to have an important influence on Japan's reform agenda.

Domestic Business Interests

Japanese business is actively calling for reform and deregulation in response to competitive pressures at home and abroad. In its December 1995 report, the Administrative Reform Committee, a private sector advisory body monitoring the implementation of administrative reform and deregulation, and reporting to the Prime Minister, called for structural reform of Japan's society, politics and economy of a magnitude to 'rival and even exceed the Meiji Restoration and postwar reforms'. (See Chapter 3 - *Politics*.)

....

[22] Although holding companies are commonplace in most countries, they are a sensitive subject in Japan, due mainly to their association with the former *zaibatsu*.

Proponents of reform tend to be larger companies in export-oriented sectors rather than smaller businesses in domestically oriented sectors. Small to medium-sized enterprises (SMEs) are usually more reluctant to back deregulation as it has often protected them from open market forces. The survival of the Large-Scale Retail Stores Law, for example, is in large part due to SMEs' lobbying efforts. (See Chapter 9 - *Distribution*.) The Japan Chamber of Commerce, which traditionally represents smaller companies, opposes further deregulation, citing its negative impact on employment and regional development. Even in larger companies, some are cautious about deregulation. While a positive attitude to reform may prevail generally, when it comes to specific deregulation proposals, strong vested interests usually oppose reforms that directly involve them. However, as understanding of both the need for and the benefits accruing from reform are becoming more widespread, even conservative elements are re-evaluating their attitudes.

COMPETING INTERESTS IN DEREGULATION

Not all foreign firms welcome deregulation. Some foreign cosmetic manufacturers, including Christian Dior, did not appreciate the removal of barriers to cosmetic imports in 1996. The Ministry of Health and Welfare removed a regulation requiring importers to submit manufacturer-certified lists of ingredients for cosmetic products. The regulation had restricted such imports to Japanese subsidiaries of foreign manufacturers or to licensed importers able to obtain certified lists of ingredients. It had kept out parallel importers who undercut designated importers by offering products obtained through unofficial distribution routes. Now, foreign brand-name cosmetics are brought into Japan by parallel importers at prices 30 to 50 per cent below those offered by official distributors.

Parallel imports have long been a source of contention between Japanese retailers and foreign brand-name manufacturers. European ski makers and US car parts makers have tried to stop parallel imports by pursuing patent claims on their goods. However, the FTC ruled that attempts to block parallel imports by designated importers were illegal. In March 1995, the FTC accused an agent of Herend Porcelain Manufacturing, a Hungarian porcelain maker, of violating the antimonopoly law by trying to obstruct a discounter from selling products at 30 per cent below the official price.

The deregulation of the drug law created interest from discount retailers and supermarket chains. Pasona, a discount retailer in Tokyo, began offering brands including Chanel, Christian Dior and Clinique. Daiei, Japan's largest supermarket chain, and Seven-Eleven, a convenience store chain, were also exploring the possibility.

Source: *Financial Times*, 20 March, 1996, p. 6.

Japan's peak business organisation, the Japan Federation of Economic Organisations, or *Keidanren*, strongly supports deregulation, recently calling on the Government to rid Japan of unnecessary regulation and criticising the bureaucracy's inordinate slowness to cooperate in this process.[23] *Keidanren* believes that the existing socioeconomic system is reaching the limit of its effectiveness and has even become an impediment to further progress. It calls for strong political leadership and a small, transparent and efficient government (Keidanren, 1996). *Keidanren* and other pro-reform business groups, such as the Committee for Economic Development (*Keizai Doyukai*), criticised the March 1996 revision of the Deregulation Action Plan as too weak, especially in relation to the Antimonopoly Law, retail trading and the labour market (*Nikkei Weekly*, 1 April 1996, p. 3).

Consumer Interests

Japanese consumer advocacy groups tend to be conservative, do not want to upset the status quo and favour government control. In fact they often appear more concerned about producers' interests than consumers'. They are most prolific in the food sector, where they lock out imports with often unsubstantiated concerns about food safety and the need for food self-sufficiency. (See Chapter 11 - *Agrifood*.)

Consumers instead exercise influence through their purchasing power. In 1993, before the influx of cheap imported goods, average prices in Tokyo were 1.4 times higher than in New York and Paris, and 1.5 times higher than in London (Japan External Trade Organisation [JETRO], 1995, based on a survey by the Economic Planning Agency). The difference was especially apparent in food, clothing, shoes, energy, water and rent. (See Chapters 11 - *Agrifood* and 12 - *Energy*.) The growing demand for value for money and a greater willingness to try foreign products is placing inefficient domestically oriented manufacturers under considerable pressure. (See Chapters 2 - *Socioeconomic Evolution*, 6 - *Internationalisation*, and 9 - *Distribution*.)

A PERSONAL PERSPECTIVE

Makiko Mannami's local supermarket always stocked the same Japanese vegetables; the store's range was limited and prices were high, but no one expected otherwise. However, in the last year, the store suddenly began selling oranges from Florida, apples from New Zealand, grapefruit from Israel and pumpkins from Mexico. Mannami worries that foreign growers use dangerous chemical sprays on their produce - one of the claims that Japanese farmers have used against food imports - but she likes the prices and the variety. So she's buying foreign. 'I can't read the labels on some of them but they're cheap and look good, so I buy them all the same', says the 37-year-old Tokyo housewife.

Source: *Far Eastern Economic Review*, 1 February 1996, p. 40

....

23 Speech by Dr Toyoda, head of *Keidanren* and Chairman of Toyota, to symposium on The Economic Benefits of Deregulation, Tokyo, July 1996.

The World Trade Organisation

Japan has always attached high priority to multilateral trade diplomacy and is a founding member and strong supporter of the WTO. Japan is party to the Plurilateral Trade Agreements concluded in parallel with the Uruguay Round trade negotiations, including the new Agreement on Government Procurement. Japan's bilateral relations also are likely to benefit from the reinforced multilateral rules embodied in the WTO (GATT, 1995, p. 15).

With the establishment of the WTO, the scope of its work has broadened from that traditionally dealt with by its predecessor, the GATT. Japan appears to support, to varying degrees, most of the WTO's new work: trade-related issues arising from investment, competition policy, the environment and regional trade arrangements; but not trade and labour standards. However, Japan has been reluctant to discuss further negotiations on agricultural trade liberalisation ahead of their formally agreed recommencement date of 1999. (See Chapter 11 - *Agrifood*.)

WTO DISPUTES INVOLVING JAPAN

Disputes at consultation stage (date of filing)

- Lack of Japanese copyright protection for pre-1971 sound recordings: complaint by the EU (May 1996, earlier complaints by EU and USA)
- Restrictions in Japanese photo-film market: complaint by USA (June 1996)
- Japan's retail distribution system: complaint by USA (June 1996)
- Brazil's car import regime: complaint by Japan (July 1996)

Panel investigations under way (date established)

- Japanese liquor taxes: complaint by EU, Canada and USA (October 1995). Panel report upholding complaint completed June 1996. Japan considering an appeal

Disputes settled

- Japanese telecom's procurement complaint by EU suspended
- Threat of US punitive sanctions: complaint by Japan withdrawn after car dispute settled.

Source: *Financial Times*, 8 August 1996, p. 6.

Asia-Pacific Economic Cooperation (APEC)

Japan has strong economic interests in APEC. In the first eight months of 1996, APEC countries accounted for 74 per cent of Japan's exports and 68 per cent of its imports. Japan's involvement in APEC has had two main effects on its trade policies and markets:

1. It provided a new focus for trade and investment liberalisation. As one of the instigators of APEC, host to the third Leaders' summit in Osaka in 1995, and

one of the strongest economies in the region, Japan's commitment to the APEC concept is strong.

2. The commitments made collectively and individually in APEC have added to the momentum for deregulation and reform in Japan.

Japan's 1996 Individual Action Plan (IAP), containing a significant number of measures already underway, was comprehensive. Issues concerning Australia, such as food labelling and timber standards, are to be addressed early in the program. The main elements of Japan's IAP include:

- to undertake to accelerate implementation of its Uruguay Round obligations as per its 1995 downpayment package and its 1996 deregulation package
- to commit to revise administrative arrangements to facilitate plant and animal imports, indicating that Japan accepts agriculture as a legitimate element of APEC liberalisation (see Chapter 11 - *Agrifood*)
- to review access for foreign lawyers (see Chapter 14 - *Services*)
- to review telecommunications and maritime services (linked to successful outcomes in ongoing WTO negotiations), other transport, energy and tourism
- to eliminate the prior notification requirements for foreign investors in the mining industry by 2000
- to begin aligning all domestic and international standards from 1997, completing the task by 2010.

Japan's commitment to APEC should continue to generate strong pressure for liberalisation of trade policies and market access. However, as the 2000 deadline for implementing Uruguay Round commitments and the 2010 deadline for liberalising trade and investment under APEC draw closer, Japan will need strong political leadership to deliver its commitments. Domestic opposition to liberalisation of the agriculture sector, in particular, will present a formidable challenge. (See Chapter 11 - *Agrifood*.)

The USA-Japan Relationship

The USA has wielded enormous influence on Japan's post-World War II trading environment. Over the past decade, however, the US-Japan relationship has been strained by highly publicised trade disputes, fuelled by the simultaneous increases in the Japanese trade surplus and the US trade deficit. In the second half of 1996, China displaced Japan as holder of the largest trade surplus with the USA, and Asian countries displaced the USA as the main contributors to Japan's overall trade surplus.

The USA has pressured Japan to liberalise its markets (Appendix 8.2). Many US-Japan market access arrangements benefit all exporters to Japan because they are implemented on an MFN basis. However, a degree of trade diversion is evident from US pressure on Japan and Japan's interest in relieving that pressure in the most effective way. For example, the Australian car and beef industries have had concerns that US-Japan trade agreements could displace Australian exports to Japan.

TRADE POLICY - USE AND MISUSE IN US-JAPAN RELATIONS

USA-Japan trade disputes usually arise from US accusations of unfair Japanese trade practices - typically involving claims that Japan's markets are closed to US imports or that Japan is dumping products on the US market. The resulting bilateral negotiations often span several years, climaxing with US threats of tough trade measures against Japan, and being resolved by a form of 'managed trade'. Whether these USA-Japan trade disputes are based on real barriers to trade with Japan, or on other factors, is a highly divisive issue. However, these differences cause considerable friction between Japan and its trading partners, leading to calls both for protectionist retaliation and for Japan to increase its imports. For Australia and other third countries, such disputes raise concerns that purchasing decisions may not be commercially based.

Japan's rapid rise to economic superpower status coincided with a period of declining competitiveness in the USA. The threat to US economic hegemony is arguably a major cause for heightened trade tensions between the USA and Japan. Laura Tyson, Chief Economic Adviser to President Clinton, in a 1993 book gives an informative perspective on this conflict. She claims that what was once considered an alarmist view had become a mainstream opinion: that the USA's economic competitiveness was in slow but perceivable decline. She believes that the debate in Washington had shifted from discussing the problem to taking action on it.

Motorola's attempts to sell cellular telephones in Japan in the 1980s is one US-Japan trade dispute examined by Tyson. She claims that Motorola's case was clear cut in that the company used trade policy to win the opportunity to compete on the basis of its proven abilities, and not as a substitute for them. However, Motorola's case is exceptional in this respect. Tyson argues that more often than not, weak producers, not strong ones, fall back on trade policy to protect themselves at home, rather than to exploit market opportunities abroad. Furthermore, given the politics of trade policy decisions in the USA, she believes it is hard to be optimistic that deserving cases will always be distinguished from undeserving ones.

Although the USA was successful in using trade policy to allow Motorola to compete fairly in the Japanese market, Tyson argues that this was not without cost. First, the dispute heightened trade tensions between the USA and Japan. It strengthened stereotypes in each country: in Japan it reinforced the view that Americans are 'unreliable and whining bullies', and in the USA, that Japan is an 'unfair and predatory' trader. Even more importantly, Tyson argues that the Motorola case was dangerous because it strengthened incentives for US companies to resort to trade policy to win their competitive battles.

Source: Tyson, 1993

Threatened US retaliation against Japan over alleged barriers to car and car parts imports in 1995 raised fears that the USA may continue to rely on unilateral trade measures, thereby undermining the rules-based dispute mechanisms of the WTO. Since then, the USA has largely adhered to the multilateral agenda. The US decision to allow the WTO to mediate in the Fuji/Kodak film dispute is a marked shift from its previous bilateral approach, whereby agreements were usually clinched at the last minute under the threat of US trade sanctions.

Probably Japan will continue to take a more proactive stance in bilateral trade disputes with the USA and be less inclined to capitulate to pressures for 'managed trade' outcomes.[24] This is illustrated by Japan's insistence on a multilateral resolution of disputes over cars, semiconductors and colour film. Despite this trend, the USA is likely to remain the strongest single external influence on Japanese markets and trade policies.

The Australia-Japan Relationship

Australian economic and trade interests are actively pursued by the Australian Government through the Australian Embassy in Tokyo, including through government-to-government consultative arrangements. Austrade, through its offices in Japan and Australia, directly assists Australian companies to access the Japanese market. (See '*Information for Companies*' section at the back of this book.) The Government takes a proactive and vigilant approach to market-access issues, closely monitoring Japan's deregulation and market-opening measures, and pursuing concerns through a range of multilateral and regional mechanisms, as well as bilateral consultations (Table 8.6).

24 A type of international trade in which some sectors or products are not traded according to the demands of market forces. More modern versions of managed trade seek to increase exports through numerical targets, usually at the expense of third-country exporters.

Table 8.6

Australian Embassy Pursues Australian Business Interests

Australia-Japan Bilateral Market Access Developments
Fourth Quarter, 1996

Event	Timing	Comment
Research and voluntary testing programs for E-coli 0-157 conducted by MHW and MAFF	Mid-August to end October	In consultation with AQIS and AMLC, close liaison was maintained with MHW / MAFF on research and voluntary testing programs for imported beef and some vegetables following major outbreak of E-coli 0-157 in July. Successfully ensured no Australian product implicated.
Interhome Expo in Kobe featuring Australian Pavilion with representation from 30 Australian companies	4-8 September	Australian pavilion visited by 63 000 people. Approximately A$10 million worth of business in Australian housing and building products contracted, with greater commercial benefits in the longer term.
Seminars on Australian housing in newly erected Consul-General's residence in Kobe for Japanese industry and local government officials	5-6 September	Stimulated interest in Australian housing in the industry, and greater understanding of Australian performance standards for building practices among construction officials and industry.
Approval for export of emu meat and meat products to Japan	12 September	Following approach from industry, agreement reached with MAFF and MHW on conditions of export. Procedure requires AQIS certification similar to that negotiated for kangaroo meat exports. Small niche market.
Inaugural Australia-Japan housing and building talks	17-18 September	Wide-ranging exchange of information between officials as well as industry organisations. Both sides agreed to closer cooperation in this area, including through mutual recognition, harmonisation of standards and joint research projects.
Prime Minister Howard launched Australian Business Internet site during his visit to Tokyo	19 September	Embassy site already rated one of the most popular in Japan. Prime Minister's launch attracted positive press coverage.
Australian citrus exports - sealing of individual cartons	20 September	On behalf of AQIS, negotiated lifting of longstanding MAFF requirement for each carton of citrus exports (oranges and lemons) to be individually sealed. MAFF now accepts freight container-sealing, reducing costs to industry.
Exports of molluscan shellfish (including natural oysters)	20 September	Negotiated extension of agreement with MHW to include access for molluscan shellfish from six major harvesting areas in South Australia, adding to earlier access for Tasmania.

Table 8.6 (Cont.)

Event	Timing	Comment
Annual Import Board meeting	25 September	Presentation by the Chairperson, ANZCCJ - with input from the Embassy - highlighting benefits of deregulation for foreign companies and Japanese consumers, and urging more progress. Also identified ongoing difficulties Australian exporters face in selected areas.
Finalisation of protocol for export of1995/96 season stored hay to Japan	September	A$200 million market suspended of following death of Japanese dairy cows due to rye grass toxicity from hay imported from Western Australia. Negotiated new industry-wide protocol with MAFF.
Electronic health certification for export meat	September/ October	Agreement finalised with MHW for pilot trial of health certificate via Australian-developed (unaccepted) system. Trial to commence February 1997 and run 6 to 8 weeks. Full implementation will lead to significant cost savings (documentation and time) for Australian meat industry.
Officials meeting on MRA between Australia and Japan	8 October	Australian interest in multisectoral proposal aimed at easing market entry for a range of products. Australian delegation included representatives from DIST, DPIE, JAS-ANZ and NATA. Raised level of understanding of Australian certification system. Agreement to establish technical/ official working group to carry forward negotiations.
Visit by AJBF delegation to examine Japan's distribution	6-10 October	Facilitated high-level business mission report on distribution system for system exporters and potential exporters to Japan.
Submission of Australian market access complaints to OTO	18 October	OTO agreed to examine two issues: difficulties in access to the Japanese market for Australian race horses; and financing by the Maritime Credit Corporation acting as a barrier to entry for foreign ferries/boat builders.
Follow-up visit to Japan MBA	21-24 October	Facilitation of further contacts by Australian housing and building materials exporters, including attendance at Tokyo home fair.
Clarification of Australian interest in a film co-production agreement with Japan	24 October	After several years of negotiations, Australian Film Commission advised it does not wish to pursue an agreement with Japan.

Table 8.6 (Cont.)

Event	Timing	Comment
Gazettal of Area Freedom for Tasmania from Tobacco Blue Mould	26 October	Negotiations commenced in 1991 and actively pursued over the past 12 months. Opens market opportunities for tomatoes, capsicums and other eggplant family products.
Preparation of a market access survey of ANZCCJ members	end October	In conjunction with NZ Embassy, survey prepared a questionnaire to help identify impediments to Australian business operating in Japan.
Lodging of Australian Government's third submission on deregulation, including a number of meetings with agencies concerned	15 November	Submission contained priority requests relating to regulatory barriers covering land and housing issues, telecommunications, shipping, food and agricultural products, and other discriminatory trade practices.
Representations to MHW on date marking for bulk dairy products	22 November	Joint submission with Danish, US and NZ Embassies, lodged with MHW seeking exemption on behalf of the dairy industry from 'use by date' markings on all bulk dairy products (10kg packs and above). Major market for Australian bulk cheese and skimmed milk powder.
Ambassador's presentation to the Administrative Reform Committee	28 November	Registered Australia's keen interest in further deregulation.
Approval for export of new-born calf serum	4 December	Following acceptance by MAFF on AQIS certification requirements for export of calf serum originating in NZ and further processed in Australia. New market for Australian company.
Lifting of import ban on Kensington Pride Mangoes	4 December	Following acceptance by MAFF of disinfestation research, ban on mangoes from within 80km quarantine zone has been lifted, opening way for further exports of over A$1 million during current season.
Approval for export to Japan of carry-on packs of Australian beef jerky from Guam Airport duty-free shops	4 December	Submission originally made on behalf of Australian exporter in 1993. Actively pursued issue with MAFF following renewed interest by exporter. MAFF approval is based on current AQIS export certification arrangements.

Notes: MHW: Ministry of Health and Welfare; MAFF: Ministry of Agriculture, Forestry and Fisheries; AQIS: Australian Quarantine Inspection Service; NZ: New Zealand; AMLC: Australian Meat and Livestock Corporation; ANZCCJ: Australia and New Zealand Chamber of Commerce in Japan; MRA: Mutual Recognition Agreement; DIST: Department of Industry, Science and Technology; DPIE: Department of Primary Industries and Energy; JAS-ANZ: Joint Accreditation System - Australia New Zealand; NATA: National Accreditation Testing Association; AJBF: Australia-Japan Business Forum; MBA: Master Builders Association; OTO: Office of the Trade Ombudsman.

Source: Department of Foreign Affairs and Trade, 1997.

JAPANESE ASSISTANCE TO FOREIGN BUSINESS

The Japanese Government has numerous programs to facilitate inward foreign direct investment (FDI). (See Chapter 6 - *Internationalisation*.) The March 1994 External Economic Reform Package extended measures announced in 1992 to promote inward FDI, such as preferential tax treatment, an extended loss carry-over period, an enlarged preferential loan scheme and strengthening of the activities of the Foreign Investment in Japan Development Corporation (FIND)[25] and JETRO. This package also included the establishment of the Japan Investment Council to further improve the investment climate for foreign firms. Chaired by the Prime Minister, it includes representatives of foreign firms, business associations and relevant authorities. In 1995, it was decided to continue many of these measures until 2006. (See *Information for Companies* after Chapter 15.)

The Japanese Government also has introduced measures to promote imports. Import promotion programs aim to encourage domestic producers and distributors to switch to imported products by temporarily subsidising their transition costs and to attract foreign exporters and investors by temporarily subsidising entry costs (GATT, 1995, p. 73). Measures include tax incentives, concessional loans, import promotion activities by JETRO, improvements in infrastructure and programs to teach foreigners how to do business in Japan. Since 1994, more specific programs have been introduced in targetted sectors such as vehicles and components, housing and building materials. In contrast to most general measures, tax incentives are only available for manufactured products already entering Japan duty free (GATT, 1995, p. 73).

Foreign Access Zones

Foreign Access Zones (FAZs) were introduced to address Japan's trade surplus and the post-bubble recession. These high-profile zones have been established close to ports and airports to facilitate imports under the temporary Import Promotion and Domestic Investment Act. FAZs aim to revitalise local economies, facilitate imports and encourage inward investment. They differ from free-trade areas by offering a much more comprehensive range of facilities and not necessarily having integrated bonded areas. By 2000, Japan will have 21 FAZ sites, with the first six announced in 1992. Each FAZ involves massive capital investment in facilities and infrastructure, such as roads, airports and sea ports. Many FAZ facilities are in low-growth areas and regions where foreign companies have not traditionally conducted business.

A FAZ typically consists of:

- processing and assembling factories for imported goods
- storage and distribution facilities
- joint physical wholesale centres
- permanent exhibition halls/trade fair grounds
- import-related information centres

[25] The Foreign Investment in Japan Development Corporation is a mixed capital company established in June 1993 exclusively to provide technical support services to foreign investors in Japan.

- support facilities for import procedures
- subsidised offices for foreign import businesses
- cargo information control
- direct sale shopping centres.

Managing each FAZ is a 'third sector' company (*daisan sector kaisha*) comprising both private and public (all levels of government) investment. Each FAZ determines its own specialisation and geographic focus. Appendix 8.3 presents a case study of the Ehime FAZ, one of the first to come into operation.

The FAZ initiative, now five years old, is yet to have significant impact on the economy. While FAZ objectives are seen as useful, some questions have been raised about their future.

- *Are FAZs the most effective method of increasing imports into Japan?* Heavy government involvement appears contrary to pressure for less government intervention in the economy.
- *Is there enough underlying consumer demand to justify the size of the capital investment in FAZ sites?* Officials from four FAZ sites in Japan could not offer rigorous evidence of sufficient demand to support the investment.
- *Is the primary focus of the FAZ on promoting imports or on revitalising local economies?* In many cases, emphasis is on revitalising the local economy. While both objectives are important, FAZs were established under a law for 'import promotion and domestic investment'.

NEW MARKET BARRIERS?

As old barriers to foreign competition in Japan are removed, new ones may take their place. The most recent economic revitalisation measure, the five-year Specific Measures Law to Promote Business Reform for Specific Industries, announced in the second half of 1996, applies to over 200 industries including manufacturing, mining, retail and wholesale industries. It offers wide-ranging benefits including:

- subsidised capital from Japan's Development Bank and the Industrial Structure Improvement Fund
- tax exemptions
- concessionary treatment under the Factory Land Law and cuts to real estate acquisition tax
- grants to promote employment stabilisation and job training by local governments
- cooperation with educational institutions to promote research and development through tax concessions and low interest loans
- introduction of stock options to motivate and improve the quality of executives.

As a safeguard, the legislation provides for relevant business reform plans to be sent to the FTC to ensure they are compatible with international arrangements. Nevertheless, the significant subsidies and government intervention implied under the Specific Measures Law raises concern that bureaucratic power and discretion may not be reduced significantly in the short to medium term.

THE MARKET IS OPENING, ACCESS IS IMPROVING

Japan's formal protection through tariff and core nontariff barriers does not make its market more difficult to access than those of the EU or USA. Indeed, the Japanese Government has introduced many measures to actively promote imports and foreign participation in its markets. However, Japan's regulatory environment presents a significant obstacle for foreign companies. Over-regulation, a lack of transparency and excessive bureaucratic discretion in decision making, all make it a difficult market for new domestic and foreign entrants. An important step will be to break the strong link between the public and private sectors and delineate a more appropriate government role in the economy.

The Japanese economy continued to evolve structurally during the first half of the 1990s. While the pace of change has been brisk considering the recession, it has lagged behind the business community's expectations. Even with the strong domestic pressure for deregulation, the bureaucracy is generally reluctant to reduce significantly its market intervention. This has provoked public dissatisfaction, particularly as the bureaucracy is now often perceived to be self-seeking.

Government efforts to reduce the regulatory drag on the economy have improved efficiency. However, excessive regulation and weak enforcement of antimonopoly provisions still impede many sectors. Although Japan's market is now more open and easier to do business in, remaining vested interests will necessitate continued pressure from consumers, industry and foreign governments for free and fair competition. Nevertheless, strong support from the Hashimoto Government provides the prospect of faster reform in the last years of this decade.

Appendix 8.1

A Long Process, But The Pace is Quickening

A Decade of Unfolding Regulation in Japan

Date	Name	Major measures	Comments
Nakasone Government			
1986	Maekawa Report	Offered recommendations for long-term structural reform.	Noted as beginning of period when attempts to deregulate the Japanese economy gradually gathered momentum.
Hosokawa Government			
Sept 1993	Emergency economic stimulus package	Proposed deregulation as one of three elements of package - 94 regulations to be eased in four main areas: increasing business opportunities, enhancing competition, promoting imports, reducing paperwork.	Criticised for insufficient measures and some items already were announced or deregulated.
Sept 1993	Interim Report on Deregulation	Recommended abolishment of all regulation 'in principle' and establishment of an Administrative Reform Promotion Headquarters chaired by the Prime Minister (established January 1994).	Used words 'in principle' - interpreted as weakening the recommendations. Criticised for business leaders and academics not being involved enough.
Feb 1994		Deregulated 250 items over short term, with additional 531 items to facilitate the coordination and streamlining of various procedures such as submission of notifications and reports.	Offered impressive number of reforms; however, many were no more than an effort to reduce overall number of regulations by combining them.
Hata Government			
June 1994		Proposed bureaucratic reform.	Drafted proposal to abolish, privatise or otherwise reform special government corporations which met with hostile reaction from bureaucracy; final report failed to note a single special corporation in need of review.
Murayama Government			
July 1994		Listed 279 items for deregulation focussing on real estate, access to markets by foreign and Japanese companies, information and communications, financial services.	Noted some items were from recommendations of *Keidanren* package of 196 proposals submitted to the government in May 1994. Described as the most substantial move forward in several years. However, many items left for medium-term resolution, including abolition of LSRSL.

Appendix 8.1 (Cont.)

Date	Name	Major measures	Comments
Oct 1994		Convened Administrative Reform Committee (ARC) under LDP coalition government.	Aimed to incorporate private sector suggestions into five-year deregulation and import program. Specifically: to simplify standards and certification procedures for car parts and provide preferential tax treatment for inward FDI.
Jan 1995	Interim deregulation report of ARC	Listed 500 areas for deregulation out of total 1 800 requested.	Categorised only 117 areas as substantive steps; no timeframe given for implementation.
Mar 1995	Deregulation Action Plan (DAP)	Indicated 1 091 measures in ten major sectors aimed at creating an internationally open economy. Included annual reviews and ongoing consultation with trading partners. Initially was to be implemented over 5 years, then reduced to 3 years.	Repeated many items from previous announcements. The 700 new items were of no great consequence and lacked implementation detail. The package was criticised for lacking substance.
July 1995	Annual Report on Deregulation	Aimed to give the public a true and clear picture of deregulation process. First such report released by Economic Planning Agency.	Work begun under Hosokawa Government. Criticised for not describing regulations in simple terms or explaining why so many regulations remained.
Nov 1995	ARC deregulation report	Offered 53 proposals for revising the government's ongoing deregulation plan.	Acknowledged for adding to debate on deregulation but criticised as not offering enough to consumers, especially on failure to recommend abolishment of LSRSL
Hashimoto Government			
Mar 1996	Revised DAP	Added 569 measures (and 1 extra sector), bringing total to 979. Announced that 818 of original DAP measures partially or wholly implemented. Competition policy to be strengthened.	Contained potentially useful deregulation in telecommunications and financial services but criticised as falling far short of ambitious deregulation, especially in its failure to abolish LSRSL.
July 1996	White Paper on the Current State of Deregulation	Management and Coordination Agency examined effects of deregulation on 13 sectors. Reaffirmed commitment to deregulation in face of mounting criticism from business about slow pace of reform.	Reported that deregulation had a positive effect on a range of business activities. Of 655 deregulation requests from private sector in JFY1995, 119 had measures taken (18 per cent) with a further 54 under review. Suggested continuing bureaucratic reluctance to respond to private sector requests.

Appendix 8.1 (Cont.)

Date	Name	Major measures	Comments
July 1996	EPA proposal for priority areas for deregulation	Highlighted five priority areas for deregulation: information and telecommunications, distribution, finance, land and housing, and labour. Medical care and welfare added.	Noted as important step in creating deregulation momentum. Attempted to break link between political leadership and bureaucratic organisations. Estimated 4.3 million jobs could arise from reform in the six sectors. Hashimoto upgraded proposal to 'Cabinet Priority Measure'.
Nov 1996	Financial sector 'Big Bang'	Represented a landmark proposal to reform Japan's financial sector by 2001. Set clear markers for the reform of important parts of the system. Aimed to ensure free and fair operation of financial markets and to make Tokyo a global market.	Received generally positive reaction, though criticised for the long implementation period. In March 1997 some suggestion the end date for reform may be brought forward to 1999. Seriousness of the Big Bang questioned in April 1997 following rescue of Nippon Credit Bank.
Jan 1997	Hashimoto's agenda for reform	Set six priority areas for reform: fiscal structure; education; social security; economic structure; financial system; and administration.	Gave Hashimoto opportunity at opening of Diet to outline agenda for reform of Japanese economy, to reaffirm commitment to reform and warn against 'slackening or postponing the pace of reform'.
April 1997	Revised DAP	Final annual review of DAP. 890 new measures added, brought total to 2823, covering all sectors of economy. The deregulation process accelerated by a new requirement that government advisory councils examining potential deregulatory measures conclude discussions by September 1997.	Criticised by some private sector commentators as lacking in substance, but Japan's business leaders generally positive. Key business organisations stressed the need for effective implementation and further promotion of deregulation. Useful progress in agriculture, housing and legal services.

Notes: EPA: Economic Planning Agency; FDI: Foreign Direct Investment; JFY: Japan Financial year (April to March); LDP: Liberal Democratic Party; LSRSL: Large Scale Retail Store Law.

Sources: Department of Foreign Affairs and Trade, 1997; George-Mulgan, 1996.

Appendix 8.2

Market-Opening Measures Resulting from US Pressure

USA-Japan Trade Arrangements

Date of initiation (expiry date)	Product / service	Arrangement	Measures taken
I. Arrangements and measures affecting exports (Voluntary Export Restraints)			
… (July 1993)	Ball bearings	na	Restricted exports to US market
1962 (Dec 1994)	Metal flatware	na	Restricted exports to US market
1964 (Dec 1994)	Pottery and chinaware	na	Restricted exports to US market
1981 (Mar 1994)	Passenger cars	na	Restricted exports to US market
1986 (Dec 1993)	Machine tools	Arrangement concerning trade in certain machine tools	Restricted exports to US market
1992 (within 7 years)	Fibre	na	
II. Arrangements and measures affecting imports			
1. Trade liberalisation and deregulation			
1986	Medical equipment and pharmaceutical products	Report on Market Opening Sector Selective. Talks on medical equipment and pharmaceuticals	Relaxed legal approval system and tariff revision
1988	Beef and oranges	na	Abolished import quotas and tariffication
June 1990	Wood products	Measures to be taken by the Government of Japan relating to wood products	Relaxed standards and revision of tariff category
Oct 1994	Insurance	Measures by the Government of Japan and the Government of the US regarding insurance	Increased both governments' market access of foreign insurance suppliers' intermediaries
Feb 1995	Financial services	Financial services agreement between both governments	Allowed foreign investment advisory companies to compete in Japan for the management of public pension assets for the first time, and for larger share of corporate pension assets. Japan also liberalised corporate securities market and cross-border financial transactions
July 1995	FDI in Japan	Agreement between governments on inward FDI and buyer-supplier relations	Promoted increased foreign business presence in Japan and encourages stronger links between Japanese buyers and foreign suppliers

Appendix 8.2 (Cont.)

Date of initiation (expiry date)	Product / service	Arrangement	Measures taken
2. Public procurement procedures			
June 1990	Supercomputer	Procedures to introduce supercomputers	Streamlined procedures and improved transparency
June 1990	Satellites	na	Streamlined procedures and improved transparency
Jan 1992	Computer products and services	Measures related to Japanese public sector procurement of computer products and services	Streamlined procedures and improved transparency
Dec 1992	Telecommuni-cations equipment	Improvement measures on NTT procurement procedures	Streamlined procedures and improved transparency
Jan 1994	Public works	Action plan on reform of the bidding and contracting procedures for public works	Streamlined procedures and improved transparency
3. Import facilitation			
Sept 1990	Amorphous metals	Joint announcement	Established evaluation method based on economic efficiency and encouraged purchase of amorphous metal transformers by Japanese utilities
June 1991	Semiconductor products	Semiconductor products arrangement	Improved market access through, inter alia, development of foreign semiconductor design-ins, avoidance of injurious dumping through antidumping measures
Jan 1992	Automobile parts	Global partnership plan of action	Japanese auto manufacturers announced would increase part imports and government indicated it would promote design-ins and assist sales missions
Jan 1992	Glass products	Global partnership plan of action	Government offered encouragement for establishing internal antimonopoly act compliance programs by the private sector, and for establishing buyer-supplier relationships with foreign producers

Appendix 8.2 (Cont.)

Date of initiation (expiry date)	Product / service	Arrangement	Measures taken
April 1992	Paper products	Measures to increase market access in Japan for foreign paper products	Provided government encouragement for establishing internal antimonopoly act compliance programs by the private sector, and for establishing buyer-supplier relationships with foreign producers
Nov 1994	Telecommunications products and services	Measures on Japanese public sector procurement of telecommunications	Streamlined procedures and improved transparency
Nov 1994	Medical technology products and services	Measures related to Japanese public sector procurement of medical technology products and services	Streamlined procedures and improved transparency
Jan 1995	Flat glass	Measures by the government of Japan and the government of the USA regarding flat glass	Increased market access for competitive foreign flat glass; efforts by manufacturers to export to Japan
July 1995	Civil aviation	Accord between two governments	Offered access for Federal Express to the Japanese market from its regional hub in the Philippines
August 1995	Automobiles and auto parts	Accord between both governments	Eliminated unnecessary and burdensome regulations placed on foreign auto parts. Provisions for measuring anticipated increase of US cars in Japan
March 1996	Civil Aviation	Accord between both governments	Relaxed restrictions on air cargo services
III. Broader Arrangements Affecting Imports, Exports and Production			
Jan 1986	Structural issues	Market Opening Sector Specific (MOSS) talks	Focused on telecommunications, electronics (with separate semiconductor negotiations), forest products, medical equipment and pharmaceuticals. USA achieved many of changes sought. Examples: Japan to implemented tougher intellectual property rights for electronics and accepted foreign test data for most pharmaceuticals
Jan 1992	Structural issues	Structural Impediments Initiative (SII) talks	Japanese measures: amended Large Scale Retail Store Law; Antimonopoly Act and Corporate Law; enacted Administrative Procedures Law US measures: committed to budget deficit reduction

Appendix 8.2 (Cont.)

Date of initiation (expiry date)	Product / service	Arrangement	Measures taken
July 1993	Structural issues	Framework for a new economic partnership	Committed Japan to address major barriers in five defined areas: government procurement; regulatory reform and competitiveness; other major sectors; economic harmonisation; implementation of existing arrangements and measures. Japan committed to reduce its current account surplus as a percentage of GDP

Note: na: Not available.

Source: General Agreement on Tariffs and Trade, 1995, p. 21; United States Trade Representative, 1996.

Appendix 8.3

CASE STUDY: EHIME FOREIGN ACCESS ZONE

The Ehime Foreign Access Zone (FAZ), one of the first in Japan, is situated close to the airport and seaport of Matsuyama, the largest city in Ehime Prefecture, Shikoku. (See map in Chapter 10 - *Regions*.) The Ehime FAZ aims to:

- revitalise the local economy by creating new employment opportunities, increasing the efficiency of the distribution system and immersing the local business community in a more competitive, international environment
- increase imports, especially of raw materials from Pan-Pacific countries for further processing, value adding and sale in Japan.

Capital invested in the Ehime FAZ Company was ¥3 427 million. Around 60 per cent of this capital came from the prefectural and local governments and the Ministry of International Trade and Industry (MITI); the remainder came from private investors (with an average investment of ¥10 million to ¥50 million). In 1996, the company employed 47 people, 42 of whom were seconded from other companies which continued paying their salaries.

The Ehime World Trade Centre, known as Item Ehime, and Ehime International Logistics Terminal, known as I-Lot, are the two main components of the Ehime FAZ. The Ehime Government built Item Ehime, which opened in 1996, and the FAZ company manages it. I-Lot is an integrated bond site. The cost of building this site was ¥3 400 million, of which ¥940 million came from the Ehime Government, the remainder came from other levels of government and the private sector. Some offices at Item Ehime also belong to I-Lot.

The Ehime Government actively promotes its FAZ, providing nearby vacant land for lease to companies involved in importing, especially processing firms. Tax incentives and grants from the different levels of government assist companies relocate. Both the Ehime and Matsuyama Governments contribute to the costs of holding trade exhibitions and sending missions overseas.

By 1996, its third year of operation, the Ehime FAZ company was still not profitable. Although activity in Matsuyama port had increased, economic activity and interest in internationalisation had not changed notably. The small market makes it difficult for potential exporters to fill containers destined for Ehime. The Ehime FAZ Company therefore encourages exporters to share containers. It also tries to match Japanese with foreign business interests.

While the Ehime FAZ initially focused on China and the Republic of Korea, Australia is one of its most recent interests. In February 1997, the Governor of Ehime, Sadayuki Iga, led a trade delegation of 30 business representatives to Sydney to meet Australian companies active in building materials, processed and fresh food, cut flowers, furniture and car components. Kakadu Traders, Marbletrend Bathrooms, Emerald Export and George Weston Foods were some of the 60 companies that met directly Japanese business representatives, without using a trading company. Several building companies were asked to quote prices on kit homes, which could lead to the development of the first Australian housing development in Ehime Prefecture.

REFERENCES

Asian Wall Street Journal, various issues.

Department of Foreign Affairs and Trade, 1997, various, including Australian Embassy in Tokyo.

Drysdale, P., 1995, The Question of Access to the Japanese Market, *Economic Record*, Vol. 71, No. 214, pp. 271-83.

Economist Intelligence Unit, 1996, consultancy for East Asia Analytical Unit.

Far Eastern Economic Review, various issues.

Financial Times, various issues.

General Agreement on Tariffs and Trade (GATT), 1995, *Trade Policy Review Mechanism - Japan*, GATT, Geneva.

George-Mulgan A., 1996, 'Politics of Economic Reform in Japan - The Politics of Deregulation and Japanese Agriculture', presented at a roundtable discussion, Australian National University, Canberra, 26 July.

Ishiguro, K., 1996, 'Restrictive Business Practices and Competition Policy in Japan in the Context of Trade Friction Between the US and Japan', paper presented at the Trade and Trade Practices in Japan Colloquium, Australian National University, August.

Japan External Trade Organisation (JETRO), 1995, *JETRO Business Facts and Figures - Nippon 1995*, Japan External Trade Organisation, Tokyo.

Johnson, C., 1982, *MITI and the Japanese Miracle: the Growth of Industrial Policy 1925-1975*, Stanford University Press, California.

Lawrence, R.Z., 1993, 'Japan's Different Trade Regime: An Analysis with Particular Reference to Keiretsu', *Journal of Economic Perspectives*, Vol. 7, No. 3, pp. 3-19.

Murakami, Y., and Patrick, H. (eds), 1987, *The Political Economy of Japan*, Stanford University Press, California.

Nikkei Weekly, various issues.

Organisation for Economic Cooperation and Development (OECD), 1996a, *Economy-Wide Effects of Regulatory Reform*, Organisation for Economic Cooperation and Development, Paris.

____ 1996b, *Indicators of Tariff and Non-Tariff Trade Barriers*, Organisation for Economic Cooperation and Development, Paris.

____ 1996c, *OECD Economic Surveys - Japan 1996*, Organisation for Economic Cooperation and Development, Paris.

____ 1996d, *Quarterly National Accounts - Number 2 1996*, Organisation for Economic Cooperation and Development, Paris.

Oppenheim, P., 1992, *Trade Wars - Japan Versus the West*, Weidenfield and Nicolson, London.

Sheard, P., 1996, 'Introduction - Japanese Firms, Finance and Markets', paper presented at the Trade and Trade Practices in Japan Colloquium, Australian National University, August.

____ 1994, *Keiretsu, Competition and Market Access*, Discussion Paper 94-17, Faculty of Economics, Osaka University, Osaka.

Shigehara, K., 1996, 'Results of Regulatory Reform for Consumers, Innovation and Economic Performance', paper presented at the Tokyo Symposium on Regulatory Reform: Building a Dynamic Economy for the Future, Tokyo, 2 December.

Tabb, W., 1995, *The Postwar Japanese System - Cultural Economy and Economic Transformation*, Oxford University Press, New York.

Tokyo Chamber of Commerce and Industry, 1993, *Building a New Corporate Network - Report on Research into Corporate Keiretsu*, Tokyo Chamber of Commerce and Industry, Tokyo.

Tyson, L., 1993, *Who's Bashing Whom? - Trade Conflict in High Technology Industries*, Institute for International Economics, Washington DC.

United States Trade Representative, 1996, *1996 National Trade Estimate - Japan*, from internet address: http://www.ustr.gov/reports/nte/1996/japan.html

FURTHER READING

Funabashi, Y., 1995, *Asia Pacific Fusion - Japan's Role in APEC*, Institute for International Economics, Washington DC.

Khan, S., and Yoshihara, H., 1994, *Strategy and Performance of Foreign Companies in Japan*, Quorum Books, Connecticut.

Wood, C., 1994, *The End of Japan Inc. and How the New Japan Will Look*, Simon and Schuster, New York.

Chapter 9

DISTRIBUTION REFORMS - A NEW CONSUMER FOCUS

Long characterised by excessive regulation and protection, high land costs, public tolerance of the highest prices among member countries of the Organisation for Economic Cooperation and Development (OECD), notorious inefficiency and support for the status quo, Japan's distribution system is changing radically. Consumers have unprecedented choice; companies have unprecedented challenges and opportunities. Although the fragmented, multitiered traditional system is becoming more streamlined and modernised, persistent efforts will be required to achieve improved efficiency and liberalisation.

In the past ten years, key factors driving change in the distribution system have included:

- growing market access pressure from overseas, preeminently the USA, providing vital impetus for deregulating the distribution sector
- the 1992 to 1995 recession, which heightened consumer price consciousness and forced manufacturers, wholesalers and retailers to compete by cutting costs and reducing prices
- the appreciation of the yen from 1985 which led to rapid import growth, intensifying and diversifying competition.

Notable results are that:

- fierce competition is forcing weaker firms out of business or into mergers
- the number of retail and wholesale firms is shrinking, while the average size of firms is growing
- both domestic and foreign firms are restructuring their distribution channels, and the distribution system is flattening out
- continuing technological advances are increasing the gap between large and smaller firms, the latter finding it difficult to invest in new technology
- large retailers are challenging manufacturers for control of the distribution system, especially through control of the price chain
- retailers and wholesalers are increasingly expanding offshore to source cheaper products and take advantage of emerging opportunities, primarily in Asia.

The Japanese distribution system is being transformed, offering more choices and lower prices for consumers, and more opportunities for domestic and foreign firms. However, the patterns of deregulation and change have been largely reactive. The real challenge lies in Japan's taking a more proactive approach in setting priorities for reform and change in the distribution sector.

This chapter explores how reforms in the distribution system are influencing competition, prices, choice and channels. It also assesses prospects for further change.

HIGHLY COMPLEX TRADITIONAL SYSTEM

The Japanese distribution system has long been unusual among OECD countries because of its multiple tiers and players, with their tight vertical links.[1] Until the 1990s, a stark contrast existed between the Japanese system and the much flatter and more competitive distribution systems that had evolved elsewhere.

Japanese feudal commerce was based on numerous specialised trade organisations separated by product type or artisan skill. Highly segmented vertical distribution channels dominated each area of trade,[2] with interpersonal relationships and loyalties playing a strong part in business connections. Until recently, Japan's postwar distribution system was similarly complex and multitiered. Each tier comprised hundreds of thousands of mostly specialised companies: manufacturers; primary, secondary and tertiary wholesalers; and retailers. The vast majority were very small. Close associations and interfirm loyalties connected numerous vertical specialised distribution channels, an important link contributing to continuity of the system.

The merchant-wholesalers dominated Japanese commerce from the early seventeenth century to the end of World War II. They controlled most warehousing and transport and financed most transactions within the distribution system. They became the primary entrepreneurs between producers and consumers (Kikuchi, 1994, p. 12). They financed the early manufacturers and reinforced their interest by distributing the manufacturers' products. They also wielded control over small and medium-sized retailers by providing the means of distribution and finance.

In the postwar period, manufacturers took over leadership of the distribution system because:

- the large-scale government financing and channelling of national savings targetted manufacturers
- manufacturers led product development
- large-scale manufacturing grew with automated mass production
- mass marketing developed through new media, especially television
- manufacturers liberated themselves from the wholesalers' control, by selecting their own wholesale agents and building up their own marketing channels

1 France also has a fragmented distribution system, with similar numbers of wholesalers and retailers, although not as extensively vertically integrated as the Japanese system (OECD, 1995).

2 The *za* of the twelfth to sixteenth centuries were feudal guilds of artisans or merchants, separated by product type. The *kabu-nakama* of the seventeenth to nineteenth centuries were specialised, closed unions with trade monopolies in their respective areas of business. Similar exclusive unions operated from the late nineteenth into the mid-twentieth century (Kikuchi, 1994, pp. 10-12).

- many large manufacturers established their own affiliated stores, bypassing wholesalers. Some allowed such stores to stock only their products, with very little autonomy in pricing or other matters.

WHOLESALERS IN THE POSTWAR PERIOD

Most of Japan's primary wholesalers (around 230 000 in the early 1990s) are relatively old firms with historical ties to particular manufacturers. The top several hundred are generally referred to as Class A wholesalers and include all the large trading houses. The secondary wholesalers (300 000 to 400 000 registered and unregistered) have traditionally bought from the primary wholesalers and sold to both large retail outlets and a vast network of subwholesalers who service the hundreds of thousands of tiny shops and stalls throughout the country. While many secondary wholesalers are sizeable, they have generally not been able to buy directly from manufacturers because of the primary wholesalers' exclusive rights. Most of the 300 000 or so registered and unregistered tertiary wholesalers are very small specialised operators using small trucks and even bicycles to service small retailers (Kikuchi, 1994, p. 12).

Price control was the key factor in manufacturers' dominance of the postwar distribution system. This was asserted through an intricate system of rebates which gave all players a share of the profits. The traditional distribution system favoured multiple specialised firms and highly segmented sales channels. Extensive regulation of specific industries and products through licensing and permit systems, taxation, administrative guidance and other measures protected small and medium-sized wholesalers and retailers.

The key legislation supporting this policy was the Large-Scale Retail Store (LSRS) Law, enacted in 1974 to contain the fast growth of department stores and supermarkets (Terada, 1994). The LSRS Law instituted a lengthy (up to ten years) and complicated approvals process to establish and expand large retail outlets (involving application for 42 licences stipulated under 19 different laws).

IMPACTS ON EFFICIENCY

Extensive protection, regulation, multiple tiers and marked product segmentation, close vertical associations and loyalties, and rigid pricing discouraged competition and change. As a result, consumers had limited choice of prices and products. With manufacturers selling goods on consignment and allowing the return of unsold items, wholesalers and retailers were protected from losses and had little incentive to determine what customers really wanted to buy. All this contributed to overall inefficiency and higher costs.[3] The President of Daiei, Japan's largest supermarket chain, once described Japan's traditional distribution system as doing 'little more

....

3 View of Nobuyuki Ohta, a retail analyst and Chairman of the Council of Fashion Designers, reported in *Nikkei Weekly*, cited in *Australia-Japan Economic Institute Economic Bulletin*, 1995, p. 8.

than performing an inventory control function, quietly buying up (domestic) manufacturers' production'.[4]

This, combined with the large number of retail stores and low labour productivity in the sector, produced the highest prices among OECD members (OECD, 1995, pp. 82-118). Japanese prices steadily rose from 30 per cent below the OECD average in 1960 to 50 per cent above the average by 1993. Although prices have fallen (*kakaku hakai*: 'price destruction') since mid-1994, and the currency has depreciated since mid-1995, Japan continues to have the highest overall prices in the OECD. High income only partially explains this phenomenon (Ariga and Ohkusa, 1994).

Japan's higher prices originate in the distribution channel (OECD, 1995). Surveys of factory gate prices revealed Japan's differentials with the USA and Germany to be only 14 and 3 per cent, respectively. Yet, final sales prices were 50 per cent dearer in Japan than in the USA in 1994, and 35 per cent dearer than in Germany. Services and inputs such as international air freight, telephone calls, financial transactions and energy also cost 30 to 150 per cent more in Japan than in the USA and Germany (OECD, 1995). Largely because of price rigidities in the system, consumers benefitted little from the large rise of the yen in the late 1980s, from ¥238:US$1 in 1985 to ¥141:US$1 in 1990. (See Chapters 4 - *Macroeconomics* and 5 - *Trade*.)

Restricted entry of foreign manufactures and nonbulk foods further limited choice and competition (Saxonhouse, 1993). Even with lower tariffs, the closed distribution system ensured that imported goods cost at least the same as local goods, restricting the number of wholesalers and retailers willing to handle them.

REFORMS AND FORCES FOR CHANGE

Since the 1980s, however, far-reaching changes in the distribution system have injected greater competition and consumer choice.

Factors contributing to regulatory and market-driven reform (see Chapter 8 - *Market Access*) include:

- US pressure to deregulate large-scale retail stores, licensing and other areas
- the massive yen appreciation since 1985 and the recession of the early 1990s. These led to substantially higher imports, placing considerable cost pressures on companies. Consequently, suppliers and distributors were urged to produce savings, leading to more streamlined distribution networks
- the recession-enhanced awareness of the need for further economic reform in the distribution system
- prominent Japanese businessmen championing change in the retail sector, affecting the whole distribution system
- the dramatic post-bubble decline in land prices lowering entry and operating costs, enabling new types of wholesale and retail operations to emerge.

4 Isao Nakauchi, reported in *Tokyo Business Today*, cited in *Australia-Japan Economic Institute Economic Bulletin*, 1995, p. 10.

Deregulation and US Market Access Pressure

US pressure in the Structural Impediments Initiative (SII) Talks provided the major impetus for deregulating the distribution sector.[5] Small and medium-scale retailers and most large-scale chains saw the existing system as working to their benefit, so few retailers pushed for reform (Terada, 1994). However, when the US toy chain, Toys 'R' Us, failed to secure approval to establish outlets in Japan in the late 1980s (a common experience for large-scale foreign retailers), the USA argued that the distribution system and the LSRS Law blocked access to the market. The G7[6] and OECD also criticised the Japanese distribution system and the LSRS Law.

The strong US focus on the issue in the Structural Impediments Initiative (SII) Talks raised Japanese awareness of the issues and influenced consumers regarding the desirability of reform. Surveys by the *Nihon Keizai Shimbun* in 1990 and 1991 found strong support for reforming or abolishing the LSRS Law among consumers who expected reform to lead to lower prices and greater product choice (Terada, 1994).

While refusing to abolish the LSRS Law, the 1990 Final Report of the SII Talks incorporated commitments to significantly reform it. So far, the following changes have been implemented:

- May 1990 - introduction of an 18-month deadline for government action on retailers' new store plans, in contrast to the previous 35 months on average
- May 1990 - provision for greater freedom to increase size up to specified limits without going through the approval process
- May 1990 - extension of operating hours from 1800 to 1900 and reduction of the minimum closed days for large retailers from 48 to 44 days per year
- January 1992 - centralisation in the Ministry of International Trade and Industry (MITI) of jurisdiction coordination functions and decision-making responsibilities (previously shared with prefectural governments)
- May 1994 - extension of large store operating hours from 1900 to 2000, and further reduction of the minimum closed days for large retailers to 24 days per year (Australia-Japan Economic Institute, 1995, p. 8).

Yen Appreciation and Import Growth

Pressure on domestic producers from the post-1985 yen appreciation and burgeoning imports focused attention on high distribution costs and their role in influencing Japanese prices. (See Chapters 4 - *Macroeconomics* and 5 - *Trade*.)

....

5 The (SII) Talks were launched in mid-1989 as part of the Bush Administration's bilateral trade strategy towards Japan, and for the first time encompassed discussion of the two countries' economic structures .

6 The G7 is the group of seven leading economies, comprising the USA, Japan, France, Italy, UK, Germany and Canada.

Collapse of the Bubble Economy and Recession

The collapse of the bubble economy in late 1990 and the subsequent recession reduced demand and burdened manufacturers with excess stock and production capacity. Fierce competition, especially with cheap foreign products, pressed manufacturers and retailers to reduce costs and prices. The intermediaries literally were 'caught in the middle' of their clients' efficiency drives, being squeezed to provide savings and often being dropped altogether.

The recession, together with the rising unemployment and limited salary increases and bonuses, ended a massive five-year surge in consumer spending and gross consumer debt. Moreover, as pressures grew to pass on import price savings to consumers, and as Japanese consumers became more price sensitive, support for reforming the distribution system increased.

Strengthened awareness of the need for broader economic reform heightened public expectations of government and business action to achieve it. In 1994, the Price Stabilisation Council advised the Prime Minister that to remedy the continuing price differentials between Japan and other OECD countries, Japan needed:

- more new entrants into markets
- flexible price regulations
- promotion of price competition through a review of business practices
- more imports of finished goods
- more effective use of land
- reduced distribution costs
- a business environment which provided consumers with broad choice.

Champions for Change

Despite Japan's image as a highly conformist society, radicals and mavericks have provoked change at crucial times. Part of the force for change in the distribution system has come from mavericks at the retail level. For example, Isao Nakauchi, Chairman and President of Daiei Inc, has prominently advocated deregulation and radical price reduction to put Japan on a par with other OECD countries; moreover, Daiei has put these principles into practice. Toshifumi Suzuki, President of Ito-Yokado, pioneered high-technology inventory and customer purchase monitoring systems to prioritise what the customers want, rather than what manufacturers and wholesalers offer.

Lower Land Prices

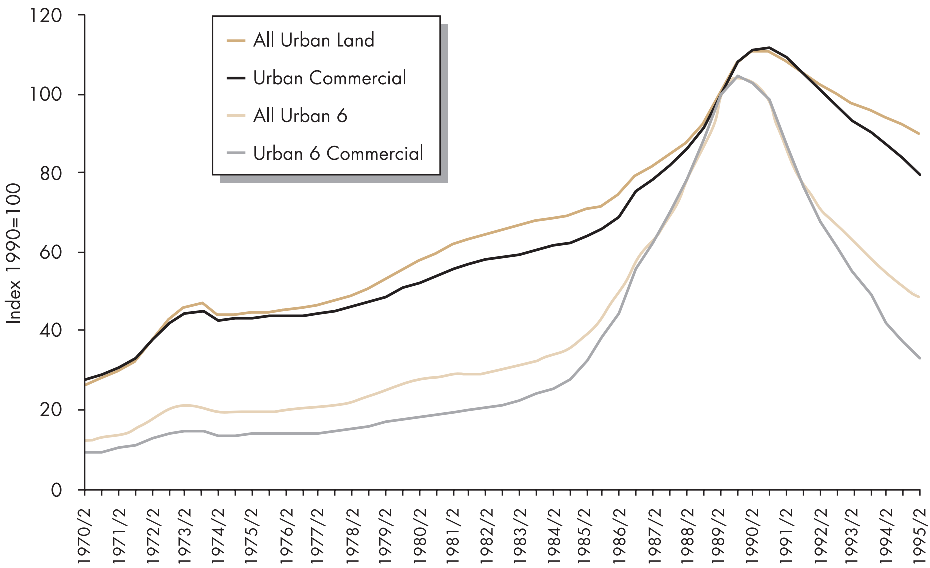
Japan's high land costs have had a major impact on the distribution system, especially by keeping the average retail enterprise small. Costly storage combined with small facilities (due to land shortages in key areas) discouraged businesses from developing economies of scale or holding much inventory, thus requiring multiple daily movements for supply. The steep increase in land prices from 1970 to 1991 coincided with a sharp rise in general goods and services prices (Figure 9.1).

Land prices fell dramatically when the asset price-inflated bubble burst. This reduced investment and operating costs in the distribution sector and, coinciding with other important changes, encouraged new entrants. Commercial land and premises supply continues to exceed demand, which will continue to depress land prices (*Nikkei Weekly*, 25 March 1996).

Figure 9.1

Land Prices Still Falling

Indices of Land Prices in Japan
1970 to 1995; 1990=100



Notes: 1990 = 100 is the common index. Numbers following years indicate half-year periods.
Urban 6 refers to Japan's six largest cities: Tokyo, Yokohama, Osaka, Nagoya, Sapporo and Kobe.

Source: Nikkei Data Base *Indices of Urban Land Prices*.

MAJOR IMPACTS OF REFORMS

The recent regulatory and market-driven reforms have dramatically changed Japan's distribution system.

- Retail outlets are more varied. With more discount stores and large-scale supermarkets being opened during the recession, consumers showed a marked shift in their purchasing preferences towards the new outlets.
- Goods are more varied and cheaper, with many imported.
- Moves from fixed retail prices to 'open pricing', led by retailers, are now being followed by manufacturers.
- Wholesalers are forging new links with manufacturers, retailers and other wholesalers.

- Many smaller wholesalers are going out of business or merging with others to survive.
- More manufacturers and retailers are restructuring their distribution channels and introducing new technology to cut costs and improve efficiency.
- Foreign firms are reassessing their distribution links in the new environment.

Retail Diversification and Rationalisation

In mid-1994, around three-quarters of all retail stores were still small unincorporated outlets employing fewer than five people (Asano, 1997, p. 2). However the LSRS Law reforms have produced a rapid proliferation of large-scale stores, particularly supermarkets, hypermarkets, general and specialty discount outlets, and shopping centres. Annual applications to open new large-scale stores have quadrupled since 1990, reaching 2 206 in JFY 1995, compared to 564 on average in the 1980s (Australia-Japan Economic Institute, 1996, p. 5).[7]

Over the same period, however, the total number of stores fell by 6.6 per cent to below 1.5 million, as many small stores went out of business. A May 1995 MITI study found that one out of every five small and medium-sized retailers was contemplating going out of business (*Yomiuri Shimbun*, 13 May 1995).

By the mid-1990s, 57 per cent of households were in the vicinity of one of the big three supermarket chain outlets, Daiei, Ito-Yokado or Jusco (Japan External Trade Organisation [JETRO], 1995, p. 2). These have expanded rapidly in recent years, particularly into regional Japan.

The leading supermarket chains and discount chain operators are opening many large outlets each year, often in the mammoth shopping centres with dense clusters of specialty shops. Daiei, for example, is building enormous no-frill 'Hypermarkets' in suburban areas, offering low-cost goods and self-service. Similarly, Jusco is opening 'Megamarts' offering discount prices.

BURGEONING SHOPPING CENTRES

The first shopping centres in Japan were developed around major train stations in the 1950s, with supermarket operators moving into suburban shopping centre development in the late 1960s. By the late 1980s, 1 760 shopping centres had opened across Japan (MITI , 1995, pp. 58-59). The revision of the LSRS Law has accelerated the process, with more than 3 000 shopping centres expected to be operating by 2000. Most will be in suburban residential and outer commercial areas.

Supermarkets and convenience stores have fared best in the more competitive environment. From 1991 to 1994, convenience stores grew by 6 560 outlets to a total of 48 400 (Table 9.1). This trend is set to continue. Smaller-scale specialty stores are generally declining.

7 Japan financial or fiscal year (JFY) ends 31 March.

Table 9.1

Retail Sales by Type of Venue

1991 to 1994

	Number of retail stores			Annual sales		
	1994	Share of total per cent	Change 1994/91 per cent	1994 ¥ million	Share of total per cent	Change 1994/91 per cent
Department stores*	463	0.0	-3.1	10 640 330	7.4	-6.3
General supermarkets	1 804	0.1	7.2	9 335 933	6.5	9.9
Other general supermarkets	476	0.0	25.6	159 088	0.1	36.4
Specialty supermarkets	9 354	0.6	30.2	10 426 521	7.3	28.8
Convenience stores	48 405	3.2	15.7	8 335 279	5.8	19.3
Other supermarkets	80 036	5.3	19.0	10 568 825	7.4	14.4
Specialty stores	930 123	62.0	-7.8	61 020 258	42.6	-9.1
Other retailers	429 103	28.6	-7.3	32 821995	22.9	12.3
Other	159	0.0	-98.9	17 178	0.1	-99.0

Note: * This represents the number of outlets of department store chains only and does not include cooperative department stores (which numbered around 2 000 by 1994). Other sources give a higher number for department store outlets, for example, 561 outlets by 1995 (*Almanac of Large Retailers in Japan*, 1996).

Source: Ministry of International Trade and Industry, 1995b, *1994 Census of Commerce*[8], cited in Japan External Trade Organisation (1996).

Mail-order and catalogue purchasing are gaining wider acceptance among Japanese consumers. Sales grew rapidly in the past decade, accounting for 1.7 per cent of retail sales in 1993-94, worth around ¥2.3 trillion, or US$22 billion (Figure 9.2). Door-to-door sales have reached over 10 per cent of retail turnover, with further growth likely, along with home delivery services. Clothing, bedding and accessories are the most popular mail order products.

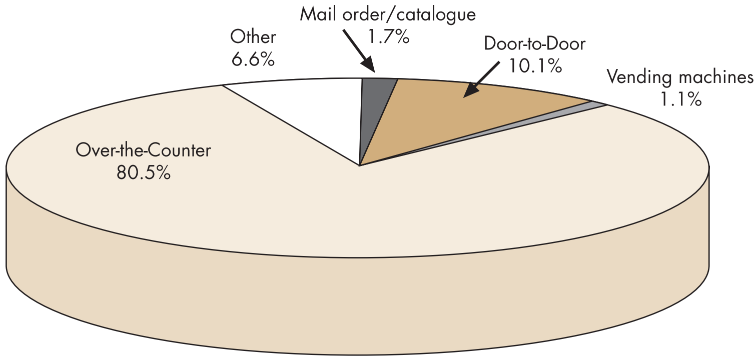
Vending machines, selling mainly beverages and tobacco, account for about 1 per cent of retail sales. The shake-up in retailing, especially the fast spread of convenience stores, will probably reduce the need for vending machines in future (Riethmuller, 1996). Consumer cooperatives were once a fast growing segment of the distribution sector, with over 40 per cent of households belonging to 652 cooperatives and a turnover of about ¥2.9 trillion or US$21 billion in the mid-1990s (Riethmuller, 1996). These have also been hard hit. (For information on agricultural cooperatives, see Chapter 11 - *Agrifood*.)

8 The MITI Census of Commerce is the main statistical source on retail and wholesale trade, based on a triennial survey. The 1993 to 1994 Census, undertaken and published in late 1995, is the latest available; the next will be published in 1998.

Figure 9.2

Consumers Still Prefer Stores

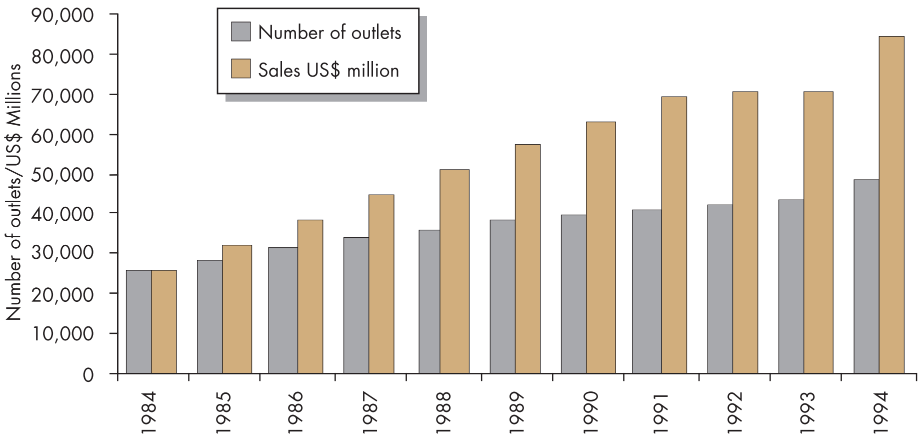
Main Forms of Retail Trade by Sales Shares
Total Retail Sales: ¥140,907 Billion; Year to June 1994



Source: Ministry of International Trade and Industry, 1995b, Table 10.

Figure 9.3

Convenience Stores: Outlet Numbers and Sales Growth 1984 to 1994*



Note: * 1994 data is for July 1993 to June 1994, from the Ministry of International Trade and Industry's *1994 Census of Commerce*, but used here to give some indication of 1994 trends.

Source: Economist Intelligence Unit Australia, 1996; Ministry of International Trade and Industry, 1995b.

CONVENIENCE STORES - GROWTH OR SATURATION?

Over the past decade, convenience stores have proliferated at the expense of traditional small stores. The number of outlets doubled from 1984 to reach nearly 50 000 by 1994, while sales also grew strongly, exceeding US$83 billion in 1994 (Figure 9.3). Much of the growth has come from development of convenience store chains by the leading supermarket retailers: Daiei's Lawson, Ito-Yokado's Seven-Eleven Japan, Seibu's Family Mart, Jusco's Ministop, and UNY's Circle K chains dominate (Table 9.2). At least half of all convenience stores belong to large chains, although many small and specialty retailers are also becoming convenience stores.

Yet the period of rapid growth in convenience stores may have passed. While the large chains continue to open new outlets, sales are falling at older convenience stores, and in JFY1995, chains closed nearly 20 per cent of their stores (*Nikkei Weekly*, 30 September 1996, p. 9). Under deregulation, supermarkets are competing more strongly with convenience stores.

Table 9.2

Major Japanese Retailers

1995

Main company	Subsidiaries affiliates	Main focus	Sales Feb '92 ¥ billion	Sales Feb '96 ¥ billion
Daiei Group	**Daiei**	merchandise chain (c,f,hu)	2 026	2 503
	Lawson	convenience chain	599	885
	Maruetsu	supermarket chain (f)	321	290
	Jujiya	medium-sized chain (c,hu)	87	67
Ito-Yokado Group	**Ito-Yokado**	supermarket chain (c,f,hu)	1 460	1 545
	York-Benimaru	regional chain (f,c,hu)	190	260
	Seven-Eleven	convenience chain (f)	163	231
Jusco		supermarket chain (f,c,hu)	1 041	1 202
	Ministop	convenience chain (f)	14	21
Mycal (formerly Nichii)		supermarket and department store chain (c,f)	767	1 053
Seibu Saison Group	**Seiyu**	supermarket chain (f,c,hu)	1 095	1 023
	Seibu	department store*		
	Parco	shopping centres	281	276
	Family Mart	convenience store chain (f)	70	96
Takashimaya		department store*, mail order	843	892

Table 9.2 (Cont.)

Main company	Subsidiaries affiliates	Main focus	Sales Feb '92 ¥ billion	Sales Feb '96 ¥ billion
Mitsui Group	**Mitsukoshi**	department store*	877	757
UNY Group	**UNY**	chain stores (f,c,hu)	556	640
	U.Store	chain stores (f)	74	104
	Sagami	luxury store chain (c)	73	70
	Circle K Japan	convenience chain (f)	(March) 34	(March) 54
Daimaru		department store*	608	510
Marui		department store*	(Jan) 539	(Jan) 486
Matsuzakaya		department store*	502	428
Isetan		department store*	(March) 468	(March) 414
Izumiya		supermarket chain	400	402
Nagasakiya		chain stores (c)	437	371
Hankyu Group	**Hankyu Department Stores**	department store*	(March) 355	(March) 331
Tokyu Group	**Tokyu Dept Stores**	department store*	(Jan) 411	(Jan) 321
	Tokyu Store Chain	supermarket chain	274	275
Kotobukiya		supermarket chain	281	271
Nichiryu Group	Heiwado	regional supermarket chain	197	252
	Izumi	regional supermarket chain	146	219
Life		supermarket chain	171	230
As'ty Co Group	Fuji	regional chain stores	138	185
Inageya		regional supermarket chain	(March) 163	(March) 182
Marutomi Group		shoe store chain	130	172
Sogo		department store*	311	152
Keiyo		regional chain stores	105	141
Kasumi		regional supermarket chain	108	134
Matsuya		department store*	116	94
Yamazaki Baking	**Sun-shop Yamazaki**	convenience chain (f)	26 (Dec 91)	37 (Dec 95)

Note: * department store chains.
c: clothing; f: food; hu: household utensils.

Source: *Japan Company Handbook*, 1995. *Japan Company Handbook*, 1996. EAAU communications with individual companies, 1996 and 1997.

Shift of Main Purchasing Venue

Consumers have responded to the stronger customer focus of the supermarkets, convenience stores and discount outlets. Table 9.2 reveals the significant scale of the shift of consumer purchases by comparing sales revenue for JFY1992 and 1995 for the major Japanese retailers of clothing, foodstuffs and household utensils. Almost universally, the supermarket, convenience and discount chains maintained or increased sales despite the recession, while department store sales fell markedly.

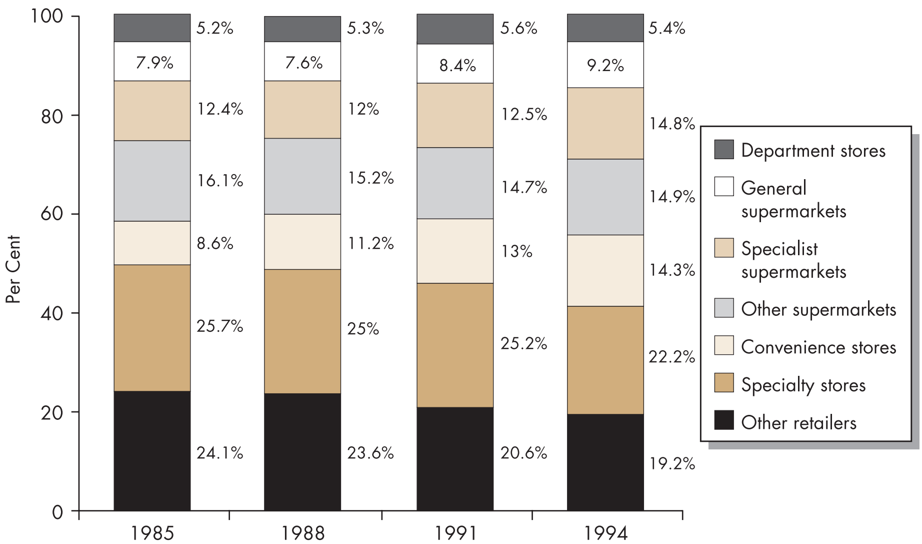
Consumers' main purchasing venues for food shifted from 1985 to 1994 (Figure 9.4). Retail food sales accounted for around 30 per cent of total retail sales of ¥143 trillion (US$1.4 trillion) in 1994. The biggest shift was away from specialty stores to convenience stores and, to a lesser extent, supermarkets.

Figure 9.4

More Food Shopping at Convenience Stores, Supermarkets

Shift of Consumers' Main Purchasing Venue: Food

Total Value of Retail Food Sales: ¥43 trillion[9] in 1994



Source: Ministry of International Trade and Industry, 1995b, p. 75.

9 The ¥43 trillion (US$418 billion) for total retail food sales is for 1 July 1993 to 30 June 1994, the period covered by MITI's 1994 Census of Commerce. Figures given in Chapter 11 - *Agrifood* for the total value of food consumption or food sales are drawn from different sources, cover different periods, and have somewhat different product coverage.

Price Reductions and 'Open Pricing'

Supermarket, convenience and discount store operators significantly cut prices during the recession, giving rise to the term *kakaku hakai* or 'price destruction'. Daiei was a leader in this, using bulk purchasing direct from domestic manufacturers to obtain lower prices, directly importing large shipments of consumables and passing on the benefits of yen appreciation. Discounting of alcohol, consumer electrical goods and men's suits became widespread through many small retail chains.

Discount stores tended to set their prices 20 to 30 per cent lower than manufacturers' recommended retail prices (Economic Planning Agency survey cited in *Nikkei Weekly*, 11 July 1994). Retail price differences also depended on the type of retailer, with prices at discount stores around 17 per cent lower than the average and prices at department stores around 69 per cent higher (MITI survey cited in *Japan Times*, 17 May 1994).

The general Consumer Price Index (CPI) fell by 0.1 per cent in 1995, the first fall in 25 years, but it rose again in 1996. Some analysts suggest that the CPI remains weighted in line with out-of-date purchasing trends and venues, and does not take account of the purchasing shift towards cheaper imports and to discount and cheaper stores (Australia-Japan Economic Institute, 1995, p. 11). The authorities are examining this situation.[10]

Table 9.3

Consumer Price Index 1985 to 1996

1990 Average = 100

	CPI General	CPI Food	CPI Non-alcoholic beverages	CPI Alcoholic beverages	CPI Furniture and household utensils	CPI Clothes
1985	93.5	94.1	100.7	99.1	100.5	85.5
1986	94.1	94.2	101.5	99.1	100.5	87.9
1987	94.2	93.4	99.7	99.0	99.9	88.8
1988	94.9	94.1	97.7	99.0	99.4	90.1
1989	97.0	96.1	99.3	97.8	99.9	94.8
1990	100.0	100.0	100.0	100.0	100.0	100.0
1991	103.3	104.8	101.9	102.1	100.8	105.2
1992	105.0	105.4	106.3	102.4	102.0	108.3
1993	106.4	106.4	108.0	102.3	101.8	107.4
1994	107.1	107.4	108.5	104.3	99.7	105.0
1995	107.0	106.1	110.0	105.1	98.0	103.9
1996	107.3	105.9	n.a.	n.a.	96.3	n.a.

Source: Nikkei Data Base.

10 In August 1996 the Management and Coordination Agency announced that henceforth it was adding new and imported goods to its CPI surveys, and the results were to be included when it shifted the base year from 1990 to 1995 (*Nikkei Weekly*, 26 August 1996, p. 2).

Community attitudes have shifted from passive acceptance of manufacturer-set prices to support for greater competition. As a result, the Fair Trade Commission (FTC) and the courts have supported retailers' right to discount and have upheld the Antimonopoly Law. For example, several small retailers selling cosmetic products at below-list prices won court cases against major cosmetic makers, Kao Corporation and Shiseido Co Ltd (*Mainichi Shimbun*, 24 July 1994).

Major retailers and discounters led the way in setting prices independently outside the *tatene*, or traditional list price system, whereby manufacturers set standard prices for products at each stage of distribution. Most manufacturers have accepted the new system of 'open pricing', whereby they lower ex-factory prices to wholesalers and retailers in return for the abolition of rebates and of *henpin*, or the return of unsold merchandise (JETRO, 1995, pp. 17-18).

RAPID GROWTH IN IMPORT PENETRATION

The national attitude towards imports has changed. The former preference for Japanese products has weakened, driven by cost imperatives. Japan's imports of manufactured goods doubled from 27 per cent of total overseas purchases in 1984 to over 56 per cent in 1995. Durable consumer goods' share in total imports trebled from around 3 per cent in the mid-1980s to 9 per cent in 1995, with household appliance imports growing particularly strongly (*Nikkei Weekly*, 6 May 1996).

Three distinct categories of imports have emerged: indirect, direct and 'development imports'. Growth is strongest in indirect imports (through wholesalers and trading houses), but direct importing is expanding rapidly among the larger retailers and wholesalers. Between July 1993 and June 1994, direct imports comprised 4.8 per cent (¥30.2 trillion, US$293 billion) of wholesale and retail enterprises' total sales (MITI, 1995, Table 18). Of this ¥30.2 trillion, wholesalers accounted for ¥29.5 trillion, and retailers ¥729 million. Among wholesalers, the larger companies (such as trading houses) undertook 70 per cent of direct imports, while among retailers, small and medium-sized firms accounted for 71 per cent.

Ito-Yokado plans to double the share of direct imports in its sales to around 30 per cent in future (*Far Eastern Economic Review*, 4 April 1996, p. 54). Jujiya, one of the Daiei Group companies, is steadily increasing the number of outlets specifically designed for selling imported brands at discount prices (*Nikkei Marketing Journal*, 4 October 1994).

Many department stores are trying to win back customers from discounters by directly importing new foreign brands in addition to their house brands.[11] While direct imports account for only about 1 per cent of large retail stores' sales in general, the ratio is much higher among the big chains.

....

11 For example, Takashimaya department stores now directly import accessories from France and Italy (*Mainichi Shimbun*, 7 May 1995).

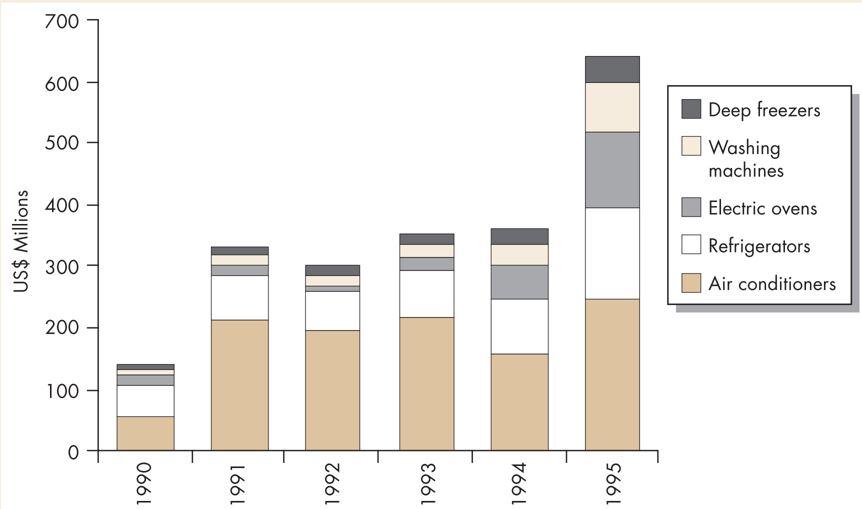
HOUSEHOLD APPLIANCE DIRECT IMPORTS CLIMBING

Sales of foreign-made household appliances have surged in the mid-1990s, mostly due to direct importing by the major retail chains. Bulk orders have enabled the retail chains to gain good discounts and thereby offer the foreign-made products at significantly lower retail prices than domestically produced ones. As a result, foreign products are winning a measurable share of the Japanese whitegoods and home appliance market (Figure 9.5).

Figure 9.5

Guess Whose Mum's Got a Whirlpool?

Japanese Imports of Selected Household Appliances 1990 to 1995
US$ Million



Source: Department of Foreign Affairs and Trade, STARS data base.

Thailand and the Republic of Korea are the largest suppliers of refrigerators, followed by the USA. The Republic of Korea and China lead in supplying electric ovens, and Malaysia and Thailand lead in air conditioning units; Italy overtook the Philippines in 1995 to become the largest supplier of washing machines. Many of the appliances imported from South East Asia come from Japanese subsidiaries, while those from North America and Western Europe tend to come from associations between Japanese retailers and Western manufacturers. Australia's share of household appliance imports into Japan is minuscule.

For example, the Japanese electrical appliance retailer Daiichi joined US whitegoods manufacturer Whirlpool to develop new Whirlpool products to be sold through Daiichi outlets in Japan, with access to Daiichi after-sales service. Whirlpool sees the Asian appliance market becoming as big as the North American and European markets combined by 2000, and views the venture with Daiichi into Japan (with 30 per cent of Asia's appliance market) as an important step in its Asia strategy (*Financial Times*, 3 June 1996, p. 22).

Potentially more important than the rise in direct imports is the fast growth of development imports: products developed overseas by Japanese companies for the Japanese market. These occupy a rising proportion of the imported items wholesalers and retailers sell. A fast-growing segment involves house brands developed by large retailers which specify a design to a domestic or overseas manufacturer, negotiate a bulk purchase rate, and sell the items at a lower price than similar branded items.

Daiei introduced its ‘Savings’ brand in 1980 and by 1994 had more than 300 products, discounted 30 to 50 per cent below their brand-name counterparts (*Nikkei Weekly*, 30 May 1994). Ito-Yokado joined Cott Corporation of Canada and two major US bottlers in 1994 to produce soft drinks selling 30 per cent below vending machine prices. In 1994, Seiyu launched its house brand ‘Meriton’, jointly developed with nine US and Asian retailers, to sell at half the price of similar brand-name products.

A 1994 Japan Chain Stores Association survey of members found that:

- imports accounted for a growing share of sales
- house brands made up 75 per cent of chain stores’ direct imports and 30 per cent of their total imports (JETRO, 1995, p. 60)
- 70 per cent of chains’ imports came from Asia, including 90 per cent of apparel, 40 per cent of food and 76 per cent of ‘development imports’ (partly reflecting the massive growth of Japanese production bases in Asia)
- 40 per cent of food-related development imports came from North America, the highest non-Asian share of any category.

Wine is a good example of a product where wider choice and lower prices have bolstered consumer demand. Increased direct importing (especially of European wines) by general and specialist discounters has allowed prices to fall to around ¥500 per bottle, a quarter of the average price prevailing in the 1980s. Japanese wine consumption doubled to 108 000 kilolitres over 1983 to 1993, although overall alcoholic beverage consumption expanded by only 30 per cent (*Nikkei Weekly*, 12 December 1994). Imported wine’s share in total wine consumption doubled from 26 per cent to 54 per cent as a wide variety of non-French wines became generally available. This has contributed to a completely new attitude toward wine.

ALCOHOL - CHANGING DISTRIBUTION, FAST RISING IMPORTS

Japan has a large, sophisticated alcohol market which offers good opportunities to exporters with a proactive and well informed market strategy.

Beer (accounting for 53 per cent of Japanese alcohol sales in 1995) and *sake*/ rice wine (26 per cent) still dominate Japanese alcohol consumption. *Shochu*, a distilled white spirit, accounts for 7 per cent. Over the past decade, whisky's share has fallen by half, to just 8 per cent. Wine's market share has risen from 2 per cent up to 3 per cent in the same period, as annual wine consumption doubled to 1 litre per capita, compared to 63 litres in France and 16 litres in Australia. Japanese beer consumption, on the other hand, is closer to OECD levels: 57 litres per capita in 1992, compared to 86 litres in the USA and 102 litres in Australia.

Alcohol distribution has undergone structural change in the 1990s due to:

- the 1989 relaxation of the liquor licensing system, which markedly increased the number of liquor retailers
- the 1990 FTC ruling to end resale price maintenance by the four major brewers
- easing of the liquor taxation and import tariff regimes in response to market access pressure from the USA and EU
- increased alcohol imports due to yen appreciation and the alcohol price-cutting war, as well as direct importing by alcohol discounters.

The new alcohol trading environment widened product choice and markedly reduced alcohol prices. In the case of wine, import market share doubled to 54 per cent by 1995 (73.7 million litres worth ¥31.5 billion, US$327 million). Imported beer however only attained a peak market share of 5 per cent in the summer of 1994, and soon fell back to under 2 per cent, due to the continued market dominance of the big four Japanese brewers, Kirin, Asahi, Sapporo and Suntory.

Australia has yet to take proper advantage of the growth and changes in the Japanese wine and beer markets. Australian beer's share of imports fell from 10 per cent in 1989 to just 4 per cent in 1995. It suffered a damaging downgrading of its image to a cheap and ordinary imported beer in the beer price wars, in contrast to Belgian beers which maintained their high price and high-quality image.

In a strongly growing wine import market, Australian exports have fallen in both volume and value terms, accounting for only 2 per cent of imports by value in 1995. Like beer, the image of Australian wine has been downgraded, due to its mostly being marketed for mass consumption at the lower end of the market. Efforts are now being made to upgrade the image.

Source: Instate, 1996[12]

....

[12] An edited version of the Instate consultancy report to the EAAU will be published as an EAAU Working Paper in 1997, under the title *The Changing Distribution System for Alcohol in Japan*.

FAST GROWING MARKET FOR IMPORTED HOUSING MATERIALS

Many foreign suppliers of housing materials are looking again at the Japanese housing market. Housing starts in Japan totalled 1.5 million units in 1995, compared to 1.4 million in the USA, and 124 000 in Australia.

The traditional distribution system for housing materials was tightly controlled by *keiretsu* groups, held together by house manufacturing companies in association with trading houses. High transport and warehousing costs, plus price setting by the *keiretsu* groups, made housing very expensive. In the 1990s, several factors are changing the system:

- the Japanese Government announced a drive to reduce the cost of housing from the late-1980s level of eight times the average annual income, down to only five times
- the 1994-95 yen appreciation focused industry attention on sourcing cheaper housing materials from overseas
- the January 1995 Great Hanshin (Kobe) Earthquake exposed the weaknesses of established Japanese housing construction methods and materials
- some Japanese builders opted to break away from their traditional supply chains to directly import from overseas suppliers, aiming to increase their profits and take market share from the large house manufacturing companies.

The Government's June 1994 'Action Program for Reduction of Housing Costs' directed the industry to halve the cost of housing construction by 2000, and commenced deregulation to enable greater use of imported housing materials. Since the beginning of 1995, imports of housing materials have risen, with longstanding North American and Scandinavian exporters of housing materials benefitting most. Many construction materials come from housing materials factories established by Japanese trading companies and large manufacturers around Asia.

Japanese trading companies already act as a channel for some Australian-made materials such as bricks and pavers. However, the Japanese housing market offers more significant opportunities, for example, kit houses. It also poses significant challenges. Australian companies proposing to enter it will need:

- a long-term perspective with clear targets and strategies
- an appropriate and well-prepared market entry plan
- good knowledge of the market and competititors
- capital to maintain market penetration and set-up costs
- capability of working in partnership with Japanese firms
- ability to monitor market information and reevaluate strategies.

Source: NasPacT Consulting, 1996[13]

13 An edited version of the NasPacT consultancy report to the EAAU will be published as an EAAU Working Paper in 1997, under the title *The Changing Distribution System for Housing Materials in Japan*.

Pressure on Wholesalers

Lower prices have reduced profit margins for manufacturers, wholesalers and retailers. Wholesalers, however, have been squeezed the most as both manufacturers and retailers increasingly bypass the middle tier of the system.

In 1994, the 429 300 registered wholesale firms were almost 10 per cent fewer than in 1991; their average per employee sales of ¥112.36 million (US$1.09 million) were 7.5 per cent less than in 1991 (JETRO, 1996). The biggest drop in numbers is in small to middle-sized firms, which make up the greatest part of the wholesaling sector (Table 9.4). In coming years, many wholesalers are expected to either merge or disappear.

Table 9.4

Rate of Establishment of New Wholesale Companies

1965 to 1994

Size of firm by number of employees	1965-1974	1975-1984	1985-1994	1989	1990	1991	1992	1993	Jan-Jun 1994
All firms total	71 376	79 213	84 647	10 964	9 274	8 609	7 985	8 270	3 681
1 - 2 people	7 018	10 428	12 677	1 564	1 363	1 297	1 245	1 452	718
3 - 4	14 375	19 034	22 812	3 027	2 555	2 434	2 159	2 249	1 091
5 - 9	23 516	26 216	27 524	3 667	3 070	2 775	2 510	2 593	1 067
10 - 19	15 360	14 965	13 578	1 743	1 409	1 313	1 316	1 173	493
20 - 29	5 046	4 075	3 711	450	403	367	342	341	125
30 - 49	3 471	2 683	2 469	306	269	242	230	250	105
50 - 99	1 890	1 371	1 297	145	134	131	124	136	56
100 or more	700	441	579	62	71	50	59	76	26

Source: Ministry of International Trade and Industry, 1995b, Table 15.

Retailers' Rationalisation Affects Wholesalers

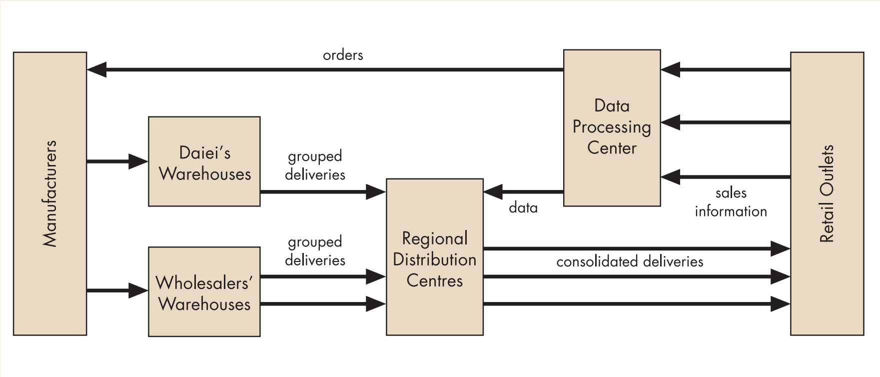
Retailers' cost-reduction strategies that have adversely affected wholesalers include:

- purchasing directly from manufacturers
- importing directly
- negotiating directly with domestic and overseas manufacturers for bulk orders and specific designs
- pressuring manufacturers and wholesalers to reduce prices
- exerting increasing control over the whole price chain
- increasingly carrying out their own wholesaling functions
- reducing the number of wholesalers with which they are involved.

For example, the Tokyu department store chain is reducing the number of wholesalers it deals with by 20 percent to 2 000 in a first stage, and eventually to about 1 000 (*Nikkei Marketing Journal*, 12 July 1994).

Figure 9.6

Daiei Streamlines Its Distribution System



Source: Japan External Trade Organisation, 1995, p. 6.

The leading supermarket chain operator, Daiei, has established a short route between manufacturer and consumer, using computerised data collection on sales and inventory requirements from all its retail outlets and communicating this to its contracted manufacturers and wholesalers (JETRO, 1995, pp. 5-6). Shipments from suppliers are sent to either Daiei's or its wholesalers' warehouses, then to one of the new Daiei regional distribution centres, for consolidation and delivery to Daiei stores.

Manufacturers Also Pressuring Wholesalers

Manufacturers also have squeezed wholesalers, trying to extract better performance and lower costs from their distributors. Manufacturers' measures include:

- reducing the number of wholesalers they deal with
- taking the lead in merging their subsidiary/affiliate wholesalers and otherwise reducing wholesale tiers
- setting up nationwide integrated wholesale networks through a single or small number of wholesalers to replace multiple individual firms
- requiring wholesalers to invest in computerisation, automation and other improved technology
- abolishing the system of rebates and consignment sales, forcing wholesalers (and retailers) to take more responsibility for product selection.

Larger food processors, for example, are shaking up the wholesale system, selecting the best performing wholesalers, discarding the less efficient ones and reviewing the rebate system. Larger wholesalers are absorbing smaller regional ones, and the food wholesale industry now consists of about ten main groups led by Kokubu, Snow Brand, Ryoshoku, Meidiya, Itochu, Mitsui and Asahi Food. Snow Brand Milk Products merged its five major foodstuff wholesalers to form Japan's second biggest food wholesaler, the first with a nationwide distribution network for frozen and chilled foods.

Wholesalers recognise the need to increase their scale to survive. Increasingly, wholesalers are considering ventures and alliances with domestic, and in some cases foreign, distributors or manufacturers to increase their scale of operation and capital base, to access new management methods and technology and to secure sources of supply. Some wholesalers have expanded their activities into retailing to make up for lost sales.

GOING GLOBAL

Growing numbers of Japanese wholesalers and retailers are going offshore to extend their importing activities and to expand business generally. Much of this activity is taking place in Asia, where costs are lower and profits are higher than in Japan.

In the 1980s, Japanese department stores established branches in the USA, Western Europe, Hong Kong, Singapore and Taiwan; now they are expanding into China, Malaysia, Indonesia and elsewhere in Asia. As the supermarket chains overtake the department store chains in turnover and capitalisation, they too are establishing an international presence. Japanese convenience store chains, specialty store operators, and restaurant and fast food chains are also expanding into Asia.

JAPANESE SUPERMARKET CHAINS EXPAND INTO CHINA

- Yaohan International, the Hong Kong and Shanghai-based holding company of Japan's Yaohan retail group, has opened several supermarkets in Shanghai and plans to have a chain of department stores and around 1 000 supermarket outlets in China within a decade (*Nikkei Weekly*, 8 July 1996, p. 19).
- Daiei, Japan's leading supermarket chain, opened its first store in China in Tianjin in 1995. In 1996 it entered a joint venture to operate a 24-hour convenience store chain in Shanghai, opening four outlets in 1996, with a total of 50 stores planned (*Nikkei Weekly*, 8 April 1996).
- Ito-Yokado, the second largest supermarket chain, entered a joint venture with Itochu and China Sugar and Wine Corp (an affiliate of the Chinese Ministry of Internal Trade) to establish a nationwide supermarket chain, starting with three large shopping centres to be opened in Beijing in 1998 (*Nikkei Weekly*, 29 April 1996, p. 1).
- Jusco, the third largest supermarket chain, with stores in Thailand, Malaysia and Hong Kong, also plans to enter the Chinese market soon.

Retailers, hoteliers and restaurateurs are choosing China, Vietnam and Taiwan for further expansion due to rising consumption in the region.[14] In addition to the trading houses, more Japanese wholesalers are expanding offshore to survive strong domestic competition and to tap into Asia's fast-evolving distribution sector.

Changing Role of Trading Houses

The large trading houses have traditionally supplied raw materials and procured intermediary and finished goods. They have been Japan's main global wholesalers. (See Chapter 6 - *Internationalisation*.)

Growing competition, however, is infringing on trading houses' traditional function. Retailers and other wholesalers are increasingly moving into direct importing, forming their own international networks, and relying far less on trading houses than in the past. Japan's imports are changing rapidly to finished goods, challenging trading companies' traditional focus on bulk imports of raw materials.

However, the trading houses' economies of scale and overseas manufacturing activities should enable them to diversify and maintain a strong share of Japan's fast-growing imports of parts, components and finished goods (*Financial Times*, 25 April 1996, p. 17). Also, their vast networks of subsidiaries and affiliates give them a strong advantage in Asia's emerging distribution industry.

ACCELERATION OF TECHNOLOGICAL CHANGE

Technological improvement and innovation is a major focus of efforts to increase efficiency and lower costs. The Japanese distribution system has long lagged its Western counterparts in adopting automation and computerisation. Large-scale distributors with access to capital are rapidly installing new technology.

Ito-Yokado, the most profitable retail chain, led the field in installing a bar-code system which registers each customer transaction in a central computer system. This sends detailed information to Ito-Yokado's wholesalers, distribution centres and manufacturers on three continents, thereby constantly monitoring consumer preferences (*Far Eastern Economic Review*, 4 April 1996, p. 54.). The leading trading house, Mitsui & Co, launched a value-added network (VAN) service connecting food processing companies and wholesalers to speed up transactions and expand contacts with networked companies. Such advances will further intensify competition among larger players and widen the gap between large and small firms.

[14] A survey conducted in late 1995 by the Nikkei Research Institute of Industry and Market on the future plans of Japanese retailers, hoteliers and restauranteurs (including the top 300 retailers), found that China, Vietnam and Taiwan were the top locations being chosen for further expansion. Around 15 per cent of the respondents already had outlets in East Asia. Over 70 per cent of responding firms cited rising consumption in the region as its main attraction (*Nikkei Weekly*, 25 March 1996, p. 22).

MORE FOREIGN COMPANIES ENTERING JAPAN'S DISTRIBUTION SYSTEM

As Japan's distribution system opens up, foreign companies are becoming more active participants and are reviewing their wholesaling arrangements to respond to the more competitive distribution environment. Many recently have become independent of longstanding joint ventures which tied them to particular distribution networks. Others that had done business 'the Japanese way' are scrapping their old networks in favour of new streamlined ones.

Foreign companies are investing in wholesale enterprises through partnerships, acquisitions and new ventures. Leading US food processor Dole Food has joined with local wholesalers to set up processing and distribution centres at ten major Japanese ports (*Nikkei Weekly*, 8 April 1996). Dole expects this to cut distribution costs and allow it to get closer to retailers, doubling its food exports to Japan to ¥100 billion per year by 2001. Large US retail chains see Japan as a prime target for overseas expansion.

OUTLOOK AND PROSPECTS FOR FURTHER CHANGE

Flatter, More Competitive Distribution System

The traditional structure of distribution - which maintained prices at levels allowing each tier of manufacturers, wholesalers and retailers comfortable profit margins and a continuing place in the system - is being dismantled irreversibly. The future will see fewer, but larger, companies in the wholesale and retail industries.

Fierce competition among large retail chains will continue to drive change across the distribution sector, as emphasis shifts from competition among individual retailers to competition among retail complexes. Leading retail chains, particularly supermarket operators, plan major expansions of both individual outlets and shopping complexes. For example, Jusco plans to build 300 more neighbourhood shopping centres by 2000 (*Nikkei Weekly*, 22 January 1996). Convenience store chains continue to expand rapidly but face more competition, especially from supermarkets.

Small and medium-sized retailers will continue to be squeezed in the fierce competition. Many small discount stores and discount chains are going out of business, as profit margins shrink and consumers demand good quality as well as low prices. The approximately 300 000 traditional 'Mom & Pop' (very small retail) stores will face increasing difficulty in competing with mass retailers and convenience store chains; their numbers are expected to decline noticeably.

Consolidation among wholesalers will continue. The sharp fall in the number of small independent wholesalers, rising bankruptcies, and increasing mergers, cooperative ventures and new alliances will result in markedly fewer and larger wholesalers. About 20 per cent (60 000) of the 300 000 incorporated wholesalers are expected to go bankrupt or be absorbed into larger enterprises (*Mainichi Shimbun*, 9 August 1994).

FUTURE OF DEPARTMENT STORES

Department stores, with high prices and high costs, suffered a dramatic downturn during the recession. Consumers hit by unemployment and uncertainty, and corporate customers who traditionally accounted for about a third of department store sales, turned to cheaper retailers. Department store sales fell from ¥9.7 trillion in 1991 to ¥8.6 trillion in 1995. The stores began instituting long-overdue changes, shedding staff, investing in technology, pressing suppliers for efficiencies, and modifying their merchandise mix to appeal to a broader, more price-sensitive clientele. The effort is paying off as consumers recover from their recession-induced 'find the cheapest deal' attitude. With the economy improving, consumers are increasingly seeking the best quality for the best price. High-status brand-name items are again selling well. Department stores catering to such consumers are doing better, and confidence is rising.

Some department store chains are also linking up with supermarket chains for joint ventures in developing shopping complexes. For example, the Seibu Department Store chain announced a joint venture with the Jusco supermarket chain to open a shopping complex in Shizuoka prefecture in 1997, which Seibu plans as the first of a chain of complexes (*Nikkei Weekly*, 18 December 1995, p. 8).

The Growing Technological Divide

Technological advances will be a major determinant of the competitiveness of firms. Computerisation of operational functions for inventory control, point-of-sales data collection and ordering will be basic starting points. Leading players, however, are actively embracing the latest technology to expand their services and create new demand.

For example, Jusco is testing a home-based shopping service using an optical fibre cable television network in Kyoto; viewers use a remote control device and a credit card to place orders (*Nikkei Weekly*, 20 May 1996). In pressing its suppliers to become more efficient, Ito-Yokado gave its wholesalers the choice of either becoming more efficient or being dropped. A key demand was that they invest in sophisticated information systems.

Retailers Challenging Manufacturers for Control of Distribution

A historic change is taking place in Japan's distribution system. While wholesalers dominated it until 1945 and manufacturers thereafter, in the 1990s the large retailers are exerting leverage and increasingly controlling all stages and elements of the system. An ongoing shift in financial resources is favouring the larger retailers. The key indicator is greater retail control over pricing. Large retailers' introduction of private brands, bulk purchasing leverage with manufacturers and direct importing, allow them to set their own prices on more goods. Many small retailers have joined the discounting trend, defying manufacturers' recommended retail prices.

Offshore Expansion to Intensify

Japanese manufacturers, wholesalers and retailers will continue to expand offshore, both to seek efficiencies and to develop new business. Asia, with its large low-cost labour pool, its growing industrial and services base, and its burgeoning consumer demand, will remain the preferred location for expansion. Such moves will affect the region's developing wholesale and retail sectors.

Japanese trading houses will also continue to increase and diversify their activities. Again, Asia is a preferred destination. Given their substantial networks and their long presence in many markets, these companies are in an excellent position to ease the entry of other Japanese firms. The trading houses actively bring projects (and potential partners or clients) to Japanese companies, and frequently take a stake in such projects. This role is likely to expand in future.

Prospects for Further Deregulation

Further change in the distribution sector will be driven primarily by market pressures, assisted by *gaiatsu* (external pressure) from foreign companies conveyed through their governments. Government deregulation could well continue to move slowly, impeding progress toward greater efficiency in the distribution sector, unless the government acts decisively on overall economic reform. However, the prospect of further employment growth in the wholesale and retail sectors from continued reform might encourage government action.

A number of deregulation proposals for the distribution sector made by the Administrative Reform Committee of the Keidanren and others have yet to be addressed (Keidanren, 1995). The USA continues to call for the Japanese Government to:

- phase out and abolish the Large-Scale Retail Store (LSRS) Law by the end of JFY2000
- eliminate by the end of JFY1996 all restrictions under the LSRS Law on operations of existing stores, including permitted hours of operation and number of days closed
- expedite processing of large-scale retail store applications, pending the abolition of the LSRS Law
- reduce significantly entry restrictions into the warehouse industry
- simplify and improve nationwide coordination of import processing
- review all standards and certification procedures to ensure conformity to international norms.

Substantial obstacles remain to attaining world best-practice efficiency, for example:

- lack of clear understanding and acceptance of the costs and benefits of further overall deregulation by the general public and much of business
- lack of clear Japanese delineation and common understanding of the most desirable reform and deregulation path for the distribution sector, as opposed to sporadic concessions to some domestic and foreign pressures for change, and mixed acceptance of US or Western arguments on the need for reform

- failure to address concerns held by many about the possible downsides to further distribution reform, for example, the proliferation of unsightly hypermarkets, disappearance of small local shops and major job losses
- with the passing of the post-bubble recession, and the competition for survival it engendered, an easing of pressure for price reductions and cost cutting
- continued resistance to deregulation by government ministries and agencies that fear loss of role and influence
- continued resistance to deregulation by less efficient participants in the distribution sector who seek support from politicians and bureaucrats
- a piecemeal and partial, rather than comprehensive and fully effective, competition policy.

STRATEGIES FOR AUSTRALIAN COMPANIES

Australian companies may wish to consider the following strategies to take advantage of the new market environment:

- review previous distribution arrangements and partners, and possibly streamline distribution channels
- reassess the range of local wholesale partners available and consider new forms of partnership, including joint ventures with small and medium-sized wholesalers
- secure contracts for direct supply to a retail chain, including department stores, supermarkets, convenience and discount stores, and national and regional chains
- pursue a regional (outside Tokyo) entry strategy into Japan (Chapter 10 - *Regions*)
- form a joint supply and marketing arrangement with other Australian suppliers for similar or complementary products and services, to increase scale and bargaining power
- expand successful supply arrangements with Japanese wholesalers or retailers to join them in other Asian markets.

REFERENCES

Almanac of Large Retailers in Japan, 1996, Tokyo.

Ariga, K., and Ohkusa, Y., 1994, *Price Flexibility in Japan, 1970-92: A Study of Price Formation in the Distribution Channel*, Pacific Economic Papers No. 238, Australia-Japan Research Centre, Canberra.

Asano, M., 1997, *The Retail Revolution in Japan*, Fuji Research Institute Corporation, Tokyo.

Australia-Japan Economic Institute, 1996, 'Global and Liberal Japanese Retail Sector Emerges After Radical Change', *Economic Bulletin*, Vol. 4, No. 11, November, pp. 2-16.

____ 1995, 'Japan's Price Revolution?', *Economic Bulletin*, Vol. 3, No. 1, January, p. 2-13.

Department of Foreign Affairs and Trade, STARS data base.

EAAU communications with individual companies, 1996 to 1997.

Economist Intelligence Unit Australia, 1996, 'Changing Distribution Patterns in Japan', consultancy report for the EAAU, Sydney.

Far Eastern Economic Review, various issues.

Financial Times, various issues.

Instate Pty Ltd, 1996, 'The Changing Distribution System for Alcohol', consultancy report for EAAU, Sydney.

Japan Company Handbook, 1995, Toyo Keizai Inc, Tokyo, Summer.

Japan Company Handbook, 1996, Toyo Keizai Inc, Tokyo, Winter.

Japan Times, various issues.

Japan External Trade Organisation (JETRO), 1996, *The Japanese Market: A Compendium of Information for the Prospective Exporter*, Tokyo.

____ 1995, *A Wealth of Opportunity: Japan's Distribution Channels*, Tokyo.

Keidanren (Federation of Economic Organisations), 1995, *The Government's Deregulation Promotion Plan: What We Hope From Its Revision*, Tokyo.

Kikuchi, T. (ed.), 1994, *Japanese Distribution Channels*, Haworth Press, New York.

Mainichi Shimbun, various issues.

Ministry of International Trade and Industry (MITI), 1995, *An Annual Report on the Trends in Small and Medium-Sized Companies*, Tokyo.

____ 1995b, *1994 Census of Commerce*, Tokyo.

NasPacT Consulting, 1996, 'The Changing Distribution System for Housing Materials', consultancy report for EAAU, Canberra.

Nikkei data base.

Nikkei Marketing Journal, various issues.

Nikkei Weekly, various issues.

Organisation for Economic Cooperation (OECD) 1995, *OECD Economic Surveys 1994-1995: Japan*, Paris.

Riethmuller, P., 1996, *The Role of Consumer Cooperatives, Vending Machines and Mail Order Sales in the Japanese Food Distribution System*, Consultancy Report for the EAAU, Brisbane.

Saxonhouse, G.R., 1993, 'What Does Japanese Trade Structure Tell Us About Japanese Trade Policy?', *Journal of Economic Perspectives*, Vol. 7, No. 3, Summer, pp. 21-43.

Terada, T., 1994, 'Political Economy of the Large-Scale Retail Store Law: Transforming Impediments to Entering the Japanese Retail Industry', *Pacific Economic Papers* No. 237, Australia-Japan Research Centre, Canberra.

FURTHER READING

Commission on Administrative Reform, 1995, *Opinions Concerning the Promotion of Deregulation (First Report): Towards a Resplendent Country*, Tokyo.

Government of Japan, 1996, *Revisions to the Deregulation Action Program*, Cabinet Decision, Tokyo, 29 March.

Homma, C. (JUSCO), 1994, 'Consumers' Concerns and Retailers' Response', *Research Institute for Asia and the Pacific Symposium on Marketing Food Products to Japan*, Sydney.

Otsuka, M., 1994, 'Time to Manufacture Japanese Foodstuffs in Australia', *Symposium on Marketing Food Products to Japan*, Research Institute for Asia and the Pacific, Sydney.

Shill, W. E., 1994, 'Lessons of the Japanese Mavericks', *The McKinsey Quarterly*, New York, No. 1, pp. 133-135.

Shill, W. E., Guild, T. and Yamaguchi, Y., 1995, 'Cracking Japanese Markets', *The McKinsey Quarterly*, No. 3, New York, pp. 32-40.

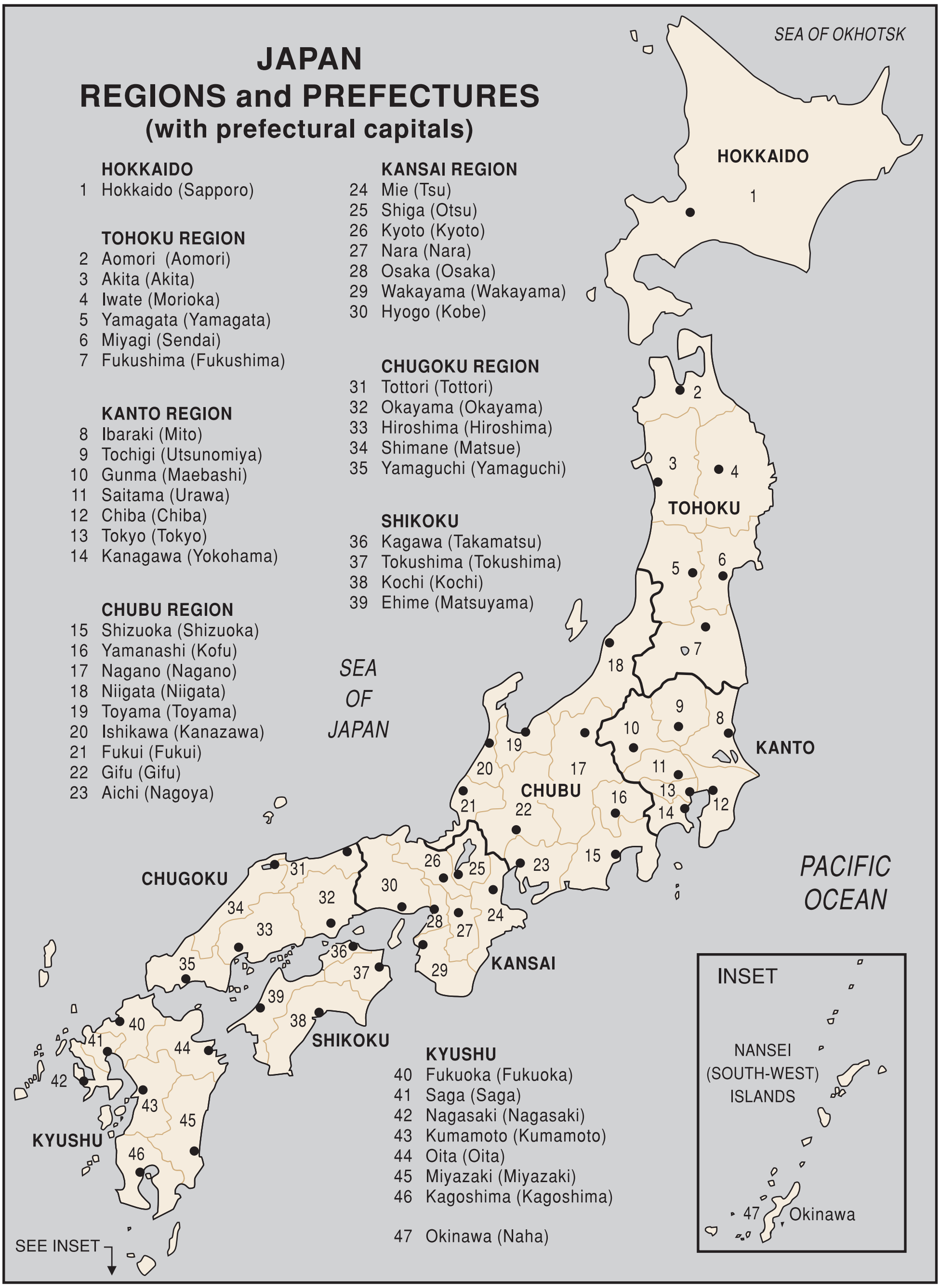
Toyoda, S. (Chairman, Keidanren and Toyota Motor Corporation), 1996, 'Keidanren's Long-Term Vision for Japan', Speech to Foreign Correspondents' Club of Japan, Tokyo, 16 February.

United States Government, 1995, *Submission by the United States to the Government of Japan Regarding Deregulation, Administrative Reform and Competition Policy In Japan*, Washington DC.

Wood, C., 1994, *The End of Japan Inc - and How the New Japan Will Look*, Simon and Schuster, New York.

____ 1992, *The Bubble Economy: The Japanese Economic Collapse*, Sidgwick and Jackson, London.

Map 10.1



JAPAN
REGIONS and PREFECTURES
(with prefectural capitals)
HOKKAIDO
1 Hokkaido (Sapporo)
TOHOKU REGION
2 Aomori (Aomori)
3 Akita (Akita)
4 Iwate (Morioka)
5 Yamagata (Yamagata)
6 Miyagi (Sendai)
7 Fukushima (Fukushima)
KANTO REGION
8 Ibaraki (Mito)
9 Tochigi (Utsunomiya)
10 Gunma (Maebashi)
11 Saitama (Urawa)
12 Chiba (Chiba)
13 Tokyo (Tokyo)
14 Kanagawa (Yokohama)
CHUBU REGION
15 Shizuoka (Shizuoka)
16 Yamanashi (Kofu)
17 Nagano (Nagano)
18 Niigata (Niigata)
19 Toyama (Toyama)
20 Ishikawa (Kanazawa)
21 Fukui (Fukui)
22 Gifu (Gifu)
23 Aichi (Nagoya)
KANSAI REGION
24 Mie (Tsu)
25 Shiga (Otsu)
26 Kyoto (Kyoto)
27 Nara (Nara)
28 Osaka (Osaka)
29 Wakayama (Wakayama)
30 Hyogo (Kobe)
CHUGOKU REGION
31 Tottori (Tottori)
32 Okayama (Okayama)
33 Hiroshima (Hiroshima)
34 Shimane (Matsue)
35 Yamaguchi (Yamaguchi)
SHIKOKU
36 Kagawa (Takamatsu)
37 Tokushima (Tokushima)
38 Kochi (Kochi)
39 Ehime (Matsuyama)
KYUSHU
40 Fukuoka (Fukuoka)
41 Saga (Saga)
42 Nagasaki (Nagasaki)
43 Kumamoto (Kumamoto)
44 Oita (Oita)
45 Miyazaki (Miyazaki)
46 Kagoshima (Kagoshima)
47 Okinawa (Naha)
SEA OF OKHOTSK
HOKKAIDO
TOHOKU
KANTO
CHUBU
KANSAI
CHUGOKU
SHIKOKU
KYUSHU
SEA OF JAPAN
PACIFIC OCEAN
SEE INSET
INSET
NANSEI (SOUTH-WEST) ISLANDS
Okinawa

Chapter 10

JAPAN'S REGIONAL MEGAMARKETS

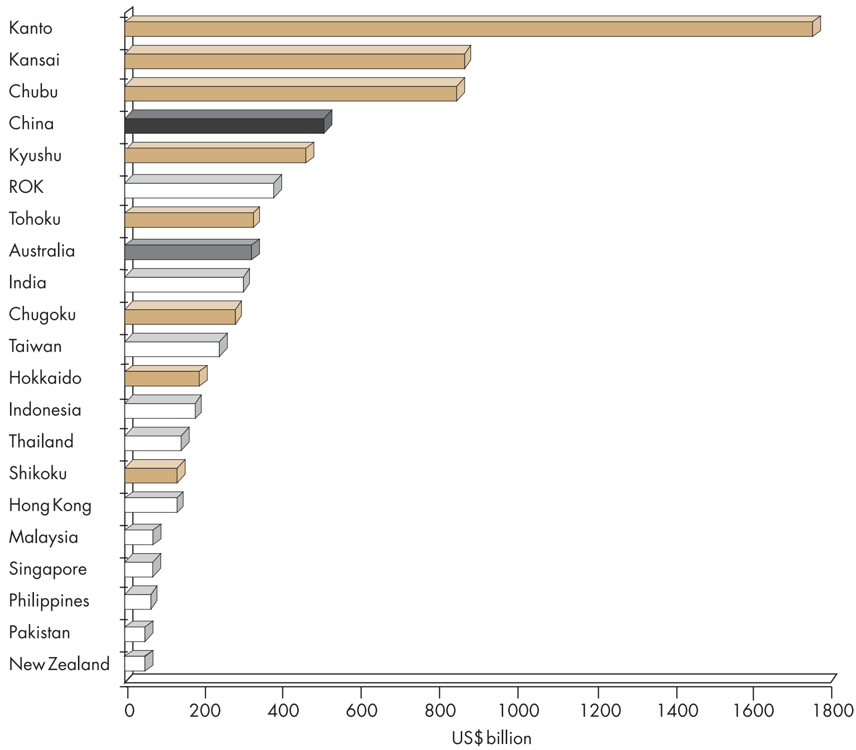
Each of Japan's eight regions constitutes a major Asian market. The Kanto area surrounding Tokyo is alone the size of the combined economies of China, the Republic of Korea, Taiwan and Australia. Some medium-sized regions, such as Kyushu, have larger economies than most countries in the Asia-Pacific region, and even the smallest regions, such as Tohoku and Shikoku, have higher per capita incomes than the rest of the region.

Figure 10.1

Each Region a Major Asian Market in Its Own Right

Japanese Regional Economies Compared to the Rest of Asia

GRP or GDP*, US$ billion, 1994[1]



Note: *GRP: Gross Regional Product; GDP: Gross Domestic Product (measured in terms of official exchange rates). GDP figures for India and Pakistan are for their respective financial year 1994.

Source: International Monetary Fund, 1997; Economic Planning Agency, 1997.

....

[1] The 1994 GRP (Gross Regional Product) figures used here are the latest available from the EPA at mid-1997.

Japanese companies increasingly are looking beyond Kanto and Kansai for domestic growth opportunities and lower costs. Foreign firms, which have tended to concentrate on Tokyo and Osaka in the past, also should examine carefully the advantages of a regional approach to expand existing activities in Japan or to enter the market for the first time. Both the Japanese and Australian Governments promote such approaches and assist companies evaluating regional entry strategies.

This chapter provides an overview of Japan's regions, highlighting their distinctive characteristics and similarities, contribution to the national economy, development priorities, and growing links with the Asia-Pacific region; then looks at opportunities for Australian business.

A MOSAIC OF REGIONAL MARKETS

Outsiders generally view Japan firstly, as a whole nation state; secondly, as a series of islands; and only thirdly, as a combination of distinctive regions. Yet most Japanese see their country primarily as a combination of its regions, and only secondly as a single nation state. A strong regional focus is reemerging in Japan, driven by factors including: disenchantment with 'national' politics; companies seeking nationwide coverage and lower-cost production bases; young families seeking a better quality of life; and older people returning 'home' to retire.

Historical Agents of Change

For most of its history, Japan existed as a composite of its regions; the concept of a national identity arose only in the late nineteenth century. Different regions, either singly or in alliances, dominated the country at different periods, accompanied by a corresponding shift of the *de facto* capital.[2] Particular regions have played decisive roles at various points in Japan's history, providing momentum and leadership for national change. In the seventeenth century, for example, the Tokugawa *han* (feudal fief), originally based near Nagoya (in the Chubu region), seized power and changed the *de facto* capital from the Kyoto-Osaka area to the small coastal town of Edo in the Kanto region, which became modern Tokyo.[3] In the mid-nineteenth century, a coalition of the Satsuma *han* of southern Kyushu and the Choshu *han* of western Honshu (in the Chugoku region) overthrew the Tokugawa shogunate. The resulting Meiji Government (1868 to 1912), an oligarchy of key Satsuma and Choshu figures, abandoned the thousand-year-old feudal system and transformed Japan into a modern nation state.

Japan has a long history of precise geographical delineation of administrative areas, which have gradually become larger and less numerous. However, since the regions generally remained based on similar combinations of areas, they maintained a mostly

2 Japan usually had until the late nineteenth century a *de facto* capital, established at the headquarters of the ruling clique of the time (from the thirteenth century onwards, the *shogun* or head of the strongest military force). The official capital was always where the Emperor resided. It was located in Nara for most of the eighth century, before being moved to Kyoto for more than 1 000 years, until 1868 when the new Emperor Meiji changed his main residence to Tokyo at the request of the new government.

3 Edo was renamed 'Tokyo' (the 'Eastern capital') by the Meiji Government.

consistent identity. Under the postwar local administrative system, Japan was divided into at first 46, and later 47 local government units (with the return of Okinawa in 1972) including: the cities of Tokyo (*Tokyo-to*), Osaka (*Osaka-fu*) and Kyoto (*Kyoto-fu*) as individual urban prefectures; Hokkaido as a district (*do*); and 43 ordinary prefectures (*ken*).[4] The prefectures are commonly grouped into eight regions, by location from north to south (Table 10.1).[5]

Table 10.1

Key Features of Japan's Regions

Region	Main cities	Population (million) 1994	Land area (sq.km)	GRP 1994* (¥ trillion / US$ billion)	GRP per capita 1994* (¥ million / US$)
Hokkaido	Sapporo, Hakodate, Asahikawa	5.7	83 000	19.01 191.3	3.34 33 552
Tohoku	Sendai, Aomori, Morioka, Akita	9.8	67 000	32.4 325.6	3.30 33 226
Kanto	Tokyo, Chiba, Kawasaki, Yokohama, Maebashi	39.3	32 000	174.4 1 754.7	4.4 44 648
Chubu	Nagoya, Shizuoka, Kanazawa, Niigata	21.3	67 000	84.2 847.2	3.95 39 775
Kansai[6]	Osaka, Kyoto, Kobe, Nara, Wakayama	22.4	33 000	85.9 863.8	3.8 38 561
Chugoku	Hiroshima, Okayama, Matsue, Yamaguchi	7.8	32 000	27.9 280.4	3.6 35 948
Shikoku	Tokushima, Kochi, Takamatsu, Matsuyama	4.2	19 000	13.2 132.8	3.1 31 627
Kyushu (including Okinawa)	Fukuoka, Nagasaki, Kitakyushu, Oita, Kumamoto, Saga, Kagoshima, Naha	14.6	44 000	46.0 463.2	3.2 31 723

Notes: * Converted at 1994 official exchange rate of ¥99.4:US$1.

Source: Japan Statistical Yearbook, 1996; Economic Planning Agency, 1997.

....

4 Local government is mainly at a prefectural level, with executive, legislative and judicial arms. Each prefecture is subdivided into *shi* (cities), *machi* (towns), and *mura* (villages). Local government elections are for prefectural local assemblies, prefectural governors, and mayors of cities. Only associations of governors exist at regional level.

5 There are variations both in the number of regions (ranging up to 10 or more, when Okinawa is treated as a separate region, and Chubu is split into its Tokai and Hokuriku subregions), and in the grouping of the prefectures into the various regions (Niigata is sometimes grouped with Tohoku, and Mie sometimes grouped with Chubu). This selection of eight regions and their respective prefectures is most common.

6 'Kinki' is another common name for this region (used since the seventh century and meaning 'in the environs of the capital' which was then Kyoto). 'Kinki' is used especially for legislative and administrative purposes, while 'Kansai' is used increasingly for international purposes.

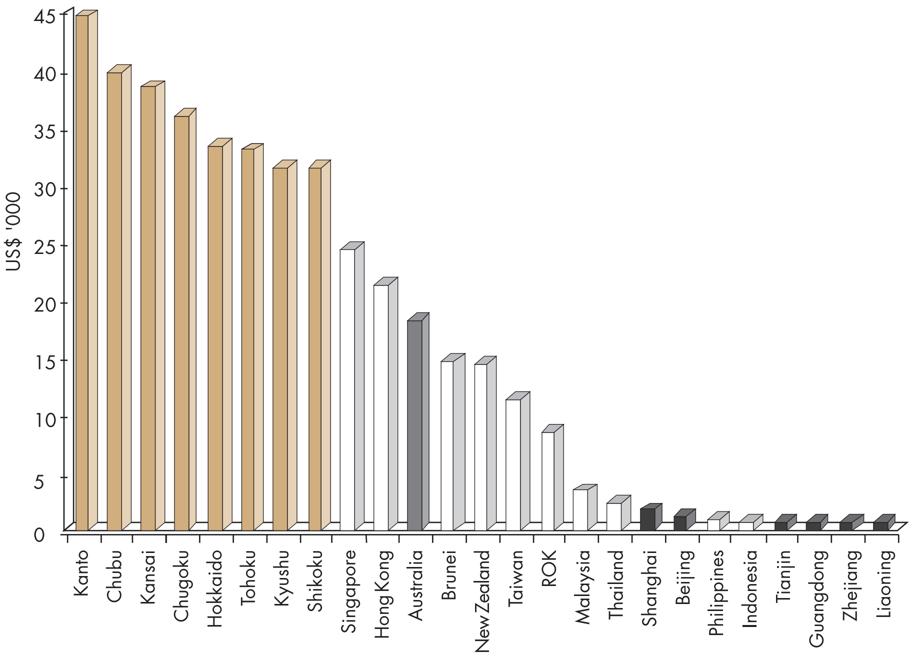
EACH REGION A MAJOR ASIAN MARKET

Compared with the rest of East Asia, Japan's regional markets are huge and extremely significant. Kanto, Kansai and Chubu are the three largest economies in Asia after Japan itself (Figure 10.1).[7] Kyushu's economy is nearly the size of China's; Tohoku's and Chugoku's economies are each about the size of Australia's or India's; Hokkaido's economy is larger than Indonesia's and Thailand's; and even in the case of the smallest region, Shikoku, the economy is larger than those of Hong Kong, Malaysia or Singapore. A 1 per cent annual increase in the Gross Regional Product (GRP) of the Kansai or Chubu region adds more to the world economy than 10 per cent growth in, for example, Singapore or Malaysia. Similarly, comparing per capita incomes shows that even consumers in Japan's 'poorer' regions of Tohoku and Shikoku are the richest in Asia (Figure 10.2).

Figure 10.2

Japan's Regions Are the Richest in Asia

Japanese Regional Economies Compared to the Rest of East Asia
Per Capita Incomes, US$ '000, 1994



Note: To strengthen the comparison, the per capita incomes for each of the six richest provinces of China are included instead of the average for all China (which would be much lower).

Source: International Monetary Fund, 1997; Economic Planning Agency, 1997; *China Statistical Yearbook 1996*.

....

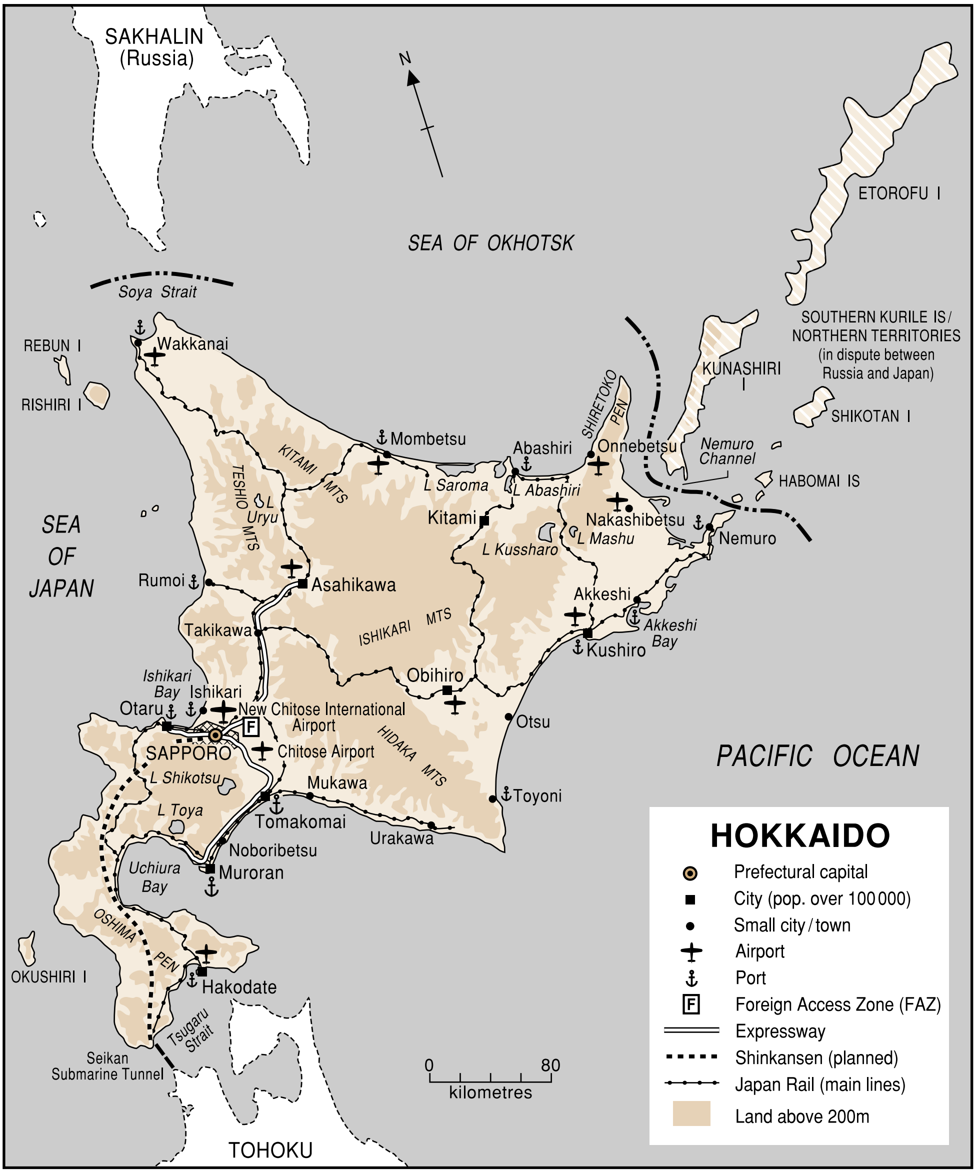
[7] All comparisons are made in terms of GDP converted into US dollars at official exchange rates. Measurement in terms of purchasing power parity would still place Japan's regions at the top of the East Asian per capita income ladder, but with a smaller lead. (For a discussion of purchasing power parity comparisons of national income see East Asia Analytical Unit, 1997, Chapter 1, Apppendix 1).

JAPAN'S EIGHT REGIONS: A BRIEF SKETCH

In the following pages, maps and brief descriptions are provided for each of Japan's eight regions:

- Hokkaido
- Tohoku
- Kanto
- Chubu
- Kansai
- Chugoku
- Shikoku
- Kyushu.

Map 10.2


SAKHALIN
(Russia)
N
SEA OF OKHOTSK
ETOROFU I
Soya Strait
REBUN I
Wakkanai
RISHIRI I
SOUTHERN KURILE IS/
NORTHERN TERRITORIES
(in dispute between
Russia and Japan)
KUNASHIRI I
SHIKOTAN I
SHIRETOKO PEN
Mombetsu
Abashiri
Onnebetsu
Nemuro Channel
HABOMAI IS
KITAMI MTS
L Saroma
L Abashiri
TESHIO MTS
L Uryu
Kitami
Nakashibetsu
Nemuro
L Mashu
L Kussharo
SEA OF JAPAN
Rumoi
Asahikawa
Akkeshi
Akkeshi Bay
Takikawa
ISHIKARI MTS
Kushiro
Ishikari Bay
Ishikari
Obihiro
Otaru
New Chitose International Airport
F
Otsu
SAPPORO
Chitose Airport
HIDAKA MTS
PACIFIC OCEAN
L Shikotsu
Mukawa
L Toya
Tomakomai
Toyoni
Noboribetsu
Urakawa
Uchiura Bay
Muroran
HOKKAIDO
Prefectural capital
City (pop. over 100 000)
Small city/town
Airport
Port
Foreign Access Zone (FAZ)
Expressway
Shinkansen (planned)
Japan Rail (main lines)
Land above 200m
OSHIMA PEN
OKUSHIRI I
Hakodate
Tsugaru Strait
0
80
kilometres
Seikan
Submarine Tunnel
TOHOKU

Hokkaido

Hokkaido GRP	¥19.01 trillion (1994) US$191.3 billion (1994)	Land area	83 000 km^2
GRP per capita	¥3.3 million (1994) US$33 552 (1994)	Prefectures	Hokkaido
Major cities	Sapporo, Asahikawa, Hakodate, Kushiro, Otaru, Obihiro, Tomakomai, Muroran, Kitami	Main economic activities	Agriculture, fisheries, forestry, pulp and paper, steel, metal products, machinery
Population	5.7 million (1994)	Main seaports	Hakodate, Muroran, Tomakomai
Pop. density	69 per km^2 (1994)	Main airports	New Chitose International and Chitose (Sapporo), Hakodate, Obihiro, Asahikawa

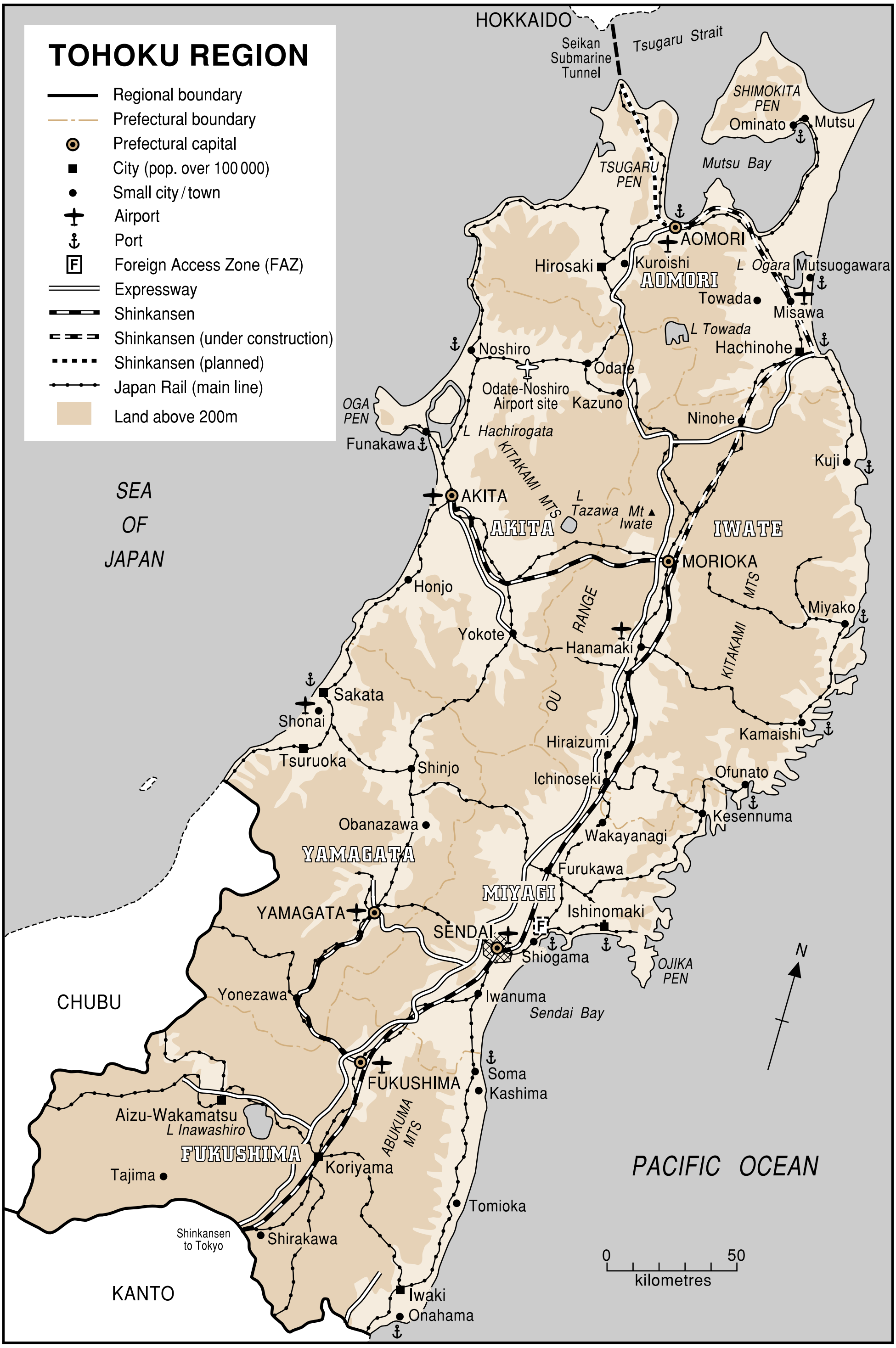
Hokkaido, Japan's second largest island and largest region, is quite distinct from the other regions, primarily for its wide open spaces, extensive agriculture and relatively limited heavy industry. Known as Yezo until the nineteenth century, it was the main refuge of the original native people of the Japanese islands, the Ainu. Hokkaido played almost no part in the development of Japanese culture and civilisation, and ethnic Japanese began to migrate there only in the fourteenth century. In the Meiji period, the central government, concerned about Russian ambitions,[8] began to promote migration and development. Today, despite having nearly 6 million inhabitants, Hokkaido still enjoys only a fraction of Kanto's population density.

Modern Hokkaido reflects the fairly recent development of its agriculture, fishing, forestry and associated processing industries. Hokkaido runs 40 per cent of the national dairy herd, produces a high proportion of the country's potatoes, apples and vegetables, and contributes 17 per cent of the national fish catch. With 22 per cent of the nation's forested land, natural and plantation, it produces one-third of Japan's paper pulp. The once important coal mining industry, as in Tohoku and Kyushu, became uneconomic and is disappearing. Manufacturing includes pulp and paper, chemical fertilisers, iron and steel, and shipbuilding. The services sector is increasingly important, and the island is a popular destination for Japanese and overseas tourists.

Hokkaido has good road and rail infrastructure, and is connected to Honshu by a tunnel under the Tsugaru Strait. Chitose International Airport near Sapporo is one of Japan's largest, with growing international connections, including to Australia. Much of Hokkaido's population is urban, and the capital, Sapporo (1.7 million people), is Japan's fifth largest city.

8 The Russian island of Sakhalin is easily visible from the northwest tip of Hokkaido.

Map 10.3


TOHOKU REGION
Regional boundary
Prefectural boundary
Prefectural capital
City (pop. over 100 000)
Small city / town
Airport
Port
Foreign Access Zone (FAZ)
Expressway
Shinkansen
Shinkansen (under construction)
Shinkansen (planned)
Japan Rail (main line)
Land above 200m
HOKKAIDO
Seikan Submarine Tunnel
Tsugaru Strait
SHIMOKITA PEN
Ominato
Mutsu
TSUGARU PEN
Mutsu Bay
AOMORI
Hirosaki
Kuroishi
L Ogara
Mutsuogawara
Towada
Misawa
L Towada
Hachinohe
Noshiro
Odate
Odate-Noshiro Airport site
Kazuno
OGA PEN
L Hachirogata
Funakawa
Ninohe
Kuji
KITAKAMI MTS
SEA OF JAPAN
AKITA
L Tazawa
Mt Iwate
IWATE
MORIOKA
Honjo
MTS
Miyako
RANGE
Yokote
Hanamaki
KITAKAMI
Sakata
Shonai
OU
Hiraizumi
Kamaishi
Tsuruoka
Shinjo
Ichinoseki
Ofunato
Kesennuma
Obanazawa
Wakayanagi
YAMAGATA
Furukawa
MIYAGI
YAMAGATA
Ishinomaki
SENDAI
Shiogama
OJIKA PEN
N
CHUBU
Yonezawa
Iwanuma
Sendai Bay
Soma
FUKUSHIMA
Kashima
Aizu-Wakamatsu
L Inawashiro
ABUKUMA MTS
FUKUSHIMA
Koriyama
Tajima
PACIFIC OCEAN
Tomioka
Shinkansen to Tokyo
Shirakawa
0
50
kilometres
KANTO
Iwaki
Onahama

Tohoku

Tohoku GRP	¥32.4 trillion (1994) US$325.6 billion (1994)	Land area	67 000 km^2
GRP per capita	¥3.3 million (1994) US$33 226 (1994)	Prefectures	Aomori, Akita, Iwate, Yamagata, Miyagi, Fukushima
Major cities	Sendai, Iwaki, Koriyama, Akita, Aomori, Fukushima, Yamagata, Hachinohe, Morioka, Hirosaki	Main economic activities	Agriculture, forestry, fishery, food processing, electrical machinery, ceramics, pulp and paper
Population	9.8 million (1994)	Main seaports	Aomori, Hachinohe, Miyako, Sakata, Shiogama, Ishinomaki
Pop. density	146 per km^2 (1994)	Main airports	Sendai, Aomori, Akita, Misawa, Yamagata, Hanamaki, Fukushima

The Tohoku region, encompassing north-eastern Honshu, was traditionally the least developed and poorest part of Japan, and the least populated part of the main island. A north-south mountain range divides the region into two climatic zones: along the Sea of Japan, where winter is harsh, and the Pacific coast, where weather is more moderate. As elsewhere in Japan, the main population centres (Sendai, Aomori, Akita and Iwaki) developed along the larger coastal plains; a few modern centres have developed inland, including Morioka, a transit hub for the Tohoku Shinkansen bullet train and the north-south Tohoku expressway.

Agriculture, fisheries and forestry remain the mainstays of the economy. Tohoku is Japan's major timber producer after Hokkaido, and accounts for one-quarter of the national rice crop, one fifth of the fish catch and much of the orchard production (apples, nashi, peaches and grapes). While most of the region's coal mines closed by the 1970s, some copper, silver, zinc, and lead mining, and petroleum and natural gas extraction occur. Tohoku generates close to 10 per cent of Japan's power through many hydroelectric, nuclear and geothermal power stations. Manufacturing includes electronics and electrical equipment, pulp and paper, food processing, cement, chemicals, iron and steel, and petroleum refining.

Improved transport and communications infrastructure increasingly integrates Tohoku with the rest of Honshu, boosting tourism based on outdoor activities like hiking, fishing, boating and skiing. Miyagi Prefecture and its capital, Sendai, is seen as one of the more dynamic regions. Its proximity to Tokyo, international airport, many educational institutions, and relatively lower cost of land and housing, attract younger Japanese to settle. In future, Tohoku plans to develop more high-technology industries and improve its research and development capacity.

Map 10.4


KANTO REGION
CHUBU
TOHOKU
Shinkansen to Morioka
Shinkansen to Niigata
Shinkansen to Nagoya, Osaka, Hiroshima and Fukuoka
GUNMA
TOCHIGI
IBARAKI
SAITAMA
TOKYO
KANAGAWA
CHIBA
KANTO MTS
L Chuzenji
L Kasumigaura
L Kitaura
Kusatsu
Nikko
Imaichi
Kuroiso
Daigo
Hitachi
Kanuma
UTSUNOMIYA
Kiryu
Takasaki
MAEBASHI
Isesaki
Ashikaga
Sano
Ota
Tochigi
Oyama
Shimodate
Katsuta
MITO
Nakagawa
Oarai
Tomioka
Fujioka
Kumagaya
Tsuchiura
Tsukuba
Kashima
Omiya
Koshigaya
Kawagoe
Tokorozawa
URAWA
Kashiwa
Matsudo
Funabashi
Sakura
New Tokyo International Airport (Narita)
Choshi
Fuchu
TOKYO
Hachioji
Ichikawa
Machida
CHIBA
Tokyo International Airport (Haneda)
Tokyo Bay
Togane
Kawasaki
YOKOHAMA
Fujisawa
Kisarazu
Kamakura
Hiratsuka
Odawara
Yokosuka
Sagami Bay
BOSO PEN
Katsuura
Tateyama
PACIFIC OCEAN
OSHIMA I
IZU IS
N
0
50
kilometres
Regional boundary
Prefectural boundary
Prefectural capital
City (pop. over 100 000)
Small city / town
Foreign Access Zone (FAZ)
F
Airport
Port
Expressway
Shinkansen
Japan Rail (main line)
Land above 200m

Kanto

Kanto GRP	¥174.4 trillion (1994) US$1.8 trillion (1994)	Land area	32 000 km^2
GRP per capita	¥4.4 million (1994) US$44 648 (1994)	Prefectures	Ibaraki, Tochigi, Gunma, Saitama, Chiba, Tokyo, Kanagawa
Major cities	Tokyo, Yokohama, Kawasaki, Chiba, Utsunomiya, Maebashi, Kawaguchi, Urawa, Funabashi, Ichikawa, Omiya, Sagamihara, Yokosuka, Fujisawa	Main economic activities	Finance, construction, heavy industry, precision instruments, government, printing and publishing, education, retail and wholesale
Population	39.3 million (1994)	Main seaports	Yokohama, Tokyo, Kawasaki, Chiba
Pop. density	1 228 per km^2 (1994)	Main airports	Narita International, Haneda

The Kanto plain around Tokyo was long one of Japan's three major rice cultivation sites (along with the major plains of the Kansai region and around Nagoya), and thus a principal area of 'economic surplus'.[9] The Tokugawa feudal capital of Edo[10] was renamed Tokyo and developed into a modern capital in the Meiji period (1868-1912). The Kanto region became Japan's political, economic and financial centre.

The Kanto region accounts for 30 per cent of Japan's population and 40 per cent of its GDP. It has three of Japan's ten most populous cities: Tokyo (8.2 million), Yokohama (3.2 million), and Kawasaki (1.2 million); two of Japan's seven largest seaports, Yokohama and Tokyo; and the principal airport,[11] Narita, which handles over 60 per cent of Japan's outbound passengers and over 70 per cent of international air cargo. Tokyo is the centre of the national railway system.

Tokyo is the centre of corporate Japan: almost two thirds of Japan's top 50 companies have head offices there. In addition to its central role in government and administration, finance, education and construction, Kanto's Tokyo-Kawasaki-Yokohama industrial belt is Japan's largest manufacturing zone. Major national scale industries in Kanto are: printing and publishing; general machinery and appliance manufacturing; precision instrument manufacturing; steel and other metal products manufacturing; pulp and paper making; plastics manufacturing; and food processing.

The Kanto region has the largest share of high-income consumers and the most extensive array of large retail centres and outlets. It also has the most expensive land, housing and commercial premises, and its transport infrastructure is under considerable strain. (See Chapter 13 - *Transport*.) Many Japanese think government and business are overconcentrated in Tokyo and support greater decentralisation, including the establishment of a new national capital.[12]

....

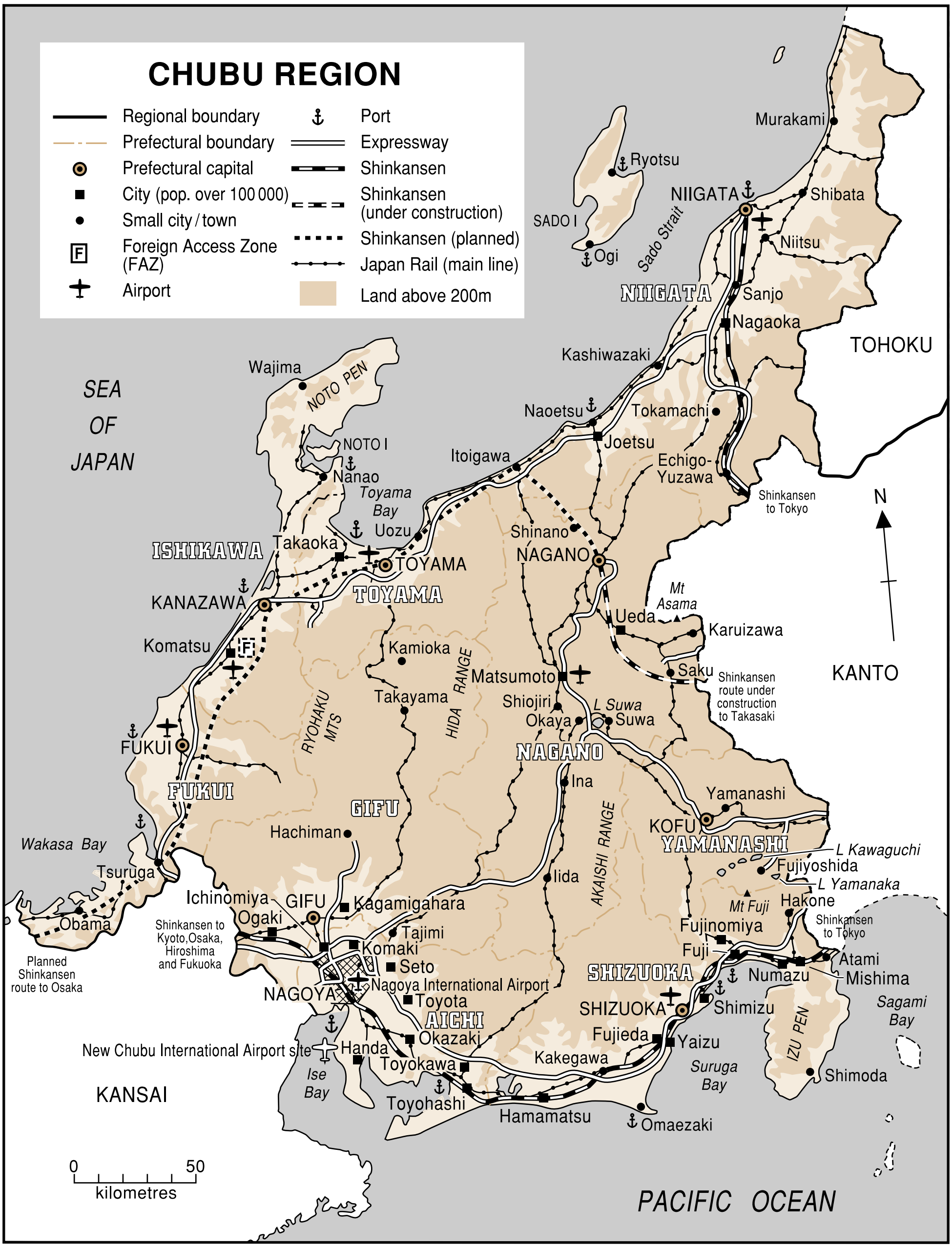
9 Excess rice production brought tax revenue to the local and central authorities, gave rise to rice trade, and allowed other economic and cultural activities to develop.

10 Edo, originally a small fishing village, was selected by the Tokugawa shogunate to be Japan's new *de facto* capital at the beginning of the seventeenth century.

11 See Table 10.8 for regional air services to Australia.

12 The central government is investigating the possibilities of moving a number of government and administrative functions to a new administrative capital.

Map 10.5



© EAAU, DFAT / Cartography, RSPAS, ANU (1997)

Chubu

Chubu GRP	¥84.2 trillion (1994) US$847.2 billion (1994)	Land area	67 000 km^2
GRP per capita	¥3.95 million (1994) US$39 775 (1994)	Prefectures	Shizuoka, Yamanashi, Nagano, Niigata, Toyama, Ishikawa, Fukui, Gifu, Aichi
Major cities	Nagoya, Hamamatsu, Shizuoka, Niigata, Toyohashi, Toyota, Okazaki, Kanazawa, Nagano, Kasugai, Matsumoto, Ichinomiya	Main economic activities	Transport equipment, steel and other metal products, general machinery, electrical machinery, agriculture, ceramics, textiles, plastics, furniture
Population	21.3 million (1994)	Main seaports	Nagoya, Shimizu, Shinminato (Takaoka), Kanazawa, Niigata
Pop. density	318 per km^2 (1994)	Main airports	Nagoya, Komatsu, Toyama, Shizuoka

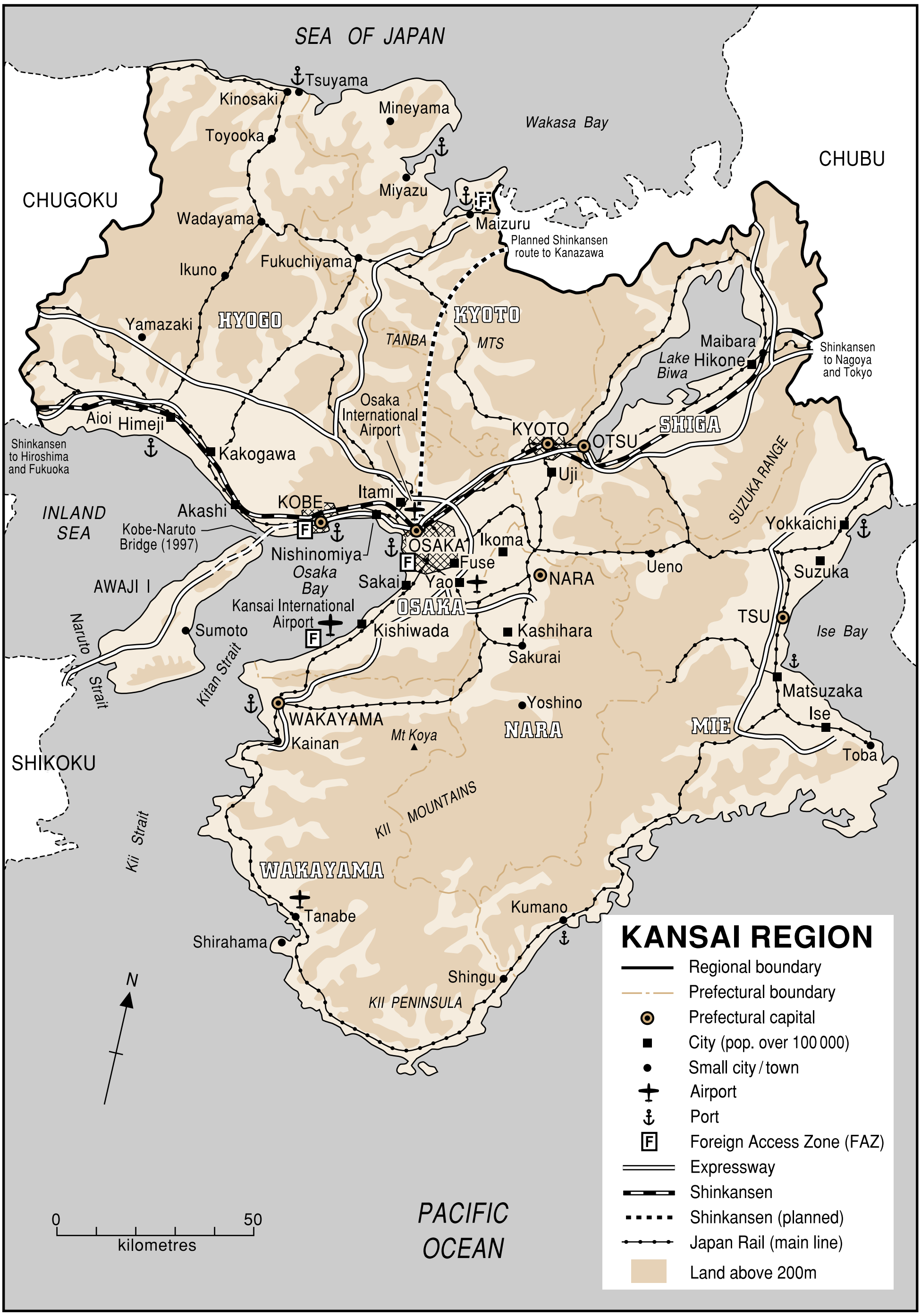
The Chubu region, extending across the middle of Honshu and including Japan's fourth largest city, Nagoya (2.2 million people), historically formed a corridor connecting the Kanto and Kansai regions. Today the Tokaido Shinkansen bullet train and the Nagoya-Kobe and Nagoya-Tokyo expressways connect the regions. Chubu stretches from Aichi Prefecture, centred on Nagoya on the Pacific coast, north towards Niigata prefecture on the Japan Sea coast, and includes mountainous Nagano and Yamanashi Prefectures.[13] Nagoya developed from a seventeenth century Tokugawa family stronghold into a major city, and had to be almost entirely rebuilt after World War II.

Chubu's economy, similar to Kansai's in size, is the third largest in both Japan and the rest of East Asia. Like Kansai, it has a large population and high per capita incomes. The economy, based on agriculture, textiles, ceramics and other light industries before World War II, was substantially deepened postwar with heavy industry, chemicals, petroleum refining, steel, fabricated metals, machinery and the motor vehicle industry. Chubu accounts for almost half of Japan's transport equipment production, with Japan's largest company, Toyota, based at Toyota City near Nagoya. One in four Chubu industries is connected to the auto sector; many as subcontractors. Textiles were a traditional mainstay of Chubu's economy and still contribute almost 40 per cent of national output, but manufacturers are relocating to cheaper centres in Asia.

Chubu's heavy reliance on manufacturing and export has led to a strong focus on strengthening competitiveness. It pressured the central Government to stabilise the yen and proceed with deregulation; now it is developing new industries for the twentieth century, including information, communications, health, social services, energy and the environment. Chubu, like other regions, also has comprehensive development plans for its transport and communications infrastructure.

13 Chubu is made up of: the Tokai subregion of Aichi, Gifu and Shizuoka Prefectures in the south near the Pacific coast (with Mie Prefecture sometimes included); the Hokuriku subregion of Fukui, Ishikawa, Toyama and Niigata Prefectures; and the Tosan subregion of Nagano and Yamanashi Prefectures.

Map 10.6


SEA OF JAPAN
Tsuyama
Kinosaki
Mineyama
Wakasa Bay
Toyooka
Miyazu
CHUBU
CHUGOKU
Wadayama
Maizuru
Planned Shinkansen route to Kanazawa
Ikuno
Fukuchiyama
HYOGO
KYOTO
Yamazaki
TANBA
MTS
Maibara
Lake Biwa
Hikone
Shinkansen to Nagoya and Tokyo
Osaka International Airport
Aioi
Himeji
KYOTO
OTSU
SHIGA
Shinkansen to Hiroshima and Fukuoka
Kakogawa
Uji
SUZUKA RANGE
Itami
INLAND SEA
Akashi
KOBE
Yokkaichi
Kobe-Naruto Bridge (1997)
OSAKA
Ikoma
Nishinomiya
Fuse
Suzuka
Osaka Bay
Ueno
AWAJI I
Sakai
Yao
NARA
Kansai International Airport
OSAKA
TSU
Naruto Strait
Sumoto
Kishiwada
Kashihara
Ise Bay
Kitan Strait
Sakurai
Matsuzaka
Yoshino
WAKAYAMA
Ise
NARA
MIE
Kainan
Mt Koya
Toba
SHIKOKU
KII MOUNTAINS
Kii Strait
WAKAYAMA
Tanabe
Kumano
Shirahama
Shingu
KII PENINSULA
N
0
50
kilometres
PACIFIC OCEAN
KANSAI REGION
Regional boundary
Prefectural boundary
Prefectural capital
City (pop. over 100 000)
Small city / town
Airport
Port
Foreign Access Zone (FAZ)
Expressway
Shinkansen
Shinkansen (planned)
Japan Rail (main line)
Land above 200m

Kansai

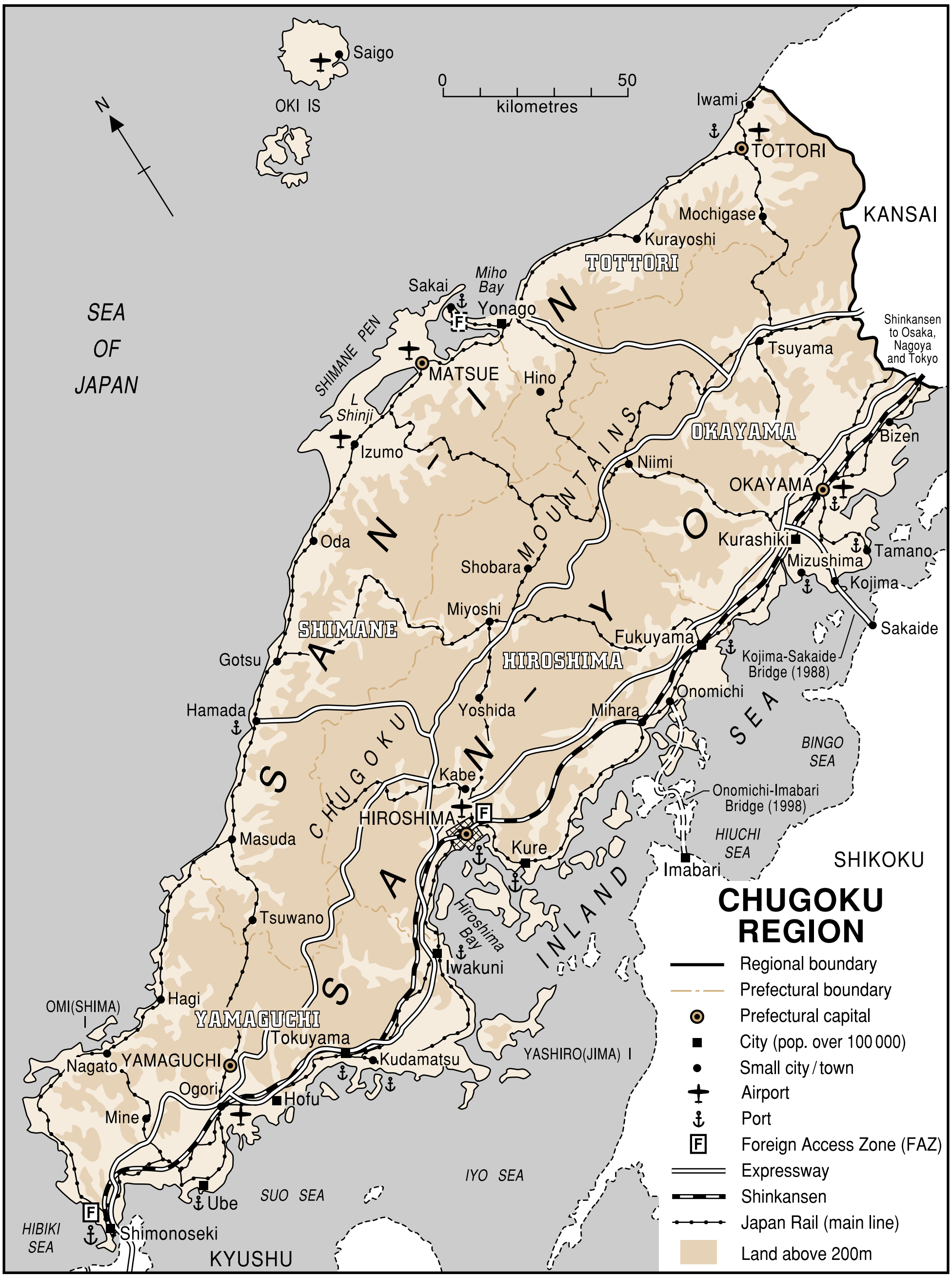
Kansai GRP	¥85.9 trillion (1994) US$863.8 billion (1994)	Land area	33 000 km^2
GRP per capita	¥3.8 million (1994) US$38 561 (1994)	Prefectures	Mie, Shiga, Kyoto, Nara, Osaka, Wakayama, Hyogo
Major cities	Osaka, Kobe, Kyoto, Nara, Wakayama, Sakai, Toyonaka, Uji, Nishinomiya, Himeji, Amagasaki, Yao, Takatsuki, Hirakata, Neyagawa	Main economic activities	Steel making, metal products, chemicals, textiles and clothing, general machinery and appliances, electronics and electrical appliances, retail and wholesale, agriculture
Population	22.4 million (1994)	Main seaports	Kobe, Osaka, Himeji, Wakayama, Yokkaichi
Pop. density	679 per km^2 (1994)	Main airports	New Kansai International, Osaka, Yao, Wakayama

The Kansai region developed as a major rice producing and trading area from an early period, with a significant economic surplus. This gave rise to the traditional centres of Japanese culture and administration: Nara, Kyoto and Osaka. Osaka, centrally located in Honshu and with a port on the crucial Inland Sea (most early transport was by water), was historically the centre of rice trading and other mercantile activities. Kansai people remain very conscious and proud of their region's long cultural and commercial supremacy, and are reluctant to fully accept Kanto's modern ascendancy. Kansai is a region of several distinct centres, in contrast to Tokyo's clear domination of the Kanto region.

The Kansai region developed a strong modern manufacturing base in the Osaka-Kobe industrial belt, initially in textiles, machinery and metal industries, and later in chemicals and heavy industries. With one fifth of the national population and a GRP of over $860 billion, the Kansai region is the second largest economy not only in Japan, but in all of East Asia, excluding Japan. Osaka, with 2.6 million people, and Kobe, with 1.5 million, are Japan's third and sixth largest cities. Osaka remains Western Japan's commercial capital. Kobe and Osaka have the country's second and third largest ports, and the New Kansai International Airport is Japan's second largest, with the largest air cargo terminal.

The Great Hanshin Earthquake which hit Kobe in January 1995 cost more than 6 500 lives, devastated residential, commercial and transport infrastructure, and crippled Kobe port. The loss of life and extent of the damage, together with the unexpectedness of the earthquake and poor disaster management, struck a major psychological blow. (See Chapter 3 - *Socioeconomic Evolution*.) While many physical scars remain, rebuilding is well underway, incorporating more earthquake-resistant designs and materials.

Map 10.7


CHUGOKU
REGION
Regional boundary
Prefectural boundary
Prefectural capital
City (pop. over 100 000)
Small city / town
Airport
Port
Foreign Access Zone (FAZ)
Expressway
Shinkansen
Japan Rail (main line)
Land above 200m
SEA OF JAPAN
OKI IS
Saigo
0
50
kilometres
N
TOTTORI
SHIMANE
OKAYAMA
HIROSHIMA
YAMAGUCHI
SAN-IN
SAN-YO
CHUGOKU
MOUNTAINS
INLAND SEA
KANSAI
SHIKOKU
KYUSHU
Iwami
Tottori
Mochigase
Kurayoshi
Sakai
Miho Bay
Yonago
SHIMANE PEN
MATSUE
Hino
L Shinji
Izumo
Tsuyama
Shinkansen to Osaka, Nagoya and Tokyo
Bizen
Niimi
OKAYAMA
Kurashiki
Tamano
Mizushima
Kojima
Sakaide
Kojima-Sakaide Bridge (1988)
Oda
Shobara
Miyoshi
Fukuyama
Gotsu
Onomichi
Hamada
Yoshida
Mihara
BINGO SEA
Kabe
Onomichi-Imabari Bridge (1998)
HIROSHIMA
Masuda
Kure
HIUCHI SEA
Imabari
Hiroshima Bay
Tsuwano
Iwakuni
OMI(SHIMA) I
Hagi
Tokuyama
Nagato
YAMAGUCHI
Kudamatsu
YASHIRO(JIMA) I
Ogori
Hofu
Mine
IYO SEA
SUO SEA
Ube
HIBIKI SEA
Shimonoseki

Chugoku

Chugoku GRP	¥27.9 trillion (1994) US$280.4 billion (1994)	Land area	32 000 km^2
GRP per capita	¥3.6 million (1994) US$35 948 (1994)	Prefectures	Tottori, Okayama, Hiroshima, Shimane, Yamaguchi
Major cities	Hiroshima, Okayama, Matsue, Yamaguchi	Main economic activities	Shipbuilding, cars, steel, textiles and clothing, petrochemicals, ceramics, agriculture, forestry, fisheries
Population	7.8 million (1994)	Main seaports	Hiroshima, Shimonoseki, Kudamatsu, Okayama, Mizushima, Tokuyama, Ube
Pop. density	244 per km^2 (1994)	Main airports	Hiroshima, Yamaguchi-Ube, Okayama, Tottori, Matsue, Izumo

The Chugoku region covers the westernmost part of Honshu. The Chugoku mountain range divides it into the relatively isolated northern half (*San'in*) along the Japan Sea coast, and the southern half (*San'yo*) along the Seto Inland Sea. One of Japan's earliest cultures, the Izumo, developed in Chugoku, and the name 'Chugoku' or 'in-between provinces' arose from its location between the two other historic centres of Japanese civilisation, Kansai and Kyushu.

North and south Chugoku have had contrasting patterns of economic development due to their geographical differences. The more remote San'in subregion remains focused on agriculture, fishing and forestry, while the San'yo subregion developed as a major industrial area. Due to greater employment opportunities, most of Chugoku's population and largest cities are in the southern subregion, where average incomes tend to be higher. Shipbuilding, cars (Mazda/Ford's head office is in Hiroshima), steel, ceramics and textiles have been the prominent industries. However, increasing competition, mainly from Asia, is forcing some local companies to relocate to lower-cost offshore sites and is putting pressure on Chugoku to diversify into higher technology and more knowledge-intensive industries.

Map 10.8

© EAAU, DFAT / Cartography, RSPAS, ANU (1997)

Shikoku

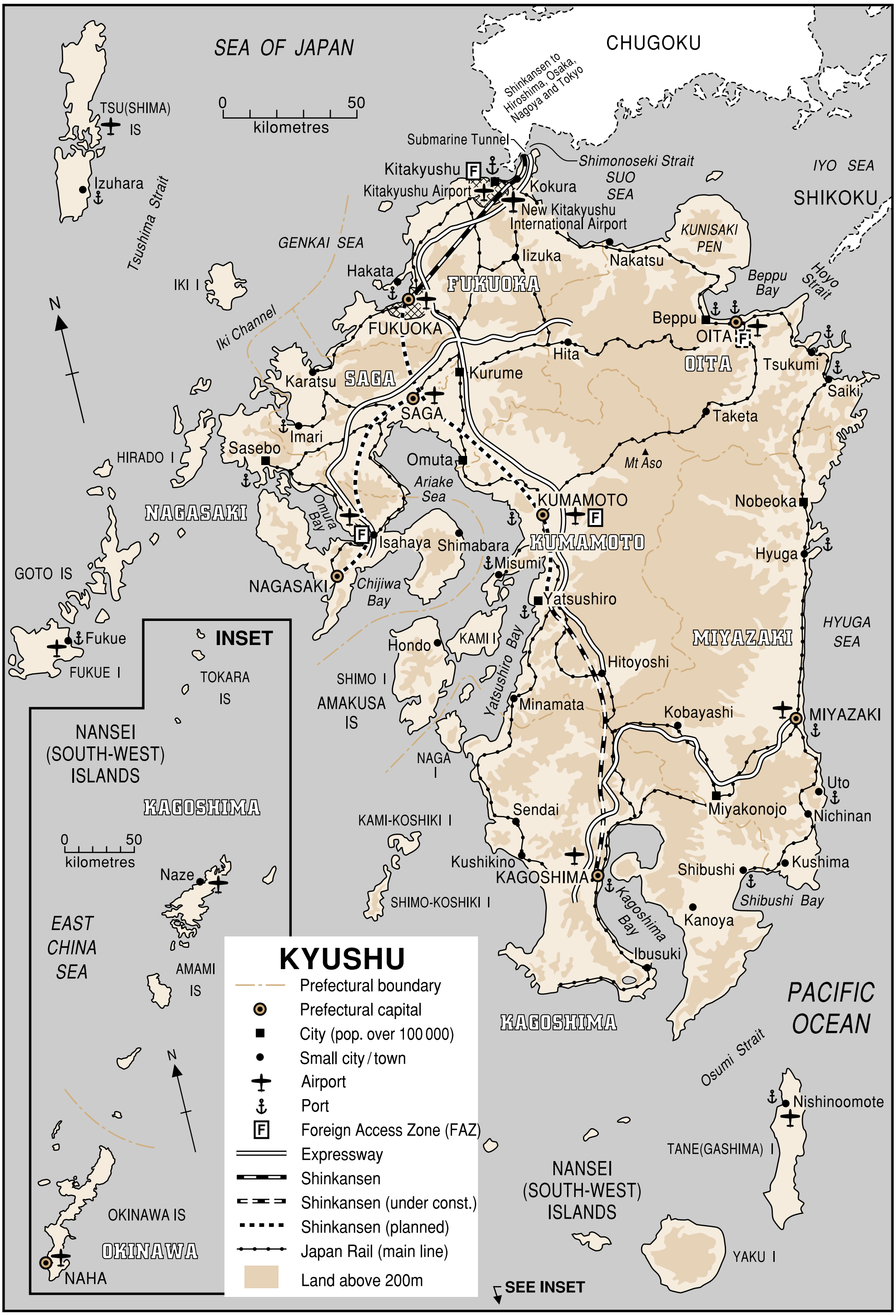
Shikoku GRP	¥13.2 trillion (1994) US$132.8 trillion (1994)	Land area	19 000 km^2
GRP per capita	¥3.1 million (1994) US$31 627 (1994)	Prefectures	Kagawa, Tokushima, Kochi, Ehime
Major cities	Matsuyama, Takamatsu, Kochi, Tokushima, Niihama, Imabari	Main economic activities	Agriculture, fisheries, shipbuilding, petroleum products, chemicals, forestry, pulp and paper, textiles and clothing
Population	4.2 million (1994)	Main seaports	Matsuyama, Komatsushima, Takamatsu, Sakaide, Imabari, Kawanoe, Kochi
Pop. density	221 per km^2 (1994)	Main airports	Takamatsu, Tokushima, Matsuyama, Kochi

Shikoku, literally 'four provinces' (Kagawa, Tokushima, Kochi and Ehime Prefectures), is the smallest of the four main islands. Up until the late 1980s, Shikoku was only connected to other islands by ship or ferry; then the first of several major bridges planned across the Seto Inland Sea was completed. Shikoku's priority is to improve transport and communication links with the rest of Japan and Asia (Table 10.3).

Like Chugoku, Shikoku is divided by a north-south mountain range. The southern region has retained more of the traditional agriculture, forestry and fishing industries, while the area along the Inland Sea developed a stronger industrial base. As elsewhere in Japan, the principal cities developed on the coastal plains with the highest agricultural productivity (Takamatsu, Tokushima, and Matsuyama on the Inland Sea coast and Kochi on the Pacific coast). In recent times, the more dynamic economic activity in the north has attracted steady migration from inland and southern Shikoku. The yen appreciation since the mid-1980s and competition from Asia are pressuring the predominant shipbuilding, pulp and paper, synthetic fibres, petrochemicals, textiles and furniture sectors.

Shikoku is making efforts to develop greater linkages with the global economy, particularly with Asia, and to attract new investment from Japanese and foreign companies. It has one Foreign Access Zone (FAZ) at Matsumoto in Ehime Prefecture, and another planned for Kochi in Kochi Prefecture. (See Chapter 8 - *Market Access* for more information on FAZs)

Map 10.9


SEA OF JAPAN
CHUGOKU
Shinkansen to Hiroshima, Osaka, Nagoya and Tokyo
0 50 kilometres
TSU(SHIMA) IS
Izuhara
Tsushima Strait
Submarine Tunnel
Shimonoseki Strait
SUO SEA
IYO SEA
SHIKOKU
Kitakyushu
Kitakyushu Airport
Kokura
New Kitakyushu International Airport
GENKAI SEA
KUNISAKI PEN
Iizuka
Nakatsu
Hakata
IKI I
FUKUOKA
Beppu Bay
Hoyo Strait
Iki Channel
FUKUOKA
Beppu
OITA
Hita
OITA
Tsukumi
Kurume
Karatsu
SAGA
Saiki
SAGA
Taketa
Imari
HIRADO I
Sasebo
Omuta
Mt Aso
Ariake Sea
KUMAMOTO
Nobeoka
NAGASAKI
Omura Bay
Isahaya
Shimabara
KUMAMOTO
Hyuga
Misumi
GOTO IS
NAGASAKI
Chijiwa Bay
Yatsushiro
HYUGA SEA
Fukue
INSET
FUKUE I
Hondo
KAMI I
MIYAZAKI
TOKARA IS
Hitoyoshi
SHIMO I
AMAKUSA IS
Yatsushiro Bay
Minamata
Kobayashi
MIYAZAKI
NANSEI (SOUTH-WEST) ISLANDS
NAGA I
Uto
KAGOSHIMA
Miyakonojo
Nichinan
Sendai
KAMI-KOSHIKI I
0 50 kilometres
Kushikino
Kushima
KAGOSHIMA
Shibushi
Naze
Shibushi Bay
SHIMO-KOSHIKI I
Kagoshima Bay
EAST CHINA SEA
Kanoya
AMAMI IS
Ibusuki
KYUSHU
Prefectural boundary
Prefectural capital
City (pop. over 100 000)
Small city / town
Airport
Port
Foreign Access Zone (FAZ)
Expressway
Shinkansen
Shinkansen (under const.)
Shinkansen (planned)
Japan Rail (main line)
Land above 200m
PACIFIC OCEAN
KAGOSHIMA
Osumi Strait
Nishinoomote
N
TANE(GASHIMA) I
NANSEI (SOUTH-WEST) ISLANDS
OKINAWA IS
OKINAWA
YAKU I
NAHA
SEE INSET

Kyushu

Kyushu GRP	¥46 trillion (1994) US$463.2 billion (1994)	Land area	44 000 km^2
GRP per capita	¥3.2 million (1994) US$31 723 (1994)	Prefectures	Fukuoka, Saga, Nagasaki, Kumamoto, Oita, Miyazaki, Kagoshima, Okinawa
Major cities	Fukuoka, Kitakyushu, Saga, Nagasaki, Sasebo, Kumamoto, Yatsushiro, Kagoshima, Naha, Miyazaki, Oita, Beppu	Main economic activities	Cars, motorcycles, food processing, microchips, electrical machinery, agriculture, ceramics, forestry, fisheries, shipbuilding
Population	14.6 million (1994)	Main seaports	Kitakyushu, Hakata, Sasebo, Oita, Nagasaki, Kumamoto, Kagoshima
Pop. density	332 per km^2 (1994)	Main airports	Fukuoka, Hakata, Kitakyushu, Oita, Kagoshima, Nagasaki, Kumamoto

Kyushu was a main site of early Japanese civilisation and as the closest region to the Asian mainland, was an important gateway for contact with China and Korea.[14] Kyushu has also played a dynamic role in Japan's history.

While agriculture, fisheries and forestry remain important to Kyushu's economy (it is Japan's largest beef producer), coal mining, steelmaking, shipbuilding, petrochemicals and other heavy industries have provided the main avenues for its modern development. The northern cities of Fukuoka (1.2 million people), with its international air and sea ports, and Kitakyushu (1 million), with one of Japan's largest seaports, are the island's main centres of economic activity.

Kyushu's lower land and labour costs, proximity to key Asian markets, and expanding regional transport links are attracting companies from around Japan. Five of Japan's largest car makers have relocated some operations to Kyushu, and the region accounts for 40 per cent of Japan's integrated circuit production. Kyushu is undertaking extensive infrastructure development, building expressways and expanding air and seaports. Kyushu is connected to Honshu by the Shinkansen and extensive sea and air links.

The capital, Fukuoka, is strongly services-oriented (85 per cent of economic activity), with Japan's fourth largest retail/wholesale/distribution sector and several universities. Kitakyushu, the region's heavy industry centre, is seeking to move into new industries and become a regional sea transport hub. Other cities and prefectures are similarly seeking to diversify their economies. For example, Oita Prefecture (with its 'one village, one product' initiative to create local specialty products) is now connected to Fukuoka by expressway; is building its first international-standard container terminal; is expanding its international airport; has a Foreign Access Zone (FAZ)[15]; and is establishing an Asia-Pacific University.

[14] Contact included most importantly the transmission of cultural, social and economic influences. Trade with China and Korea stimulated Japan's economic development, and transmitted material and ideas.

[15] See Chapter 8 - *Market Access*, for more details on FAZs.

REGIONAL MARKETS: DEVELOPMENTS AND OUTLOOK

All the regions felt the impact of the 1987 to 1991 'bubble economy', the post-bubble recession and the 1994 to 1995 yen appreciation. Kanto and Kansai and, to a lesser extent, Chubu experienced the boom and the bust in extremes, particularly in land prices, manufacturing and construction activity. They have also been slower to recover than the other regions (Table 10.2). The domestic relocation of plants to cheaper regions probably contributed to Kyushu's and Shikoku's relatively slight decline in manufacturing activity in the recession and their rapid recovery thereafter.

Regional governments and business groups still tend to assess the health and outlook of local economies by the state of their manufacturing sectors, although the services sector now has a greater share of GDP and employment.

Table 10.2

Kyushu, Shikoku and Hokkaido Recovering Faster

Indices of Manufacturing Production by Region: 1989 to 1995 (1990=100)

	Kanto	Kansai	Chubu	Chugoku	Kyushu	Shikoku	Tohoku	Hokkaido
1989	96.3	97.1	93.7	95.8	95.7	96.0	96.1	97.4
1990	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1991	101.0	102.3	101.7	101.1	102.5	104.0	104.0	101.4
1992	93.5	94.9	95.7	97.8	100.9	102.0	98.6	99.0
1993	88.3	89.8	89.8	95.0	98.4	99.8	95.1	98.5
1994	89.0	89.3	89.3	94.3	100.5	100.7	96.1	101.6
1995	92.5	90.3	90.6	96.5	106.4	106.3	99.0	103.4

Source: Ministry of International Trade and Industry, 1996.

Urgency to Revitalise Economies

The yen appreciation of 1994 to 1995 wreaked havoc with most Japanese corporations' business plans and accelerated relocations and new investments offshore. The regions viewed this 'hollowing-out' trend with alarm. Surveys by regional business groups found that in contrast to earlier periods of yen appreciation, when companies responded primarily through cutting costs and other efficiencies, this time companies focused mainly on increasing imports of parts and raw materials, and moving offshore.[16] Above all, the sense of crisis has made the regions aware of the inevitability of further economic restructuring and the need for greater revitalisation efforts. All the regions are developing detailed plans for the next

16 As part of the research for this report, the EAAU interviewed senior representatives of several regional business groups in 1995 and 1996, including the Kansai Economic Federation (Kankeiren), Osaka Industrial Association (OIA), Osaka Chamber of Commerce and Industry (OCCI), Chubu Economic Federation (Chukeiren), and Nagoya Chamber of Commerce and Industry (NCCI). Surveys of member companies revealed this common pattern.

century, although some are more ‘visionary’ than rigorously researched. Some regions appear to be embarking on projects that could prove unviable in the long term, due partly to ineffective national planning coordination.

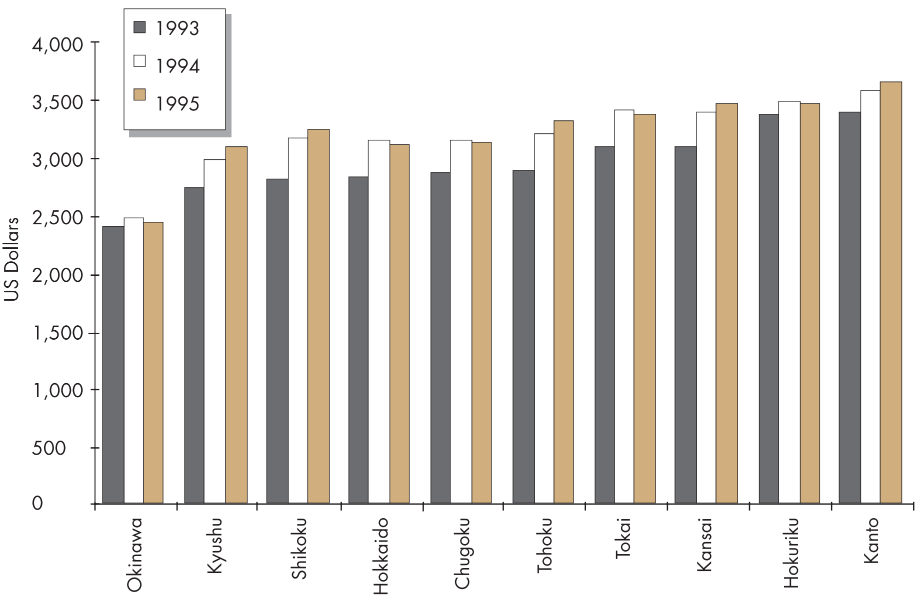
NEW URBANISATION

A new nationwide phase of urbanisation appears to be underway, with many more centres of urban growth than in the past. This is contributing to the growth of the services sector in regional economies, and to the increasing similarity of levels and patterns of household consumption across Japan. In 1995, monthly household consumption expenditure averaged ¥300 000 to ¥350 000 (US$3 000 to $3 500) in most regions (Figure 10.3).

Figure 10.3

Average Monthly Household Consumption

US$, 1993 to 1995



Note: In some Japanese statistics, the regions are divided into 10 areas, subdividing the Chubu region into its two main subregions (Tokai and Hokuriku) and separating Okinawa from Kyushu.

Source: Economic Planning Agency, 1996.

With Japan’s population growth rate close to zero, domestic migration is another indicator of regional economic trends. In contrast to the large-scale postwar rural-to-urban migration to the industrial belts of the Kanto, Kansai and Chubu regions, in the 1980s and 1990s, the rate of population decline has slowed in the smaller regions, and most migration is within rather than between regions (Instate, 1996). The three main trends are:

1. The ‘doughnut effect’: big city dwellers migrating from the inner city to outer suburbs or satellite cities which are within commuting distance and offer

better-quality, more affordable housing and living conditions. This trend is particularly evident in Tokyo, Osaka and Nagoya. For example, 61 000 people left Tokyo in 1994, and nearly 59 000 moved to surrounding prefectures in the Kanto region. Saitama Prefecture, on the northern outskirts of the Tokyo metropolitan area, has the fastest growing population in Japan, with most of the newcomers coming from Tokyo.

2. The 'magnet effect': people moving from low growth to higher growth areas for employment. Sendai and Fukuoka are key examples of this migration, which is primarily intraregional in nature.

3. Continued rural-urban drift, reflecting the consistent decline of agriculture and fisheries common within regions. For example, while rural Hokkaido's population is falling, Sapporo's is growing; similarly, in Shikoku, while the four prefectures' total population is falling, the population in the four prefectural capitals is growing.

The postwar Japanese economy featured low unemployment and a relatively small income gap between the top and bottom echelons of the workforce, making most people middle income earners. This produced a very large population with similar levels of disposable income and demanding similar stages of goods and services across the regions. Other features contributing to commonality among consumers across the regions are:

- the introduction of mandatory standardised Japanese language in education and public broadcasting, reducing the use of regional dialects
- nationwide radio, television and print media coverage
- strong desire among most Japanese to conform and follow trends
- high diffusion of consumer durables, including whitegoods, by the 1970s. (See Chapter 2 - *Socioeconomic Evolution*.)

REGIONAL DEVELOPMENT POLICIES

Japan's early postwar industrial growth was strongly concentrated in four main industrial zones: Tokyo-Kawasaki-Yokohama; Aichi (Nagoya)-Shizuoka; Osaka-Kobe; and the Inland Sea maritime prefectures of southern Chugoku, northern Shikoku and northern Kyushu. By the late 1960s, however, the environmental and social costs of a concentrated pattern of industrial growth and the long-term impact of declining agriculture and mining on other areas were concerns (Instate, 1996).

As a result, the central government introduced a number of decentralisation and regional development initiatives which were supplemented by regional and prefectural efforts (Appendix Table 10.1) (Instate, 1996). The Ministry of International Trade and Industry (MITI) designed most of the programs, which the Japan Regional Development Corporation (JRDC) and the Japan External Trade Organisation (JETRO) have mainly implemented.

MITI's 1990 and 1992 programs have had the most impact, primarily the expanded 1992 Law on Extraordinary Measures for the Promotion of Imports and the Facilitation of Foreign Investment. (See Chapter 8 - *Market Access*.) The import incentives added momentum to the basic impetus provided by yen appreciation, with increasing imports exposing regional businesses to greater competition and lowering input costs. While the impact of the 12 Foreign Access Zones (FAZs)[17] established to date (see regional maps) and 21 planned by 2000 is yet to be seen, they do appear to be heightening business interest in international links, including direct importing.

The 1995 Decentralisation Promotion Law requires the central government to formulate and implement a decentralisation plan by 2000. The Decentralisation Promotion Committee issued preliminary recommendations in March 1996, focusing on reorganising and rationalising budgetary allocations, increasing local government tax revenue and loan authorisation capacity, and promoting administrative reform and transparency at all levels.[18]

Regional Incentives - and Disincentives

Regional authorities and business groups are increasing efforts to attract domestic and foreign companies, including establishing direct links with overseas governments and corporations. In addition to central government incentives, most prefectural and municipal authorities offer a range of inducements, including tailored packages, involving most frequently tax reductions and exemptions, grants, loans and less often interest subsidies (Instate, 1996). Considerable variation exists among prefectures (Appendix Table 10.3).

Numerous domestic and foreign companies have taken advantage of these incentives. One example is the German company, Karcher, the world's leading manufacturer of high pressure cleaning equipment which initiated sales in Japan in 1988. By 1991, rising rents and insufficient space led it to accept a Japan Regional Development Corporation offer of a 10 000 square metre site in the North Sendai Industrial Park in Miyagi Prefecture. This cost Karcher ¥200 million (US$1.5 million), or approximately one-third of the market price at the time. To help finance this, plus ¥500 million in construction and equipment costs, Karcher received a ¥310 million low interest loan from North East Finance of Japan (a public development agency) and a ¥140 million loan from a local bank, arranged by the Miyagi prefectural government (*Nikkei Weekly*, 28 March 1994).

Many foreign companies believe regional authorities should also attend to issues which can act as disincentives to potential trading and investment partners. One major problem is that import regulations and customs clearance procedures are implemented unevenly from port to port, causing delays and higher costs for shippers. Another problem is that some municipalities have a 'buy local' policy, which in effect excludes foreign goods and services.

17 FAZs appear to have been mostly located in economically lagging areas.

18 Currently local governments at prefectural level collect about 37 per cent of national tax revenue but in contrast expend 66 per cent, with central government allocations providing the balance.

REGIONAL 'REORIENTATION' TOWARD ASIA

When Japan opened up to the world in the Meiji period, *kokusaika*, or 'internationalisation', was oriented primarily toward Europe and America. Japanese attitudes towards Asia were ambiguous. While on one hand, Japan wished to see Asia follow its own example of adjusting to the West, on the other it wanted to distinguish itself from the rest of Asia. In the postwar period, however, *kokusaika* was redefined to include Asia. In the past decade, Japan's regions have embraced *kokusaika* with unprecedented enthusiasm, and Asia now is the primary focus of their efforts.

Asia's increasing competitiveness has motivated new initiatives in the regions, including a growing focus on internationalisation. The regions recognise that they must compete with Asia to attract new business and investment, from Japanese as well as foreign firms. To facilitate trade, tourism and investment, regions are improving transport and communications links with Asia (Table 10.3), and engaging in intensive relationship-building activities.[19]

In many cases, Asia-oriented initiatives reflect historical ties or geographical proximity. Kyushu and Shikoku are focusing on the Republic of Korea, Taiwan, China and South East Asia generally; the part of Chubu centred on Nagoya is particularly cultivating ties with China and the ASEAN economies, building on local vehicle industry investments; and the Kansai region, by virtue of its size and the range of its companies' economic interests and offshore investments, is strengthening links throughout Asia. The Kansai region is particularly conscious of the dynamic economic challenge China poses and also developing close links with South East Asia.

Table 10.3

Flights to Asia Enhance Travel, Business

Japan's Main Regional Airports: Weekly Flights to Asia 1997

Region (Airports)	Weekly flights to Asia	Percentage of total weekly flights
Kansai (New Kansai - Osaka)	316	55
Chubu (Nagoya)	62	49
Hokkaido (Chitose -Sapporo)	10	60
Tohoku (Aomori, Niigata, Sendai)	26	50
Chugoku (Hiroshima)	16	100
Shikoku (Matsuyama)	3	100
Kyushu (Fukuoka, Kumamoto, Nagasaki, Kagoshima)	90	80

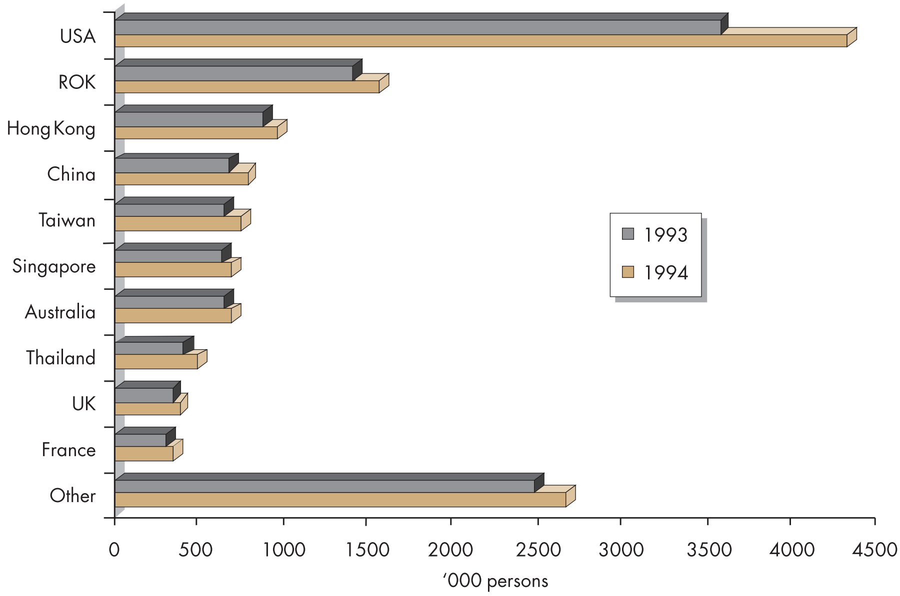
Source: Based on data from Japanese Ministry of Transport, 1997.

19 The pattern of increasing regional economic and other links with Asia includes: visits by prefectural- and regional-level politicians and officials to Asia, and hosting of similar visits to Japan; goodwill and specific-purpose visits by regional business groups to Asia, and hosting of similar visits to Japan; exchanges of officially supported goodwill visits by community groups; hosting of Asian tertiary students at regional educational institututions, mostly on Japanese Government and other scholarships; and increasing tourism to Asia.

Figure 10.4

Travel to Asia Growing

Main Destinations of Japanese Travellers Abroad
'000 People, 1993 to 1994



Source: Japan External Trade Organisation, 1995 and 1996.

AUSTRALIA-REGIONAL JAPAN TRADE AND INVESTMENT

Australians generally are not aware that individual regional markets are the major end-customers for many Australian exports to Japan. Just eight commodities account for over two thirds of Australia's exports to Japan:[20] coal, beef, iron ore, gold, aluminium, wool, wheat and sugar. Most end-users are in the regions.

- Japan's nine regional power corporations are the key customers for steaming coal.
- The Chubu region, especially Gifu Prefecture, Japan's main textile fibre processing centre, is the main destination for Australia's wool and cotton exports.
- Regional steelmakers are major customers for coking coal and iron ore.
- Tohoku, Chubu, Chugoku, Shikoku and Kyushu are the main purchasers of Australian wood chips for pulp and paper manufacture.
- Regional markets are also major customers for both traditional bulk commodities like wheat and sugar, and higher-value items like seafood, cheese and horticultural products.

....

20 A$11 billion of A$16.6 billion in 1995.

THE KANSAI REGION IN AUSTRALIA-JAPAN RELATIONS

The Kansai region is a significant destination for Australian trade and source of investment. Nearly one fifth of Japan's merchandise imports from Australia enter through Osaka and Kobe.

Item	Australian exports to Kansai (A$ million)	Share of Australian exports of item to Japan (per cent)
Foodstuffs	1 340	31
LNG/coal/petroleum products	798	12
Iron/nonferrous ores	523	18
Iron/nonferrous products	244	19
Textile raw materials (wool, cotton)	88	13
Machinery	73	13
Chemical products	56	26
Other	165	7
Total	*3 500*	*18*

Kansai companies have been important in developing Australia-Japan trade. They are involved in around 60 per cent of Australia's wool exports to Japan; 28 per cent of Japan-bound LNG; 19 per cent of iron ore exports; and 20 per cent of coking coal. About 45 per cent of Australian beef exports to Japan enter through Osaka and Kobe, and 70 per cent of Australian salmon exports. Japan's second largest cheese producer, Kobe-based Rokko Butter introduced Australian cheese into Japan and now 50 per cent of Australian cheese enters the market through the Kansai.

Kansai region companies also account for about one quarter of Japanese investment in Australia (5 per cent of the region's total investment offshore).

Source: Austrade, Osaka, 1996.

Services trade, particularly tourism and education, is growing rapidly with the regions figuring strongly. The Chubu region, for example, provides 19 per cent of Japanese visitors to Australia (Table 10.4).

Table 10.4

Japanese Tourism to Australia by Region

Number of People

	Hokkaido	Tohoku	Kanto	Chubu	Kansai	Chugoku	Shikoku	Kyushu
1992	17 522	21 070	248 318	95 094	127 274	22 569	11 653	37 064
1993	23 661	22 469	265 699	111 502	126 745	24 354	11 401	43 099
1994	25 136	24 580	279 094	114 910	144 402	27 685	14 526	45 845
1995	27 343	29 357	297 848	130 925	153 864	29 563	15 910	50 903
1996	25 685	26 721	311 562	146 096	148 828	35 238	16 366	50 969

Source: Ministry of Justice, 1997.

Regional companies account for a significant proportion of Japanese direct investment in Australia (Table 10.5). Even investments which are relatively small by Japanese standards can be rated as large in Australia. For example, Hiroshima-based (Chugoku) companies' investments in Australia include: a flour milling machinery production plant (Satake Corp) in NSW; an electric tools manufacturing plant (Ryobi) in NSW; and a coal mining concession (Nikki Kogyo) in Queensland.

Table 10.5

Major Kansai Investors in Australia[a]

Company	Industry	Location of investment	Value of investment (A$ million)
Matsushita Investment Development	Resorts	Brisbane	1 450
Sumitomo	Metals	Sydney	320
Tomen	Textiles	Sydney	205
Kobe Steel	Metals	Sydney	82
Shimadzu	Scientific instruments	Dandenong, Victoria	80
Itochu	Minerals/textiles	Sydney	55
Matsushita Electrics	Electronic	Penrith, NSW	42
Daiwa Group	Finance	Sydney	40
Hokushin	Particle board	Launceston	35
Sharp	Electrics	Blacktown, NSW	27
Hannan Corporation	Beef	Forbes, NSW	26
Yamasa Seafoods	Fish paste	Laverton North, Victoria	24
Kaneka Corporation	Biotechnology	na	20
Daimaru	Retailing	Melbourne	20
Sanyo	Electrics	Homebush, NSW	20
Senshukai	Forestry plantation	Albany, WA	18
Nippon Ham	Smallgoods	North Sydney	12

Note: a. This is an indicative list only of major recent new investments by Kansai companies. na: not available.

Source: Austrade, Osaka, 1996.

JAPANESE REGIONAL INVESTMENT IN AUSTRALIA

Kansai

Shimadzu Corporation (Kyoto) Makes Precision Equipment in Victoria

Shimadzu, a major Kyoto-based manufacturer of precision analytical, medical and testing equipment (JFY1995 sales of US$1.5 billion in Japan) has shifted some production overseas in response to yen instability and appreciation. With plants in the USA, UK, Germany and China, and an international procurement office in Singapore, Shimadzu's strategy is to minimise its international distribution in yen and trade mostly in non-yen currencies.

In 1995, Shimadzu sited an overseas production facility in Australia, an A$80 million factory in Dandenong, Victoria, on the outskirts of Melbourne. This decision was based on factors including: some predictability in the A$:¥ rate (as the Australian currency is closely linked to the US dollar); high average worker skills; good infrastructure, especially power supply; and Australia's relatively unrestricted commercial environment.

Source: East Asia Analytical Unit interview, June 1995.

Tohoku

Sakata Beika (Yamagata) Produces Rice Crackers in Victoria

In 1994, Sakata Beika, a small private company from Yamagata Prefecture in the Tohoku region, invested A$6 million in a state-of-the-art, 4 000 square metre rice cracker manufacturing plant in Laverton, Victoria, also near Melbourne. Initially employing 38 people (to expand to 50), the plant is expected to eventually generate A$7 million in annual sales. Marketed in Australia under the brand name of 'Rice Snack', the output is aimed at both the Australian domestic market and offshore markets, particularly in South East Asia.

Australia's main investment attractions were the local availability of excellent quality inputs: vegetable oil, salt, cheese, and, most importantly, rice, at one-third the cost of the Japanese product; and the fact that by the early 1990s, Australia was importing rice crackers worth approximately A$6 million per year.

Source: *Overseas Trading*, March 1996.

ENTERING JAPAN THROUGH REGIONAL MARKETS

Australian companies with offices in Japan overwhelmingly locate them in Tokyo and the Kanto region (Table 10.6). Apart from Kansai, few Australian firms are represented in the regions. Indeed, Austrade regional offices have many more enquires from Japanese enterprises seeking products from Australia, than from Australian companies seeking opportunities in Japan. Similarly, Japanese regional companies take the initiative in investing in Australia; few Australian firms approach potential investors from the regions, and fewer still invest in regional Japan.

Table 10.6

Australian Business Presence in Regional Japan

Region	Number of Australian Company Representative Offices
Hokkaido	0
Tohoku	0
Kanto	36 [a]
Chubu	1
Kansai	18
Chugoku	0
Shikoku	1
Kyushu	1
Total	57 [a]

Note: a. Estimate.

Source: Austrade, Japan Regional Offices, 1997.

Expanded Business Support Services

Since the 1960s, the Australian Government has recognised the significance of Japan's regional markets and the opportunities they offer for Australian business.[21] Until the mid-1960s, the Australian Embassy in Tokyo and its associated Austrade operations handled all business, trade and consular matters. In 1965, the Government opened a trade office in Osaka, subsequently upgraded to a Consulate-General, to augment business and consular services in the Kansai region. In 1992, Austrade set up four more small regional Consulate offices around Japan: in Nagoya (Chubu), Fukuoka (Kyushu), Sendai (Tohoku) and Sapporo (Hokkaido) (Table 10.7). Among the first foreign government representative offices based in the regions, these form a network which compares favourably with those of other countries such as the USA and the Republic of Korea. The Australian regional

....

21 In-principle approval existed in 1984 for three new Trade Commissioner posts in Japan to supplement the main one in Tokyo, but lack of funding prevented implementation. In 1992, following the McKinsey Review of its operations and structure, Austrade added four more regional offices in Japan, in addition to the one it had opened earlier in Osaka.

offices aim to help Australian companies identify and act on regional opportunities, including matching them with Japanese partners; and promote the image of Australia as a reliable supplier of high-quality goods and services, and as a priority destination for investment. High level ministerial visits have enhanced the regional awareness of Australia.

Table 10.7

Austrade's Network in Japan[a]

Office[b]	Region	Prefectures Covered
Sapporo	Hokkaido	Hokkaido
Sendai	Tohoku	Miyagi, Fukushima, Niigata, Yamagata, Iwate, Akita, Aomori
Tokyo	Kanto	Tokyo, Kanagawa, Chiba, Saitama, Ibaraki, Tochigi, Gunma, Yamanashi
Nagoya	Chubu	Aichi, *Mie*, Gifu, Shizuoka, Fukui, Toyama, Ishikawa, Nagano
Osaka	Kansai Shikoku Chugoku	Osaka, Hyogo, Kyoto, Nara, Wakayama, Shiga, Hiroshima, Okayama, Tottori, Shimane, Ehime, Kochi, Tokoshima, Kagawa
Fukuoka	Kyushu	Fukuoka, Oita, Saga, Nagasaki, Kumamoto, Kagoshima, Miyazaki, Okinawa, Yamaguchi

Note: a. Austrade's regional coverage is not an exact reflection of the regional boundaries shown in Map 10.1. Austrade is not represented in Chugoku or Shikoku, but covers these regions from Osaka, with the exception of Yamaguchi Prefecture, which is covered from Kyushu. b. Contact details for Austrade regional offices in Japan are given in the *Information For Companies* section after Chapter 15.

Source: Austrade, 1997.

Better Transport Links

The Australian Government put much effort into securing Japanese Government agreement to increase air links between Australia and regional Japan. This was partly because of the difficulty in gaining more of Narita's very limited slots, but also due to a growing appreciation of the regions as individual markets and important sources of tourists. As a result, the number of weekly flights between Australia and Japan rose from 8 to 73 over the past decade, nearly half serving regional cities (Table 10.8).

Driven by and facilitating the Japanese tourist boom, the expanded flights open up more air freight capacity and keep down Australia-to-Japan air cargo prices. (See Chapter 13 - *Transport*.) With Japanese tourists to Australia expected to reach 1 million by 2000 (Australia-Japan Tourism Summit, 1997), flights and therefore air freight capacity could increase further. Given infrastructure constraints at Narita and Kansai, most additional flights may go to other regions. The increased air freight capacity, underused at present, could facilitate more exports of perishables and high-value goods from Australia to regional Japan.

Table 10.8

Growing Links

Australia's Direct Air Links with Regional Japan
Weekly Services from Australia

Destinations	1985	1991	1996
Narita (Kanto)	8	34	38
New Kansai (Kansai)	-	-	22
Nagoya (Chubu)	-	7	7
Fukuoka (Kyushu)	-	2	4
Chitose (Hokkaido)	-	-	2
Total	**8**	**43**	**73**

Source: Australian Department of Transport and Regional Development, 1997.

Twinning Relationships

Companies are finding twinning arrangements such as sister-state, sister-city, sister-business association ties to be useful in entering regional markets. While some relationships focus on cultural, youth and teacher exchanges, others have strong business development objectives.[22] Australia has the third largest number of such links with Japan after the USA and China (Council of Local Authorities for International Relations, 1996). Over half of sister-city relationships are with cities outside Tokyo, Osaka and Nagoya. By early 1997, Australia had six sister-state, five sister-port and, and 75 sister-city arrangements with Japan. (See Appendix Table 10.5.)

In a business association twinning arrangement, in 1983 the Australian Chamber of Manufacturers established a sister-association relationship with the Osaka Chamber of Commerce and Industry which has a membership of around 42 000 small and medium-sized enterprises. In 1987, the Australian Chamber of Manufacturers set up the 'Australian Business Office' in the Osaka Chamber of Commerce and Industry's headquarters in the Osaka central business district to promote business missions and exchanges, and to assist Australian companies. It also serves, on a commercial basis, as the representative office of Australian firms (seven in early 1997).

Australian Business Response

Despite official encouragement, Australian business generally has responded slowly to new market opportunities in regional Japan, and uptake of government and other support has been small in scale. Nevertheless, successes in the Kansai region include:

- Ken Done Designs which used an Osaka-based sales agent, after trying unsuccessfully to enter the market through Tokyo

....

22 Twinning arrangements can require considerable effort and funding to be successful, especially those focusing on business development.

- Textile Industries of Australia which used Osaka/Kobe as a base for introducing their Sheridan brand of soft furnishings
- Nutri-Metics which invested substantially in its own warehousing and distribution operation in Kobe
- Boral Limited, which through its Osaka representative office, has capitalised on the growing demand for foreign building materials and prefabricated housing.

AUSTRALIAN REGIONAL SUCCESS STORIES

Red Earth

A Japanese regional initiative provided an opportunity for a small Melbourne-based manufacturer and retailer, Red Earth, to export natural body products to Kyushu. A Kyushu firm contacted Red Earth management in Australia, visited the company and negotiated a national franchise agreement for Japan. The first Red Earth store in Japan opened in Fukuoka, Kyushu, in 1995, followed swiftly by a second in Tokyo, then another in Fukuoka. By the beginning of 1997, 15 Red Earth franchise stores were operating, and 50 are targetted under the current five-year plan.

Source: Instate, 1996.

Ravensworth Beef

Ravensworth Beef, one of Australia's largest beef production and processing companies, decided in the late 1980s to adopt a regional marketing strategy to identify how beef demand in Japan varied from region to region and develop a range of products to match requirements. Its first move was to focus on demand for highly marbled beef in the Kansai and Chubu regions. It located a representative there and developed three speciality brands which a Tokyo-based wholesaler distributed nationally. Ravensworth's second move was to focus on Kyushu, Tohoku and Hokkaido, where it increased direct contact with customers to lift demand for its brands. It also accesses more easily business and government in the regions to attune its products to special local requirements and market characteristics.

Source: Instate, 1996.

Berela

Australia's twelfth largest multi-unit house builder, Queensland's Berela Limited, began its push into the Japanese market with participation in the 1996 Kobe Interhome Trade Show. Osaka-based property and resort developer and owner, Kishiren K.K., impressed by Berela's track record and association in Australia with Japanese condominium builder Daikyo, approached Berela to supply houses for a unique Australian village of 64 townhouses to be located in Hatashiro, southern Osaka. The A$4 million contract was signed in February 1997, with construction to begin in August, using major building components made in Australia in kit form, with Australian tradespeople to assist with the assembly on site. Kishiren is also now planning to have Berela and an Australian joinery and furnishings manufacturer supply a 300-room hotel.

Source: Austrade Osaka, 1997.

GOOD OPPORTUNITIES IN JAPAN'S REGIONAL MARKETS

In dealing with Japan, it is important to understand the significance of the regions. Historically, they instigated far-reaching change; now, as the continuing bedrock of Japan's national identity, they are increasingly dynamic and enthusiastic reformers, developers and proponents of internationalisation.

Entering the Japanese market through one of Japan's regions can be the best strategy for companies tackling the world's second largest economy. Some key points to bear in mind:

- The individual economies of Japan's eight regions (Kanto, Kansai, Chubu, Chugoku, Kyushu, Shikoku, Tohoku and Hokkaido) are larger than most national economies in the rest of Asia.
- Consumers in these eight regions are increasingly urbanised, have the highest per capita incomes in Asia, display a high degree of commonality and belong overwhelmingly to the middle income bracket.
- The regions take a long-term view and are striving to revitalise and internationalise their economies in order to compete effectively in the twenty-first century.
- The regions are focusing strongly on Asia, both as a market and as a competitor. This is enhancing their awareness of the importance of economic and administrative reforms in Japan.
- Corporate entities in the regions are often easier to relate to, being smaller (though still large by Australian standards), less monolithic, and often family-owned and operated.

Australians must better appreciate the significance and potential of regional Japan in Australia-Japan trade and investment flows. An Austrade network covering the main commercial centres of Japan from north to south (Sapporo, Sendai, Tokyo, Nagoya, Osaka and Fukuoka) and nonstop air services linking the regions to Australia, should encourage Australian companies to consider the regional markets as they revisit their strategies for Japan.

Appendix 10.1

REGIONAL DEVELOPMENT PROGRAMS AND INCENTIVES

Appendix Table 10.1

Decentralisation and Regional Development

Major Programs 1961 to 1995

Year	Program	Agency	Origins / function
1961	Industrial development in former coal mining areas	Coal Mining Area Development Corporation	Formation of predecessor body to Japan Regional Development Corporation
1962	Act for the Development of New Industrial Cities	National Land Development Council	15 areas designated between 1964 and 1966 in each of the eight regions
1973	Industrial Relocation Promotion Law	Coal Mining Area Development Corporation	Directed at relocation of industry from major metropolitan areas to regions
1974	JRDC - Japan Regional Development Corporation	Responsible to the MITI Minister	Formed from a revamp of the Coal Mining Area Development Corporation
1974	Regional City (New Town) Development	JRDC	Development by JRDC of housing and industrial estates
1980	Technopolis Policy	MITI / JRDC	Development of decentralised knowledge-intensive industrial centres (first technopolis sites not approved until 1984)
1986	Private Participation Promotional Law	MITI	To provide support for establishing research facilities ('research cores') in regional locations with particular emphasis on involvement by the private sector
1988	Key Facilities Siting Plan	JRDC	Promotion of industrial development outside existing major industrial zones (by establishment of research parks, low interest loans for business relocation)
1990	Relocation of Advanced Industrial Functions	JRDC	For establishment of 'intellectual industry zones' within JRDC research parks
1990	Import Expansion Program	MITI	To stimulate import growth with significant regional development elements
1992	Regional Core Cities Law	JRDC	Promotion of regional core cities strategy and relocation of industrial facilities program including through land redevelopment and the establishment of research, industrial and business parks
1992	Second MITI Import Expansion Program	MITI	Provides umbrella for expanding measures introduced in 1990 MITI program
1992	Foreign Access Zones	JETRO	To facilitate foreign company activities and stimulate imports in the regions
1995	Decentralisation Promotion Law	Diet	Framework for central government action to promote decentralisation through fiscal and administrative reform

Sources: Japan Regional Development Corporation, 1994 and 1995.

Appendix Table 10.2

Types of Prefectural and Municipal Incentive Measures

Incentive measure	Explanation
Special land holding tax exemption (municipal tax)	Tax exemption is valid if plant construction or expansion commences within one year of purchase in the designated area.
Prefectural/municipal tax reduction/exemption	If plant is relocated, newly constructed or expanded, following programs can be applied: **Prefectural level** • real estate acquisition tax exemption or reduction for 3 years* • enterprise tax exemption or reduction for 3 years* • fixed asset tax exemption or reduction for 3 years* **Municipal level** • fixed asset tax exemption or reduction for 3 years*
Grants and subsidies	In 30 prefectures, grants and subsidies are available for the establishment of factories and research facilities. Program conditions vary by prefecture. The maximum amount is generally in the range of ¥100 million to ¥200 million. The exception is Nagasaki, where a maximum of ¥1.5 billion is available. In Kumamoto, subsidies are provided only to foreign companies. Other subsidy programs may be available at municipal level.
Loans	In 32 prefectures, capital investment loans and/or working capital loans are available for re-locating enterprises and for the establishment of factories and research facilities. The maximum loan amount is generally in the range of ¥100 million to ¥200 million. The exceptions are Saitama and Shimane prefectures, where it is ¥1 billion.
Interest subsidies	Interest subsidies are available for companies relocating facilities to Nagasaki and Kagoshima Prefectures.

Note: * Five years for Okinawa Prefecture.

Source: Instate, 1996, adapted from, JETRO, 1995, *Incentive Programs*.

Appendix Table 10.3

Incentive Measures by Prefecture

Region / prefecture	Tax reduction or exemption	Cost subsidy	Loans	Interest subsidy
Hokkaido	✔	✔	✔	✕
Tohoku				
Aomori	✔	✔	✔	✕
Iwate	✔	✕	✔	✕
Miyagi	✔	✔	✔	✕
Akita	✔	✕	✔	✕
Yamagata	✔	✕	✔	✕
Fukushima	✔	✕	✔	✕
Kanto				
Ibaraki	✔	✕	✔	✕
Tochigi	✔	✔	✔	✕
Gunma	✔	✕	✕	✔
Saitama	✕	✕	✔	✕
Chiba	✔	✔	✔	✕
Tokyo	✕	✕	✕	✕
Kanagawa	✕	✕	✕	✕
Chubu				
Niigata	✔	✔	✔	✕
Toyama	✔	✔	✔	✔
Ishikawa	✔	✔	✔	✕
Fukui	✔	✔	✔	✕
Yamanashi	✔	✔	✕	✕
Nagano	✔	✕	✕	✕
Gifu	✔	✔	✕	✕
Shizuoka	✔	✔	✕	✕
Aichi	✔	✕	✕	✕
Kinki				
Mie	✔	✕	✔	✕
Shiga	✔	✕	✕	✕
Kyoto	✔	✔	✔	✕
Osaka	✕	✕	✕	✕
Hyogo	✔	✕	✕	✕
Nara	✔	✕	✕	✕
Wakayama	✔	✔	✕	✕
Chugoku				
Tottori	✔	✔	✔	✕
Shimane	✔	✕	✔	✕
Okayama	✔	✔	✔	✕
Hiroshima	✔	✔	✔	✕
Yamaguchi	✔	✔	✕	✕

Shikoku				
Tokushima	✔	✔	✔	✘
Kagawa	✔	✔	✔	✘
Ehime	✔	✔	✔	(lease)
Kochi	✔	✔	✔	✘
Kyushu				
Fukuoka	✔	✔	✔	✘
Saga	✔	✔	✔	✘
Nagasaki	✔	✔	✔	✔
Kumamoto	✔	✔	✔	✘
Oita	✔	✔	✔	✘
Miyazaki	✔	✔	✔	✘
Kagoshima	✔	✔	✔	✔
Okinawa	✔	✔	✘	✘

Source: Instate, 1996, reproduced from JETRO, 1995, *Incentive Programs*.

Appendix Table 10.4

Location Attraction Packages: Kyushu

Location	General attractions	Location incentives	Supplementary features
Oita City and environs (Oita Prefecture)	Port facilities permit the handling of domestic and international freight; it offers convenient access to fast growing Asian markets; land prices are low; there is concentration of companies in the steel and petroleum sectors as well as firms in such high-tech fields as semiconductors.	Employment and plant-construction subsidies available up to ¥50 million each, depending on the number of employees and the size of production facilities. Special low-interest loans are available (up to ¥200 million at rates below the long-term prime rate).	Oita will prepare sites that exactly meet the needs of firms that want to locate in the Prefecture.
Jonan Industrial Site (Kumamoto Prefecture)	This industrial site is located in central Kumamoto Prefecture, not far from Kumamoto City, with a population of 640 000. Good transportation and communications infrastructure.	In addition to qualifying for conventional investment incentives, foreign affiliates are eligible for subsidies up to ¥50 million and low-interest loans up to ¥400 million.	Three universities with engineering schools and 19 technical high schools. A major north-south expressway. Kumamoto airport.
Sasebo Techno Park Omura High-Tech Park Higashi-sonogi Green Techno Park (Nagasaki Prefecture)	Sasebo Techno-Park is 40km from Nagasaki Airport and 3km off a major expressway. Omura High-Tech Park, is 6km from the airport and 2km from an expressway. Higashisonogi Green Techno-Park, is 17km from the airport and 3.3km from an expressway.	Maximum subsidy of ¥1.5 billion per company. Tax and financing incentives are also available.	The addition of planned new air services will provide regular links to nearby destinations in China, on the Korean Peninsula and elsewhere.
Miyazaki Techno-Research Park and other facilities (Miyazaki Prefecture)	Miyazaki Techno-Research Park has good land, sea and air transport links, offers an attractive living environment and prices for goods and services are lower than the national average.	Firms that qualify can receive as much as ¥500 million under an industrial location subsidy program.	Miyazaki is home to two subsidiaries of leading US-based pharmaceutical companies. Sea Gaia, a large-scale seaside resort, is a nearby leisure option.

Source: Instate, 1996, adapted from JETRO, 1996, *Investment News*, Vol 4.

Appendix 10.2

AUSTRALIA - JAPAN TWINNING ARRANGEMENTS

Appendix Table 10.5

Sister States (6)

Australian state	Japanese prefecture
Victoria	Aichi Prefecture, Chubu
Western Australia	Hyogo Prefecture, Kinki
New South Wales	Tokyo Metropolitan Government, Kanto
Queensland	Saitama Prefecture, Kanto
Queensland	Osaka Prefecture, Kinki
South Australia	Okayama Prefecture, Chugoku

Sister Ports (5)

Australian city, state	Japanese city	Prefecture
Port of Sydney, NSW	Port of Yokkaichi	Mie
Port of Melbourne, Vic	Port of Osaka	Osaka
Port of Fremantle, WA	Port of Nagoya	Aichi
Port of Adelaide, SA	Port of Mizushima	Okayama
Port of Melbourne, Vic	Port of Yokohama	Kanagawa

Sister Cities (75)

Australian city, state	Japanese city	Prefecture
Adelaide, SA	Himeji	Hyogo
Ballarat, Vic	Inakawa-cho	Hyogo
Bankstown, NSW	Suita	Osaka
Bathurst, NSW	Ookuma-machi	Fukushima
Belmont, WA	Adachi-ku	Tokyo
Blue Mountains, NSW	Sanda	Hyogo
Brisbane, Qld	Kobe	Hyogo
Broome, WA	Taiji-cho	Wakayama
Bunbury, WA	Setagaya-ku	Tokyo
Cairns, Qld	Hiwasa-cho	Tokushima
Campbelltown, NSW	Koshigaya	Saitama
Canberra, ACT	Nara	Nara
City of Greater Geelong, Vic	Izumiotsu	Osaka
City of Hobsons Bay, Vic	Anjo	Aichi
City of the Gold Coast, Qld	Takasu-cho	Hokkaido
Clare, SA	Yoshinaga-cho	Okayama
Clarence, Tas	Akkeshi-cho	Hokkaido
Coffs Harbour, NSW	Sasebo	Nagasaki
Cooma-Monaro, NSW	Kamoto-machi	Kumamoto
Devonport, Tas.	Minamata	Kumamoto
Duaringa, Qld	Fujisawa-cho	Iwate
Dubbo, NSW	Minokamo	Gifu
Frankston, Vic	Susono	Shizuoka
Fremantle, WA	Yokosuka	Kanagawa
Glenelg Shire, Vic	Uchiura-machi	Ishikawa
Gosford, NSW	Edogawa-ku	Tokyo
Grafton, NSW	Izunagaoka-cho	Shizuoka
Greater Shepparton, Vic	Esashi	Iwate
Hawkesbury, NSW	Tanba-cho	Kyoto
Hervey Bay, Qld	Otsuki	Yamanashi
Hobart, Tas.	Yaizu	Shizuoka
Hurstville, NSW	Shiroishi	Miyagi
Ipswich, Qld	Nerima-ku	Tokyo
Lake Macquarie, NSW	Hakodate	Hokkaido
Lake Macquarie, NSW	Tanagura-machi	Fukushima
Launceston, Tas.	Ikeda	Osaka
Lismore, NSW	Yamatotakada	Nara
Liverpool, NSW	Toda	Saitama
Logan, Qld	Hirakata	Osaka
Logan, Qld	Shibukawa-shi	Gunma
Mackay, Qld	Matsuura	Nagasaki
Manly, NSW	Taito-ku	Tokyo
Marion, SA	Kokubunji	Tokyo

Sister Cities (cont.)

Australian city, state	Japanese city	Prefecture
Maroochy Shire, Qld	Tatebayashi	Gunma
Melbourne, Vic	Osaka	Osaka
Mitchell, Vic	Honbetsu-cho	Hokkaido
Moira, Vic	Katsuyama-mura	Yamanashi
Newcastle, NSW	Ube	Yamaguchi
Orange, NSW	Ushiku	Ibaraki
Penrith, NSW	Fujieda	Shizuoka
Penrith, NSW	Matto	Ishikawa
Perth, WA	Kagoshima	Kagoshima
Pittwater, NSW	Tadaoka-cho	Osaka
Port Lincoln, SA	Muroto	Kochi
Port Macquarie, NSW	Handa	Aichi
Port Phillip, Vic	Obu	Aichi
Queanbeyan, NSW	Hatta-mura	Yamanashi
Redcliffe, Qld	Onoda	Yamaguchi
Rockhampton, Qld	Ibusuki	Kagoshima
Snowy River, NSW	Kusatsu-machi	Gunma
Sutherland, NSW	Chuo-ku	Tokyo
Swan Hill, Vic	Yamagata	Yamagata
Sydney, NSW	Nagoya	Aichi
Temora, NSW	Izumizaki-mura	Fukushima
Toowoomba, Qld	Takatsuki	Osaka
Townsville, Qld	Tokuyama	Yamaguchi
Townsville, Qld	Iwaki	Fukushima
Warringah, NSW	Chichibu	Saitama
Warrnambool, Vic	Miura	Kanagawa
Wellington, NSW	Osawano-machi	Toyama
Wentworth, NSW	Azai-cho	Shiga
Whitehorse, Vic	Matsudo	Chiba
Willoughby, NSW	Suginami-ku	Tokyo
Wollongong, NSW	Kawasaki	Kanagawa
Wyong, NSW	Tanabe	Wakayama

Twinning Arrangements: Business Associations

	Kanto
Chamber of Commerce and Industry, NSW	Tokyo Chamber of Commerce and Industry
	Kansai
ACCI Australian Chamber of Commerce and Industry	Kankeiren Kansai Economic Federation
ACM Australian Chamber of Manufacturers	OCCI Osaka Chamber of Commerce and Industry
CCM Canberra Chamber of Manufacturers	NCCI Nara Chamber of Commerce and Industry
WA Chamber of Commerce & Industry	Kobe Chamber of Commerce & Industry
SA Chamber of Commerce & Industry	Himeji Chamber of Commerce & Industry

REFERENCES

Australia-Japan Tourism Summit, 1997, *Conference proceedings*, Canberra.

Australian Consulate-General, Osaka, 1996, *A Business Guide to the Kansai Region*, Austrade, Osaka.

Australian Trade Commission (Austrade), 1996, 'Special report: Attractions of the Japanese Market', *Asiatrade*, Vol. 4, No. 10.

Council of Local Authorities for International Relations (CLAIR), 1996, *Australia and Japan - Sister City Activities*, CLAIR Report No. 5, Sydney.

East Asia Analytical Unit, 1997, *China Embraces the Market, Achievements, Constraints and Opportunities*, Department of Foreign Affairs and Trade, Canberra.

____ 1995, interview with Shimadzu Corporation in Kyoto, June.

Economic Planning Agency (EPA), 1997, *Kenmin Keizai Keisan Nenpo [Annual Report of Prefectural Accounts]*, Tokyo, May.

____ 1996, *Chiiki Keizai Doko [Economic Trends in Japan's Regions*], Tokyo.

Foreign Press Centre, Japan, 1995, *Facts and Figures of Japan, 1995 edition*, Tokyo.

Instate Pty Ltd, 1996, 'Japan's Regional Markets: Opportunities for Australian Companies'. Consultancy report to East Asia Analytical Unit.

Ishida, Ryuziro, 1969, *Geography of Japan*, Kokusai Bunka Shinkokai, Tokyo.

Japan External Trade Organisation (JETRO), 1996, *Nippon Business Facts and Figures 1995 and 1996*, Tokyo.

Japan Regional Development Corporation (JRDC), 1995, *New Frontiers in Regional Development*, Tokyo.

____ 1994, *Achieving Coordinated Regional Activities*, Tokyo.

Statistics Bureau, Management and Coordination Agency, 1995, *Japan Statistical Yearbook 1996*, Tokyo.

Ministry of International Trade and Industry (MITI), 1996, *Statistics on Japanese Industries 1996*, Tokyo.

____ 1995 and previous years, *Shogyo Dotai Tokei [Statistics on Trends in Commerce]*, Tokyo.

Ministry of Justice, 1997, communication with Austrade Osaka.

Ministry of Transport, 1997, communications with Austrade Japan Offices.

____ 1995, *Unyu Keizai Nenji Hokoku [The Annual Report on Transport Economy]*, Tokyo.

Nikkei Weekly, various issues.

No, Toshio, and Gordon, D.H. (eds), 1974, *Modern Japan: Land and Man (Teikoku's Geography of Japan)*, Teikoku-Shoin, Tokyo.

Overseas Trading, 1996, March.

State Statistical Bureau (PRC), *China Statistical Yearbook 1996*, China Statistical Publishing House, Beijing.

Chapter 11

AGRIFOOD: OPPORTUNITIES DESPITE PROTECTION

Despite its highly protected agricultural and food markets, Japan is the world's largest net importer of agrifood[1] products and Australia's most valuable agrifood customer. While Prime Minister Ryutaro Hashimoto has said that agriculture will be reformed, changes in policies and market opening are more likely to be incremental than radical. Thus, while agrifood imports should continue to grow strongly, food self-sufficiency sensitivities and influential agricultural lobbies are likely to hinder the reforms needed to ameliorate inefficiency and stagnation in Japan's agrifood sector.

This chapter examines Japan's agrifood markets, the policy environment, the rationale behind the policies, the costs they incur and likely future directions. It also analyses the overall outlook for agrifood imports and prospects for Australia-Japan agrifood trade.

THE AGRICULTURE SECTOR

Agriculture's already small share of the domestic economy is shrinking rapidly (Table 11.1). In 1995, approximately 2.8 million farm households were cultivating five million hectares,[2] fewer than 20 per cent on a full-time basis. Despite repeated attempts to increase the scale of farming, little has changed in the past 30 years because:

- politically influential farm interest groups oppose change
- the fragmented nature of farming in Japan empowers cooperatives and gives them a vested interest in resisting change
- the taxation system favours farmers over most other workers
- land taxes favour farm land in urban areas over residential land
- the pension system provides farmers with a government supported pension in addition to the national pension
- the land tenure system hinders change in land ownership and use
- high land prices make consolidating small holdings prohibitively expensive[3]
- rice support and protection policies guarantee relatively high incomes, making it unattractive to farm other commodities.

....

1 The term 'agrifood' refers to processed and unprocessed food products, ranging from live animals and unmilled wheat to cheese and chocolate confectionery.

2 The average farm size is 1.8 hectares, slightly higher than the early 1990s.

3 For example, rice pricing policies and special agricultural land taxes make rice growing land in Japan about 20 times more expensive than in California, despite California's higher yields (Johnson, 1995, p. 52).

Due to the many part-time farmers and heavy reliance on off-farm income, agriculture generates only a small proportion of farm household income. In 1994, only 14 per cent of average farm household income came from agricultural activities, 63 per cent from nonagricultural activities, and the remaining 23 per cent from other sources such as annuities and gifts (Ministry of Agriculture, Forestry and Fisheries [MAFF], 1996d, pp. 250-51). Incomes of farmers who rely solely on agriculture have fallen relative to those of the average salaried worker. In contrast, in the early 1990s part-time farmers' incomes were about 16 per cent higher than the average salaried worker's income; in the mid 1980s they were 30 per cent higher (General Agreement on Tariffs and Trade [GATT], 1995, p. 107; Australian Bureau of Agricultural and Resource Economics [ABARE], 1988, p. 83).

Labour productivity in agriculture is low (Table 11.1) compared to other sectors and other countries, and has improved little since 1975 (Japan Productivity Centre for Socioeconomic Development, 1995). Australian and US agricultural workers are respectively two and three times more productive than their Japanese counterparts. While Japan's small average farm size and large number of part-time farmers partly explains this, the fundamental reason is that government intervention policies have effectively insulated the sector from competition, technological innovation and restructuring.

Japan's rural population continues to migrate to urban areas, and the average age of those remaining is increasing rapidly: 50 per cent of farmers are now aged over 65 years. New entrants to agriculture are generally aged 45 to 60 and have retired from nonfarm jobs to take over family farms and reap the associated tax benefits. Only a few hundred young people enter agriculture each year (Johnson, 1995, p. 51). Government policies to entice young people to rural farming consist of subsidies and government investment in rural amenities, such as free housing, rent-free cultivated land and grants to individuals and families.[4] However, farming does not attract young Japanese people, especially those who seek a dynamic career in a forward-looking industry. Life on the family farm is closed and farmers' children commonly reject agriculture both as an occupation and as a way of life. Furthermore, farm ownership is almost impossible for people who are not part of an existing farm household (*Nikkei Weekly*, 9 October 1995, p. 6).

---

4 For example, in fiscal 1995, the government allocated ¥427 billion to improve rural infrastructure and encourage industries to establish in rural areas (includes expenditure under the package related to implementation of the Uruguay Round Agreement on Agriculture). The 'Beautiful and Comfortable Village Promotion' project, which provides assistance for the preservation of the landscape, ecosystem and traditional culture, was continued with a budget of ¥10.4 billion - similar to 1994 expenditure (OECD, 1996, p. 54).

Table 11.1

Agriculture and Food Processing - Declining Industries in Japan

Agriculture and Food in Japan - Vital Statistics

Per Cent

Indicator	Previous period	Most recent period
AGRICULTURE		
	1970	**1994**
GDP of agriculture (US$ billion)	26.5[a]	74.2
Share of total GDP	5.9	1.6
Share of employment	17.4	5.1[b]
Labour productivity (average annual increase - base 1975)	0.3[c]	1.8[d]
Area of cultivated land (million hectares)	5.8	4.9[e]
Farm households (millions)	5.3	2.8
of which:		
Full-time farming	0.8	0.4
Part-time farming	4.5	2.3
FOOD PROCESSING		
	1970	**1994**
Value of total food consumption (US$ billion)	40.8	652.0[f]
Share of GDP	3.7	2.7
Share of employment	2.5	2.7
Productivity growth (real GDP per worker)	3.3[g]	-1.5[h]
Proportion of production located offshore	1.2[i]	3.2
TRADE		
	1988	**1995**
Share of food and live animals exports (in total exports)	0.6	0.4
Share of beverages and tobacco exports (in total imports)	0.04	0.1
Share of food and live animals imports (in total exports)	14.4	13.7
Share of beverages and tobacco imports (in total imports)	1.2	1.5

Notes: Food excludes tobacco; based on current prices; NDP: Net Domestic Product; a. 1980; b. 1995; c. 1975-1979; d. 1990-1992; e. 1995; f. 1993; g. 1970-1980; h. 1980-1994; i. 1990.

Source: Organisation for Economic Cooperation and Development, 1996; Management and Coordination Agency, 1996; Japan Productivity Centre for Socioeconomic Development, 1995; Ministry of Agriculture, Forestry and Fisheries, 1996b.

Agricultural Production Outlook

Government projections to 2005 indicate that rice, potato, fruit and sugarbeet production will fall, while that of cut flowers, forage crops, soybeans, beef and others will increase (Table 11.2).

Table 11.2

Cut Flower Production Grows; Rice Production Declines

Past and Future Agricultural Production[a]

	Fiscal 1992 Cultivated area (million hectares)	Fiscal 1992 Production volume (million tonnes)	Projection for fiscal 2005[b] Cultivated area (million hectares)	Projection for fiscal 2005[b] Production volume (million tonnes)	Per cent change in production (1992 to 2005)
Rice	2.1	10.6	1.9	9.6	-8.8
Wheat and barley	0.3	1.1	0.3	1.2	17.6
Potatoes	0.1	3.5	0.1	3.4	-2.0
Soybeans	0.1	0.2	0.1	0.3	36.8
Vegetables	0.6	15.6	0.6	15.7	0.3
Fruit	na	4.9	na	4.6	-5.3
Sugarbeet[c]	0.07	3.6	0.07	3.5	-3.1
Sugarcane[c]	0.04	1.8	0.04	2.1	15.2
Tea	0.06	0.09	0.06	0.09	2.2
Flowers, plants[d]	0.05	5.6	0.06	8.6	53.6
Raw milk	na	8.6	na	10.1	17.2
Beef	na	0.6	na	0.8	25.0
Pork	na	1.4	na	1.5	1.4
Chicken	na	1.4	na	1.4	2.9
Chicken eggs	na	2.6	na	2.7	5.4
Forage crops	1.0	4.3	1.2	6.0	38.6

Note: na: Figures not available. a. Figures are rounded to nearest decimal place. b. Where the original source gave a range of values, the average is given in this table. c. Production volume is on refined basis. d. Production volume measured in billion units.

Source: Ministry of Agriculture, Forestry and Fisheries, 1996c, pp. 9, 11.

THE FOOD MARKET

While expenditure on food increased 13 per cent between 1983 and 1994, the proportion of disposable income spent on food fell from 21 to 17 per cent over the same period (Tables 2.6 and 2.8).[5] Japanese dietary patterns continue to change, creating more demand for nontraditional products. Rice consumption has fallen steadily, although the rate of decline slowed after peaking in 1987. In contrast, between 1985 and 1995, beef consumption rose 70 per cent, and milk and dairy product consumption rose 25 per cent (GATT, 1995, p. 107). Strong demand for these products, as well as for potatoes and cut flowers, should continue (Table 11.3).

....

5 Chapters 2 - *Socioeconomic Evolution* and 9 - *Distribution* provide more detail on aspects of this section.

Table 11.3

Demand Growing for Nontraditional Products

Past and Future Demand for Agricultural Products

	Fiscal 1992		Projection[a] for fiscal 2005		Per cent change in consumption (1992 to 2005)
	Total demand (million tonnes)	Net per capita consumption (kg)	Total demand (million tonnes)	Net per capita consumption (kg)	
Rice	10.5	69.7	10.0	63.0	-9.6
Wheat and barley	9.0	31.9	9.3	32.3	1.3
Potatoes	4.0	15.4	4.1	18.0	16.9
Soybeans	4.8	6.7	4.8	6.4	-4.5
Vegetables	17.3	106.7	17.9	106.0	-0.7
Fruit	8.2	38.8	9.2	42.0	8.2
Milk and dairy products	10.7	83.6	13.1	99.0	18.4
Beef	1.2	6.7	2.0	10.3	53.7
Pork	2.1	11.5	2.1	11.5	0.0
Chicken	1.8	10.6	2.0	11.5	8.5
Chicken eggs	2.7	17.7	2.8	18.0	1.7
Sugar	2.6	20.2	2.3	17.0	-15.8
Tea	0.1	0.8	0.1	0.8	0.0
Flowers and other plants[b]	0.6	48.0	1.0	76.0	58.3

Note: Figures are rounded to nearest decimal place. a. Where the original source gave a range of values, the average is given in this table. b. Total demand is in 100 million units; per capita consumption is units.

Source: Ministry of Agriculture, Forestry and Fisheries, 1996c, p. 7.

The major consumption changes are not in terms of quantity, but in the type of food demanded. According to the Nikko Research Centre (1996, p. 309), the Japanese food market was worth US$600 billion (¥61.3 trillion) in 1994,[6] consisting of:

- US$276 billion (¥28.2 trillion) for home prepared food[7]
- US$277 billion (¥28.3 trillion) for eating out[8]
- US$47 billion (¥4.8 trillion) for takeaway food.[9]

Lifestyle changes due to increasing number of working women and people living alone have expanded demand for processed food, eating-out facilities and low-priced,

....

6 Note that this is US$50 billion less than the official MAFF estimate quoted in Table 11.1. Nevertheless, the detailed insight provided by this source is considered useful.

7 This comprises the fresh and processed food retail industry (ordinary retail outlets, department stores, supermarkets and convenience stores).

8 This comprises all types of restaurants, noodle and sushi shops, accommodation facilities, coffee shops and bars. It also includes the meal provision industry for schools, companies, social welfare facilities and hospitals.

9 This comprises takeaway food suppliers for convenience stores, department stores, supermarkets, delicatessens and individual customers; takeaway shops supplying boxed lunches and sushi; and home delivery businesses such as pizza and catering services.

convenience foods. For example, over the five years to 1996, Japanese frozen food production grew 7 per cent per year, making it one of the fastest growing processed food industries (Nikko Research Centre, 1996, p. 218). Companies are responding to these changes by developing new products, lengthening business hours and establishing new business networks.

The takeaway food segment of the market has experienced the strongest growth (Table 11.4). However, many new entrants and consumer price sensitivity have made it an intensely competitive market. Many companies are reducing costs through more efficient automation, distribution and management, as well as increasing imports and offshore processing. Companies also are developing strategies to differentiate themselves, for example, by marketing additive-free frozen lunches. Another high-growth area which larger companies are beginning to focus on is takeaway foods for the elderly (Nikko Research Centre, 1996, p. 308).

Table 11.4

Takeaway Food Industry Growing Rapidly

Growth in Eating Out and Takeaway Food
¥ Trillion

	1989	1994	Average annual growth (1989-1994) (per cent)
Eating houses	17.5	21.2	3.9
- Commercial restaurants	14.0	17.1	4.1
- Noncommercial cafeteria[a]	3.5	4.1	3.1
Cafes and bars	6.2	7.1	2.7
Total eating out	23.7	28.3	3.6
Takeaway food	2.5	4.8	13.9
Overall total	25.5	33.1	5.4

Note: Figures rounded; a. Cafeterias for schools, companies and hospitals.

Source: Nikko Research Centre, 1996, p. 242, p. 309; East Asia Analytical Unit calculations, 1997.

Food Processing Industry

In 1994, food processing accounted for 2.7 per cent of GDP and employment (Table 11.1). The sector is dominated by a relatively small number of large companies (Table 11.5). Increasingly, retail competition is eroding the ability of food processors to control prices. Retailers now routinely cut prices, demand small-volume shipments of a growing range of products and offer point-of-sale promotions. Retailers also directly import cheaper products. (See Chapter 9 - *Distribution*.)

Protectionist policies, especially in the agriculture sector, constrain processors' ability to reduce costs and make both imported and domestically produced inputs relatively expensive. Processors in Japan face strongly declining profitability.

Consequently, many have moved production facilities offshore, especially to Asia. (See Chapter 6 - *Internationalisation*.) For example:

- Nippon Meat Packers anticipated the 1991 liberalisation of the beef market and relocated some production facilities offshore.
- Nisshin Oil Mills, Ajinomoto and Hohnen Corporation are preparing for market liberalisation by streamlining operations to cut domestic production costs and setting up production facilities offshore.
- Some noodle manufacturers have processing plants in the USA and Asia (Nikko Research Centre, 1996, pp. 204-17).

Table 11.5

Food Processing Industry Dominated by a Select Few

Top Four Companies' Market Share (1994)

Industry	Company name and percentage share of market (based on sales)								Combined market share
	First		Second		Third		Fourth		
Flour milling[a]	Nisshin Flour	34.7	Nippon Flour Mills	21.0	Showa Sangyo	7.8	Nitto Flour Milling	4.5	68.0
Bakery	Yamazaki Baking	37.8	Shikishima Baking	9.7	Fuji Baking	5.1	Takaki Bakery	4.9	57.5
Processed meats	Nippon Meat Packers	20.5	Itoham Foods	19.6	Marudai Food	14.4	Prima Meat Packers	13.0	67.5
Edible oil	Nisshin Oil Mills	20.7	Honen	13.1	Ajinomoto	12.4	Syowa Sangyo	9.5	55.7
Instant noodles	Nisshin Food Products	37.2	Sanyo Foods	18.5	Toyo Suisan	14.7	Myojo Foods	8.6	79.0
Sugar refining[b]	Mitsui Sugar	12.3	C. Itoh Sugar	10.6	Taito	9.0	Nisshin Sugar	8.9	40.8
Dairy products[c]	Snow Brand Milk Products	20.0	Meiji Milk Products	11.5	Yotsuba Milk Products	9.9	Morinaga Milk Products	7.3	48.7
Beer[d]	Kirin Brewery	48.4	Asahi Brewery	26.4	Sapporo Breweries	18.4	Suntory	5.9	99.1
Frozen foods	Nichirei	15.4	Katokichi	9.5	Ajinomoto	8.6	Nippon Suisan	8.3	41.8

Note: a. Based on sales volume; b. Based on production; c. Based on milk collected; d. Based on shipment volume.

Source: Nikko Research Centre, 1996, p. 206.

THE POLICY ENVIRONMENT

The stated aims of Japan's agricultural policies are to ensure food security, maintain price stability, promote a shift away from rice to new crops, stabilise farm incomes and maintain farm income parity. However, these objectives generally are not being achieved effectively and adjustment is urgently needed.

Until recently, agricultural policy reform has resulted largely from international pressures from the Uruguay Round, APEC and bilateral consultations. However, increasingly domestic factors are also stimulating change. These include:

- lower tolerance of high food prices
- changing lifestyles, which diversify demand for food products
- difficulty in attracting a new generation of farmers to replace retirees
- economic stagnation in the early 1990s, which has sharpened competition and generated questions about the costs of the present agriculture structure.

The Hashimoto Government's strong deregulation platform reflects these developments. (See Chapters 3 - *Politics* and 8 - *Market Access*.) In March 1997, Prime Minister Hashimoto declared that agriculture would not be spared from Japan's reform drive. The 1996 MAFF *Annual Report* was intended to assist the review of the Agricultural Basic Law, which has been in force since 1961 (MAFF, 1997b). While the original law was essentially designed to stimulate agricultural production, the new law is expected to consider both supply and demand issues, including consumer interests. In the past, review of such major laws took many years, but a new agriculture law is expected before 2000.

Nevertheless, continuing sensitivity to agricultural policy reform means that change is likely to be slow and difficult. While the Government regularly announces new policy directives for the agriculture sector, allegedly to improve efficiency and flexibility, these directives tend to redefine the nature of government involvement rather than remove it and allow market forces to operate.[10]

Food Security and Food Self-Sufficiency

The Japanese Government uses food security concerns to justify protection of the agriculture sector. For example, in the early 1980s, MAFF forecast that world market prices for wheat, coarse grains and rice would rise to many times their 1978 levels. In fact, real international cereal prices are now about half 1978 levels and are unlikely to recover in the near future (Johnson, 1995, p. 54). It is also unlikely that international market prices would rise to Japan's current domestic levels. Any international price instability, therefore, is unlikely to be more detrimental to Japanese consumers than current domestic policy.[11]

On a calorie basis, Japan's food self-sufficiency ratio declined from 53 per cent in 1980 to 42 per cent in 1995 (Table 11.6), and MAFF expects this could fall further.

....

[10] Three of the most important directives are: 1. *The Law for Stabilisation of Supply-Demand and Price of Staple Food* (MAFF 1995); 2. *The Direction of Policy Development in Japanese Agriculture in a New International Environment* (MAFF 1994); 3. *The Basic Direction of New Policies for Food, Agriculture and Rural Areas* (MAFF 1992).

[11] Only abnormal circumstances such as war or a major trade embargo could threaten Japan's food security. Even then, fuel supplies would create more immediate concern, due to their importance in agricultural production and the wider functioning of the economy.

Maintaining even these relatively low levels of food self-sufficiency is only possible by:

- keeping internal prices well above world market levels by restricting imports
- allowing relatively unrestricted imports of feed grains for livestock production
- intensively using fertilisers and chemicals manufactured from imported petroleum for crop production.

Another food security policy priority is to ensure that Japan has the capacity to feed its population from domestic production should the need arise. This would involve a more traditional diet with a larger proportion of high-calorie plant-based foods (MAFF, 1996a). This could be achieved with a minimum of 4.6 million hectares, the area of farmland projected for 2005.

DOES FOOD SELF-SUFFICIENCY EQUAL FOOD SECURITY?

In many countries, including Japan, food security is equated with maintaining artificially high levels of food self-sufficiency. However, food security and food self-sufficiency are different concepts, and in many instances are incompatible. Food security involves obtaining reliable and stable food supplies from affordable domestic and foreign sources. This is best achieved within the context of open markets and an efficient allocation of resources. Self-sufficiency implies meeting food requirements domestically, regardless of cost. When countries achieve food self-sufficiency by maintaining high levels of protection, they insulate their markets and are thus more vulnerable to supply shocks.

For Japan, a policy of food self-sufficiency means a loss of food security during bad years, such as the drought and rice crop failure in 1993. At that time, the ban on rice imports meant that potential suppliers did not have the production capacity to immediately supply rice to Japan's market. World food security is reduced because Japan and other countries discourage efficient overseas farmers from growing food for them by taxing or banning imports. Free trade reduces risk, yielding food that is cheaper and subject to fewer price fluctuations.

Inflation of Japan's food self-sufficiency ratio by its food and agricultural policies is very costly, making it a relatively inefficient approach to food security. The irony is that Japan could source most of its food requirements from the world market at prices substantially below those of its highly protected domestic market. Furthermore, Japanese purchasing power is strong enough to guarantee access to the highest quality products. The use of food security arguments to maintain Japan's agricultural sector, therefore, appears to be motivated mainly by cultural values, vested interests and reluctance to incur the short-term social and political costs of adjustment.

Source: Australian Bureau of Agricultural and Resource Economics and Department of Foreign Affairs and Trade, 1996.

Table 11.6

Overall Level of Food Self-Sufficiency in Japan Is Relatively Low

Food Self-Sufficiency Ratios

Japanese Financial Year - Per Cent

	Self-sufficiency ratio 1985	Self-sufficiency ratio 1995[a]
By key products:		
Rice	107	103
Wheat	14	7
Pulses	8	5
— soy beans	5	2
Vegetables	95	85
Fruit	77	49
Milk and dairy products	85	72
Hen eggs	98	96
Meat	81	57
— beef	72	39
Fish and shellfish	96	74
Sugar	27	29
Self-sufficiency ratio (original calorie basis)[b]	52	42
Self-sufficiency ratio of cereals (staple food)	69	64
Self-sufficiency ratio of grains (for food and feed)	31	30

Note: a. Estimate; b. This ratio nets out the imported component of the final calories.

Source: Ministry of Agriculture, Forestry and Fisheries 1997a.

GOVERNMENT INTERVENTION

Despite its small contribution to the economy, agriculture receives among the highest levels of government assistance and protection in countries of the Organisation for Economic Cooperation and Development (OECD). On average, nearly 80 per cent of a Japanese farmer's income is derived from some type of government assistance. The comparable figure for Australia is 9 per cent, while the average for the OECD is 40 per cent. Japanese farmers also receive, on average, 3.4 times the world price for their produce, compared to an OECD average of 1.6 times the world price. The other feature of Japanese agricultural policies is that while protection generally is decreasing in OECD countries, in Japan it has been increasing. (See Appendix 11.1.)

Although it can seem incongruous for a country which relies heavily on imported food to protect its market so strongly, the Japanese Government does so because:

- high levels of assistance support the incomes of small domestic producers
- border protection insulates producers and processors from import competition

- part of the revenue for agricultural policy measures comes from importing commodities at world market prices and selling them domestically at inflated prices, with the difference absorbed into government revenue.

In the case of wheat, for example, Japan imports about 90 per cent of its requirements; the rest is produced domestically with high levels of government assistance. However, the Food Agency controls wheat marketing and pays domestic producers much more than the public pays to buy it. The subsidy to both consumers and producers is financed largely by selling imported wheat well above its purchase price.

Agricultural policies increase the input prices for food and feed processing industries, thereby reducing their competitiveness. Thus, further assistance measures are invariably needed for higher stages of processing to prevent imports from undercutting domestic manufacturers, thereby reducing demand for domestically produced agricultural raw materials. Indeed, the bulk of agricultural protection in Japan benefits semiprocessed and processed agricultural products. Nevertheless, this protection only partially offsets the costs imposed by high input prices (GATT, 1995, p. 122).

As well as high levels of protection and assistance, tariff and nontariff barrier protection levels increase significantly between the first and second stage of processing.[12] (See Chapter 8 - *Market Access*, Figures 8.4 and 8.7, Table 8.3.) The frequency of core nontariff barriers in the processed food sector is also noticeably higher than for raw agricultural products. This structure of protection creates a bias towards domestic processors to the detriment of exporters of processed food.

The most obvious manifestation of these policies is in high prices for processed feed, food and food services, such as restaurants. In 1995, for example, consumers paid about double the world price for agricultural products in Japan. (See Chapter 9 - *Distribution*.) Australian consumers, by contrast, paid an average 10 per cent above world prices, and in many cases, the world price.

The longer-term cost of all this protection is a relatively uncompetitive industry. Japanese agriculture and food processing sectors have low levels of productivity (Table 11.1), both by domestic and international standards. As already noted, the agriculture sector is in a state of decay and many food processing companies find they can only survive by relocating offshore. Japanese companies also are increasing their investment in offshore agricultural production facilities, for instance in Australia.

The effects of these policies go well beyond food bills and government revenue. About one quarter of rice farms are in urban areas, contributing to high land costs, crowded housing and limited space for further housing development. Well known author and business strategist, Kenichi Ohmae (1995, p. 48) points out that within a 50-kilometre radius of Tokyo, 65 per cent of the land - nearly 330 000 hectares of some of the most expensive land in the world - is devoted to extremely inefficient agriculture. He argues that if only a quarter of this land were sold for private housing, Tokyo-area families would be able to afford 120 to 150 square metres of living space, instead of today's average of 88 square metres. Moreover, cheaper - and more

....

12 This is known as tariff and nontariff barrier 'escalation'.

available - land would cut the cost of essential public works like providing better sewerage, removing traffic bottlenecks and double tracking commuter trains.

In the end, Japan may pay the ultimate price for insulating the agriculture sector: its destruction. Johnson (1995) asserts that 'agriculture is being destroyed in Korea and Japan by the policies that are supposed to protect and nourish it'. The ageing of the farm workforce, the unattractiveness of farming to young people and distortions introduced by agricultural policies all prevent agriculture from becoming a stronger and more efficient, though small, sector of the economy. Additionally, government intervention creates strong vested interests among farmers and other beneficiaries such as distributors, bureaucrats and politicians, who resist necessary tax, trade, financial and agricultural policy reforms.

AUSTRALIAN BRANDED RICE ON JAPANESE SUPERMARKET SHELVES?

The Australian Rice Grower's Cooperative (ARGC) made its first commercial contact with Japan's rice market by displaying Australian rice at the 1989 Foodex trade fair in Tokyo. This was the first foreign rice ever displayed in Japan, creating much interest, amusement and even suspicion. The ARGC believed that Japan would start importing rice sooner rather than later. Following years of engineering contacts between the ARGC and Japan's rice industry, the 1989 Foodex marked the beginning of a focused strategy to export Australian rice to Japan.

Nonemergency Rice Imports

There are two systems for importing rice into Japan: minimum access tenders which go to the Food Agency and represent most tonnage; and simultaneous buy and sell tenders (SBS), which go directly onto the market. To obtain the licences necessary to participate in either system, importers must satisfy the Food Agency that they: (1) are creditworthy; (2) have experienced professionals; and (3) have previous experience dealing with rice in Japan. This requires copious detailed paperwork. The most difficult and crucial aspect is to prove Japanese rice market experience.

The ARGC realised it needed a Japanese partner. It chose Mitsuhashi, one of the top six milling companies in Japan, due to its strong commitment to quality. The ARGC's 50/50 joint venture with Mitsuhashi, called Sunrice Inc, began in 1994. The ARGC deals directly with Sunrice (which has both types of import licence but concentrates on SBS tenders) and other Australian rice importers in Japan. Sunrice allows the ARGC to operate inside the Japanese market as both importer and distributor, to be closer to the consumer and ultimately ensure the future of Sunrice in Japan.[13] The ARGC is the only foreign rice supplier to have such a joint venture.

....

13 The Australian Wheat Board has since announced a similar initiative. As reported in the *Financial Review* (16 April 1997, p. 7), it formed a grain trading and marketing joint venture with Zennoh, a giant Japanese cooperative with grain handling facilities in Japan and the largest importer of feedgrains and compound feed manufacturer in Japan.

Japan's rice crop failure and need for imported rice helped the ARGC in its quest to export rice to Japan under normal circumstances because:

- the emergency imports occurred one year before Uruguay Round rice imports began, so the Japanese rice market experience was applicable to nonemergency imports, facilitating the ARGCs licence applications for the new commercial imports
- as a supplier of emergency rice imports, Australia was regarded favourably when the nonemergency imports began in 1995
- Australian rice received positive publicity, placing the ARGC in an excellent position for a marketing campaign to coincide with the first Uruguay Round imports
- the Japanese Government had to change the perception that imported rice was unsuitable for Japanese consumption.

The Strategy

The ARGC has displayed rice at the annual Foodex trade fairs since 1989, demonstrating commitment to the Japanese market, even when imports were impossible. The ARGC's Japan market access strategy has a number of important elements:

- The ARGC strengthened its liaison with the Australian Government, leading to an effective and coordinated position on rice policy. Industry and government worked closely during the Uruguay Round negotiations on Japanese rice market access. As leader of the Cairns Group, Australia also liaised with the USA on rice access issues.
- The ARGC worked closely with the Japanese Government, maintaining good relations and open communication channels despite some difficult and protracted negotiations. The ARGC compromised and fitted in with the Japanese 'but remained Australian'. In 1996, the appointment of a full-time Tokyo representative further consolidated commitment to Japan.
- At considerable expense (about A$2 million over a three-year period), the ARGC employed a Japanese public relations firm to raise its public profile.
- The Japanese rice market has strong regional characteristics and brand preferences. The ARGC therefore developed a distinctive logo strongly associated with Japan (as rice in Japan is considered a 'Japanese' product). This logo is free to importers of Australian rice who meet quality guidelines and sell it as 100 per cent Australian rice in Japan. The idea is to develop a high-quality brand image.
- Japanese consumers are fastidious and prepared to pay for quality. The ARGC has an ongoing research and development program directed at opportunities in Japan. For example, in 1996 it successfully bred Japan's top premium rice variety, *koshihikari*, in Australia.

Although ultimately rewarding, the Japanese rice market requires patience and innovation. One consequence has been a greater focus on quality and improvement at every level of the Australian rice industry, standing it in good stead for any market in the world.

Source: Australian Rice Grower's Cooperative, 1996.

RICE POLICY

Rice is central to Japanese agricultural policy and its treatment is symbolic of the closed and protected nature of the agriculture sector. It is Japan's major staple food and has strong cultural and historical links. Consequently, any policy change affecting rice production, distribution or consumption is extremely sensitive, with repercussions for the rest of the agriculture sector.

Rice farming accounts for about 40 per cent of Japan's cultivated land use and 30 per cent of its agricultural output (GATT, 1995, p. 109). Traditionally, the Japanese Government has controlled production volumes, imports, distribution networks, retail outlets and prices. Until 1993, when it imported rice following an exceptionally poor harvest, Japan's policy of self-sufficiency meant a virtual ban on rice imports. Rice farmers' incomes are derived almost entirely from government intervention measures. The main policies keeping producer prices artificially high are:

- use of administered prices,[14] which effectively guarantee a minimum producer price for all domestic rice production
- indirect government control of all 'voluntarily' marketed rice
- use of economic incentives to reduce rice production
- government control and limits on imported rice.

As well as continuing to reduce the amount of land used for rice farming in Japan,[15] the most important recent developments affecting rice production are the 1995 Staple Food Law and the Uruguay Round Agreement on Agriculture. (See box.)

The Staple Food Law

The Staple Food Law[16] (MAFF, 1995) was introduced to prepare the market for rice imports under Japan's Uruguay Round commitments. It deregulated aspects of the rice market in an attempt to stimulate competition, increase efficiency and entrepreneurial attitudes, and reduce costs throughout the system. The Staple Food Law affects the rice market in the following ways:

- Penalties for overproduction are replaced by financial incentives whereby farmers who reduce rice production receive extra subsidies, while those who increase production receive fewer subsidies.
- Administered prices are applied to 15 per cent of rice consumption (about half the previous quantity) and are paid only to farmers who reduce rice production through land diversion programs.

....

14 That is, the government determines prices.

15 The most recent program, the New Production Adjustment Promotion Program (NPAPP), covers 1996 to 1998. In 1996/97, the land under this program was increased by just over 100 000 hectares, to 787 000 hectares. Generally, about two thirds of diverted land is allocated to feed crops and grain production, while the remaining third is allocated to vegetables (Boonekamp, 1995, pp. 21-22; OECD, 1996, p. 54). However, this is not necessarily the most economical use of this land.

16 The full name of this law is The Law for Stabilisation of Supply-Demand and Price of Staple Food. It was introduced in November 1995.

- The new Voluntarily Marketed Rice Price Formation Centre determines the price of 20 per cent of 'freely' marketed rice.[17] This price forms an index which is the basis of pricing for the remaining 80 per cent. Prices of this remaining 80 per cent cannot fluctuate more than 10 per cent either side of the previous year's average price.
- Rice sellers no longer have to be licensed, although the government requires notification of intention to sell. This means rice farmers can sell directly to retailers and consumers.

In effect, the Staple Food Law frees the rice market only to a limited extent; the major limitations are price rigidities and continuing governmental import controls. Together with the relatively high level of administered prices in 1996 (OECD, 1996, p. 53), these restrictions push up prices for domestically produced rice. Consequently, prices are likely to remain well above world market levels, further contributing to growing rice stockpiles, recently around 3 million tonnes (double normal levels). Furthermore, using imported rice as food aid to partially alleviate the stockpile problem attracts international criticism. Although imported rice only makes up about 10 per cent of the stockpile, Japan tends to blame imports for the stockpile problem. In reality, the stockpile reflects the insulation of the rice industry from market forces.

Upward price pressure may be countered to a limited extent by the removal of restrictions on rice distribution.[18] Within the first six months of the Staple Food Law, the number of rice retailers doubled to 180 000. New rice retailers are dominated by supermarkets and convenience stores, but also include liquor shops, petrol stations and chemists. Inevitably, many small traditional rice shops will not survive such competition. Consumers, however, will have more choice in quality, packaging and perhaps even price.

INTERNATIONAL PRESSURE

The Uruguay Round and the World Trade Organisation (WTO)

The Uruguay Round Agreement on Agriculture came into effect on 1 January 1995. As an industrialised country which does not use export subsidies, Japan must:

- over the six years to 2000 convert tariff and nontariff barriers into tariff equivalents[19] and reduce all tariffs by a simple average of 36 per cent (with each tariff line to be cut by at least 15 per cent)
- where nontariff barriers previously existed, open import access equivalent to a minimum of 5 per cent of domestic consumption of individual products by the end of the implementation period

....

17 'Freely' marketed rice is all rice not subject to government-determined administrative prices.

18 However, while the Government controls the import of rice, this will severely restrict the extent to which rice prices are likely to fall.

19 A process referred to as 'tariffication'.

- over the six years to 2000, reduce domestic agricultural support by 20 per cent from the 1986 to 1988 average level.

The WTO Committee on Agriculture currently is focusing on how Japan's commitments are implemented, especially if they create real commercial opportunities. Japan is subject to scrutiny due to its lack of transparency in implementation, with state importing agencies' administrative arrangements receiving particular attention. It is also focusing on the agricultural liberalisation negotiations scheduled to commence in 1999 which aim to advance the initial Uruguay Round gains. Ironically, the 'success' of the Uruguay Round has made it even more difficult for Japan to contemplate further reform.[20] While Australia and other countries have been keen to progress a preparatory work program for the 1999 negotiations, Japan and several other countries wanted to concentrate on implementation issues first. However, the December 1996 Ministerial Conference in Singapore agreed to commence forward work on agriculture, largely due to prompting by the Cairns Group which Australia chairs.

Another important aspect of the Uruguay Round Agreement on Agriculture is the WTO Sanitary and Phytosanitary Agreement (WTO/SPS), to which Japan is a signatory. The WTO/SPS Agreement aims to prevent quarantine and food safety measures being used as unjustified technical barriers to trade. It allows countries to impose only measures which are based on sound scientific risk assessment. If effectively implemented, this could resolve many barriers to trade with Japan.

Japanese quarantine officials are working cooperatively with interested parties to meet WTO/SPS objectives. Plant quarantine legislation amendments came into effect on 1 April 1997. MAFF and the Australian Quarantine and Inspection Service (AQIS) have been working to streamline requirements for Australian exports, developing a good relationship which has helped progress some outstanding issues. For example, on 25 October 1996, MAFF officially accepted that Tasmania was free of tobacco blue mould, thereby allowing the export of tomatoes and capsicums to Japan. MAFF has also shown interest in Australia's approach to satisfying international standards.

Provisions exist in the Uruguay Round Agriculture Agreement (Article 5) for special safeguard measures for tariffied products. These allow additional duties on import surges or where import prices fall below a certain trigger level. In 1996, Japan instituted special safeguard actions on some dairy products. It also notified the WTO of a range of administrative measures on pork and beef which allowed it to take safeguard action as a market control mechanism. For example, safeguard measures applied an additional substantial tariff on pork imports in early 1996. When the tariff was removed in April 1996, imports flooded in again, leading to its reapplication in July. This and other similar cases indicate the potential demand for these products.

[20] Strong domestic opposition arose to Japan's Uruguay Round commitments, with many Japanese viewing it as government betrayal. The prospect of future negotiations remains an extremely sensitive issue.

LIMITED ACCESS FOR RICE

Japan negotiated an exception for rice under the Uruguay Round Agreement, which allows:

- retention of the government import monopoly for rice
- instead of tariffication, a minimum import access commitment for 1995 of 4 per cent of domestic consumption in the base period of 1986 to 1988 (379 000 tonnes), increasing to 8 per cent by 2000 (758 000 tonnes), on a milled rice basis
- a maximum allowable mark-up of ¥292 per kilogram (or about three times the average retail price of a kilogram of rice in Australia) on rice imported under the minimum access commitment over the period of the Agreement.

To assist rice farmers manage these changes, the Government announced a package of measures worth ¥6 trillion (US$48 billion) over six years (under policy directive: *The Direction of Policy Development in Japanese Agriculture in a New International Environment* - MAFF 1994) beginning in 1995. However, a sizeable portion of this money reportedly remains unspent due to the farming sector's inability to absorb the extra assistance.

Australia has some concerns over the arrangements for Japan's Uruguay Round rice imports:

- Initially, rice tenders were only let late in the Japanese fiscal year, disadvantaging southern hemisphere suppliers such as Australia. In April 1997, SBS tenders were increased from one to four, with the first called for 28 May 1997, to coincide with the southern hemisphere harvest. While this will assist Australian rice exporters to provide Japanese consumers fresh rice in the off-season, the timing of the minimum access tenders (about 95 per cent of imports) remains unchanged and is still of concern to Australia.
- Japan has allocated tenders for some of its Uruguay Round imports to non-WTO members, which Australia believes conflicts with the spirit of the Uruguay Round Agreement.
- Rice imported under minimum access tenders is largely stockpiled rather than distributed directly to the domestic market. Some of this stockpiled rice has then been used for Japan's food aid program. Thus, Japanese consumers are denied access to fresh foreign rice, making it difficult for exporters to gain genuine commercial access to the market and build a positive image for foreign rice.
- The ¥292 mark-up, which was applied in full in 1995 and 1996, reduces the price competitiveness of imported rice.

The Australian and Japanese governments are working to address these issues.

Source: Department of Foreign Affairs and Trade, 1997.

While theoretically the conclusion of the Uruguay Round and the signing of the Agreement on Agriculture should start exposing Japanese agriculture to international competition, after two years many supports and controls remain. The framework for opening the Japanese market has been established. However, translating this access into commercial opportunities and access to Japanese consumers requires more progress. The reality is that benefits of increased efficiency and competition probably will not be felt until well into the next decade. In the meantime, foreign products should continue to establish a presence in the Japanese market which in turn will help Japanese consumers become more accustomed to and confident in using them.

Asia-Pacific Economic Cooperation (APEC)

Entrenched Japanese agricultural interest groups, who feel that too many agricultural concessions were made in the Uruguay Round, perceive the APEC goal of free and open trade by 2010 for developed countries (2020 for developing countries) as a significant threat.

Agricultural sensitivities attracted much media attention in the lead-up to the second APEC Leaders' Meeting in Osaka in 1995. Japan, China, Republic of Korea and Taiwan pushed for 'flexible treatment' of farm trade under APEC, effectively excluding agriculture from comprehensive trade liberalisation. In fact, the Osaka Leaders' Meeting and resolution of the issue of 'comprehensiveness' came to be a test of APEC's legitimacy. At the meeting, however, all APEC members accepted the principle of 'comprehensive' trade liberalisation.

At the Philippines Leaders' Meeting in November 1996, each APEC country presented an 'Individual Action Plan' (IAP) setting out the first steps towards achieving APEC's goals. Again, sensitivity over agriculture put Japan's commitment to comprehensive trade liberalisation to the test. In the event, agriculture was covered, with Japan committing to:

- introduce by June 1997, Pest Risk Analysis (PRA) and sanitary and phytosanitary (SPS) measures according to the WTO/SPS Agreement
- improve quarantine and customs inspections and clearance procedures
- align its food labelling standards with international standards.

Japan's undertaking to improve the administrative arrangements for facilitating entry of plant and animal products is a positive development for Australia's horticulture industry. Priority products such as Tasmanian Fuji apples,[21] mandarins, table grapes, melons and a wider range of mangoes are likely to benefit from this. Improving quarantine/customs inspections should reduce costs and increase opportunities for Australian exporters, particularly of cut flowers. Adopting international standards on food labelling will open up new opportunities by reducing compliance costs to exporters.

....

[21] Japan has accepted technical arguments to lift the ban on Tasmanian Fuji apple imports. Public consultation on apple imports occurred in May, 1997, and trial shipments are planned for June or July.

APEC FOOD TASK FORCE

At their meeting in Osaka in November 1995, APEC leaders noted that the Asia-Pacific's fast expanding population and rapid economic growth are forecast to sharply increase pressures on the environment and demand for food and energy. A Food Task Force, cochaired by Australia and Japan, was established subsequently under the APEC Economic Committee to analyse the food aspects of these issues, including relevant environmental considerations. Underlying the debate are the interests of major agricultural producers and exporters in encouraging reform of agricultural policies, including liberalisation of access; and the concerns of major food importing countries regarding self-sufficiency.

Source: Department of Foreign Affairs and Trade, 1996.

The remaining aspects of the agriculture component of Japan's IAP largely reflect commitments already made under the WTO, the 1995 Osaka Downpayment package and 1996 Deregulation Action Plan. Japan has committed to fully implementing its Uruguay Round commitments between 1997 and 2000, and to reducing simple bound tariffs on agricultural products to an average of 9.3 per cent.

THE POLITICAL ECONOMY OF AGRICULTURE

The strong relationship between the rural sector and the Government leads to high levels of government intervention in Japan's agriculture sector. Agricultural cooperatives, or *nokyo*, are an important link in this relationship, wielding considerable influence despite their declining numbers.[22]

Agricultural Cooperatives

Despite their enormous power in the past, cooperatives[23] are increasingly seen by analysts, and even by farmers, as an obstacle to developing a more entrepreneurial style of farming. Cooperatives have fallen behind changes in domestic and international markets and become vulnerable to the declining economic significance of agriculture and the urbanisation of rural areas. Members have become disunited and even left the cooperatives. Furthermore, the close ties between agricultural cooperatives, the government and MAFF have generated public suspicion and criticism.

....

22 Much of this section is based on George-Mulgan's manuscript, 'Political Restructuring in Japan: The Changing Context of Agrarian Power', forthcoming in *Political Studies.*

23 'Cooperatives' in this section refers to agricultural cooperatives, or *nokyo*. Until recently, they enjoyed membership of most farm households and many local residents, and had extensive links with other areas of the economy. Cooperatives exist at the local, prefectural and national level and provide members with a comprehensive range of services from inputs supply and farm management advice to marketing, insurance and financial services.

CAUGHT UP IN A BUBBLE

The most public post-bubble financial problem to hit the cooperatives has been their links with the collapsed housing loan companies, or *jusen*. During the bubble economy many farmers made huge profits selling parcels of their land. The proceeds from these sales were deposited with local agricultural cooperatives, whose nationwide deposits grew to over ¥2 trillion (US$18.4 billion). In an effort to offer attractive rates of return in an increasingly competitive market, the *nokyo* became the biggest single lenders to the housing loan companies. A typical example was the original *jusen*, Nippon Housing Loan (NHL): by the early 1990s, over one-third of its total borrowings of ¥2.2 trillion (US$20.2 billion) came from the agriculture sector.

Source: *Financial Times*, 11 March 1996, p. 8.

Some major issues are facing cooperatives.

- Financial sector deregulation and the collapse of the bubble economy have strained the financial health of cooperatives, reducing the funds available to cross-subsidise less profitable activities such as marketing.
- Cooperatives were the largest lenders to the collapsed housing loan companies, or *jusen*. Of the ¥12.8 trillion (US$117.7 billion) that the housing loan companies borrowed, ¥5.5 trillion (US$50.6 billion) came from cooperative's financial institutions. Amid much controversy, the Government decided that cooperatives should forfeit just 10 per cent of their *jusen* lendings (in contrast to 100 per cent for founder banks and 45 per cent for other lender banks) thus saving the cooperatives at direct cost to taxpayers.
- The Norinchukin Bank[24] is central banker to the cooperatives, which are estimated to hold ¥12.5 trillion (US$114.9 billion) in bad loans to non-bank financial institutions (including the *jusen*). Deposits in the Norinchukin Bank have fallen significantly due to this exposure. While in no danger of actual collapse, its financial health is of concern to bankers around the world (*Financial Review*, 9 April 1996, p. 8).
- Inefficient and overlapping agricultural cooperative institutions are anachronistic in a new era of market opening, deregulation and intensified competition. Obsolete business practices and increasingly stiff competition threaten cooperatives' survival. Many farmers are doing better deals with private companies (*Nikkei Weekly*, 25 December 1995, p. 1). One attempt to address these problems is to merge cooperatives, reducing their numbers from 3 574 in 1991 to 570 by 2000 (OECD, 1996, p. 58).

....

24 With assets of ¥44 trillion (1996 US$404.5 billion), the Norinchukin Bank is one of the world's biggest banks. It is the largest single supplier of funds to Japan's short-term money market and one of the largest dealers and investors in Japanese government bonds. (See Chapter 7 - *Finance*.)

PREMIUM CHESTNUTS AUSTRALIA AND HANKYU DEPARTMENT STORE

Hankyu has traditionally sourced its imports from the USA and the EU. Recently it has looked to Australia as a new supply base, finding Australian companies friendly, open and responsive to their approaches.

Hankyu and Premium Chestnuts Australia initially made contact in 1994 during an Austrade-assisted chestnut growers' trade mission to Japan. Hankyu imported just 350 kilograms of chestnuts in 1995 - Premium Chestnuts Australia's first-ever exports. Positive consumer reaction led Hankyu representatives to visit Premium Chestnuts Australia, after which they decided to import a further 2.5 tonnes (from a total production of 700 tonnes). Hankyu sold chestnuts in its stores and onsold to other retailers.

Growers from Premium Chestnuts Australia visited Japan on a research and marketing mission early in the relationship. They visited chestnut retailers, a MAFF research park and some local farms, and gave cooking school demonstrations. Premium Chestnuts Australia takes a long-term view of its exports to Japan, where total annual chestnut consumption is 40 000 tonnes. They are optimistic about the future and keen to introduce more varieties and sizes. However, they will wait until both the market and their relationship with Hankyu is ready for such developments.

Hankyu felt that Premium Chestnuts Australia responded well to requests related to specifications for the Japanese market. Hankyu suggested better brand identification, resulting in the 'Aussie Chestnuts' trademark, logo, posters, brochure and point-of-sale advertising. Importantly, the Osaka media gave good coverage to the initial Premium Chestnuts Australia imports. Chestnuts from Premium Chestnuts Australia have been popular with Japanese consumers because they are pest-free (chestnuts from Japan and China often have bugs inside), easy to peel and available in the off-season. According to Hankyu, high price is the only problem, due to high Australian producer prices (apparently up to three times higher than in Japan). On top of this is freight and a 16 per cent import duty. The two parties are working together to address this problem.

Both sides are keen to continue the trade. Hankyu has even asked Premium Chestnuts Australia to organise the supply of Australian wine and persimmon leaves (for sushi).

Source: Hankyu Department Store, 1996; Premium Chestnuts Australia, 1997.

Power of the Farm Vote

Demographic changes in the rural sector have reduced the power of the farm vote. The population engaged in farming and the proportion of farm households relying significantly on agriculture for their income has declined dramatically. The average age of the rural population has increased as younger generations move to the cities. These developments have changed the agricultural electorate: eligible voters declined by half between 1955 and 1979, and by another half between 1979 and

1993. Farm household voters in 1995 numbered 11.9 million, accounting for just 12.3 per cent of the national electorate (down from 13.1 million and 13.9 per cent, respectively, in 1993).

However, the power of the farm vote is not simply a function of numbers. It also depends on electoral gerrymander whereby sparsely populated rural areas are over represented in terms of votes per seat and highly populated urban areas are under represented. In the Lower House, such discrepancies have most recently been addressed by the 1994 electoral reform. (See Chapter 3 - *Politics*.) Seats have also been periodically reshuffled; for example, before the 1993 elections, nine seats were taken from rural electorates and eight seats given to metropolitan electorates.

Traditionally, the farm sector has been well represented in the Japanese Diet (Parliament) by office holders in agricultural organisations and those supported by farm organisations. Changing rural demographics and the weakening of cooperatives as vote-gathering organisations have meant that the *nokyogiin*, or those Diet members with direct links to agricultural cooperative organisations, have declined from a peak of 51 in 1971 to just 18 in 1995. Even with the decline in *nokyogiin*, just under 40 per cent of all Diet members still had some sort of agricultural connection in 1995. Despite the recent fluidity of Japanese politics, most farmers still support the LDP and most politicians with agricultural connections are affiliated with it. Farmers remain too electorally important for any party to volunteer policies that might alienate them.

AUSTRALIA-JAPAN AGRIFOOD TRADE

Over the past decade, Japan has been Australia's most valuable export market for processed and unprocessed foods.[25] In 1996, however, Australian exports fell 10 per cent to A$2.8 billion, from their peak of A$3.1 billion in 1994 (Figure 11.1). This fall coincides with a notable increase in the value of Australia's total agrifood exports to A$16.8 billion in 1996 (up 20 per cent from A$14 billion in 1994). While this development is too new to call a trend, the relative importance of the Japanese market appears to be declining as Australia's exports to neighbouring markets increase. Australia's major agrifood competitors in Japan are the USA, China and Taiwan, which were ahead of Australia as Japan's three biggest suppliers in value terms in 1995 (Table 11.7).

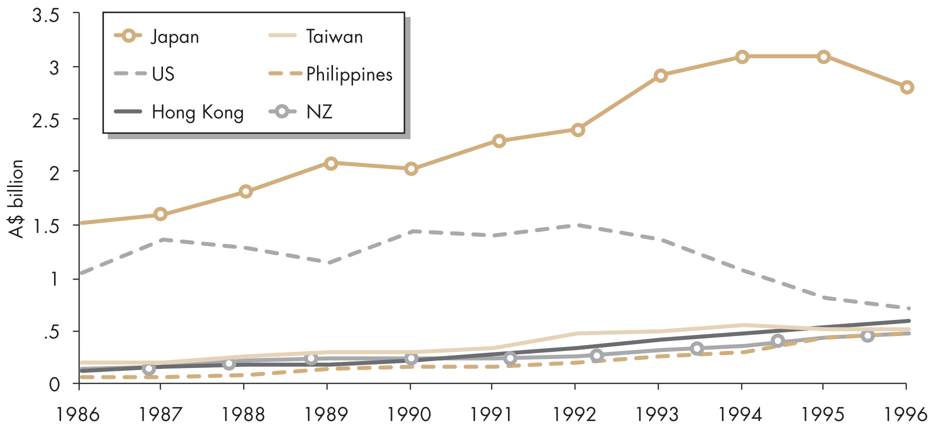
Australia's agrifood exports to Japan declined due to falls in processed foods, specifically beef. In 1996 processed food exports to Japan declined 17 per cent to A$2 billion while unprocessed food exports increased 23 per cent to A$810 million (Figure 11.2). This reversed the trend of the previous decade when unprocessed food exports to Japan declined in value while processed food exports increased.

25 This section complements the discussion of unprocessed and processed food trade in Chapter 5. The classification of processed and unprocessed foods is according to the Department of Foreign Affairs and Trade STARS data base, which uses Australian Bureau of Statistics data of the SITCR classification. Unprocessed foods are a small group of products, including animals, fish, crustaceans, grains, vegetables, fruit and nuts, tea, spices and animal feedstuffs, which are unmilled, live, fresh, chilled or frozen. All meat products, except live animals, and all dairy products are classified as processed foods.

Figure 11.1

Japan Still the Main Attraction - But Watch Other Regional Markets

Top Six Destinations of Australia's Agrifood Exports
A$ Billion

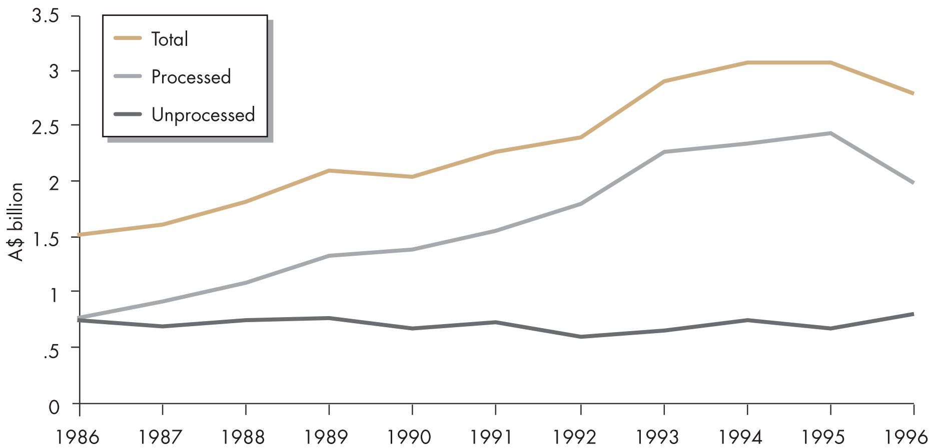


Source: Department of Foreign Affairs and Trade, 1997.

Figure 11.2

Processed Food Exports Increased Strongly to 1994

Composition of Australian's Agrifood Exports to Japan
A$ Billion



Source: Department of Foreign Affairs and Trade, 1997.

Table 11.7

Australia: Fourth Largest Supplier to Japan

Top Ten Agrifood Suppliers to Japan in 1995
US$ Millions

Country	1992	1993	1994	1995	1995 percentage share	Top three 1995 exports (in order)
TOTAL	**38 051**	**40 158**	**47 118**	**51 491**	**100**	**shrimp and prawns, pork, beef**
USA	11 579	12 003	13 103	14 833	29	corn, beef, soybeans
China	3 017	3 434	4 943	4 899	10	eels (live), tuna, vegetable preparations
Taiwan	2 861	3 078	2 991	3 237	6	pork, tuna, eels (processed)
Australia	**2 292**	**2 674**	**3 199**	**3 235**	**6**	**beef, raw sugar, wheat**
Thailand	2 158	2 226	2 904	2 832	5	shrimp, chicken, raw sugar
Canada	2 138	2 127	2 463	2 743	5	canola, wheat, crabs
Republic of Korea	1 574	1 561	1 700	1 829	4	tuna, chestnuts, pork
Indonesia	914	1 096	1 406	1 542	3	shrimp, tuna/bonito, coffee beans
Russia	601	729	1 047	1 354	3	crabs, cod roe, cod
France	1 119	1 087	1 128	1 256	2	brandy, wine, mineral water
Others	9 798	10 143	12 234	13 731	27	

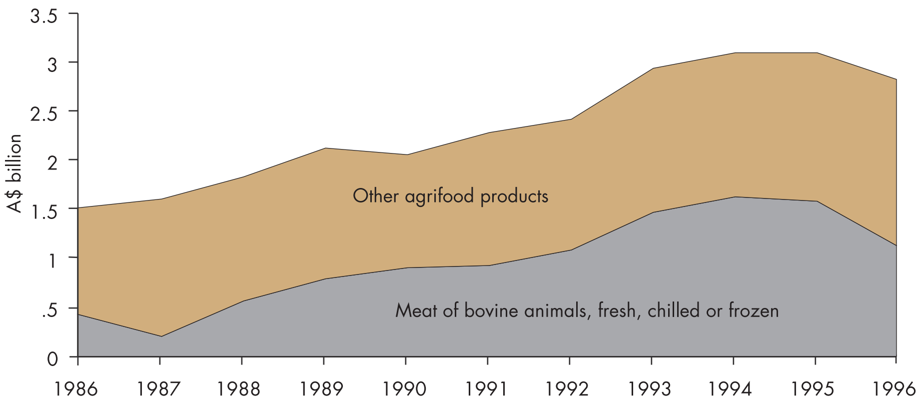
Source: Japan External Trade Organisation, 1995, p. 3; Japan External Trade Organisation, 1994, p. 1.

Australia's most important processed food export to Japan is fresh, chilled or frozen beef (Figure 11.3). Exports reached a peak of A$1.6 billion in 1994, accounting for about half the total value of Australia's agrifood exports to Japan. However, beef exports have fallen and by 1996 were worth A$1.1 billion (about 40 per cent of agrifood exports to Japan). The beef export decline has been nearly double the total decline in the value of Australia's agrifood exports to Japan. This is explained partly by Japan's reduced beef imports due to public alarm about BSE, or 'mad cow' disease, and E-coli, and partly by the aggressive marketing of US beef which has eroded Australia's premium-price chilled beef market in Japan. However, as the strong growth in other agrifood exports has partly compensated for this decline, a recovery in the value of beef exports would underpin a renewed surge in Australia's overall agrifood exports to Japan.

Figure 11.3

Beef Dominates, But Other Processed Foods Growing

Australia's Agrifood Exports to Japan: Importance of Beef
A$ Billion



Source: Department of Foreign Affairs and Trade, 1997.

Only three of Australia's top ten agrifood exports to Japan are among Japan's top ten agrifood imports (Tables 11.8 and 11.9). While Australia's three most valuable agrifood products continue to be beef, raw sugar and wheat, over the past decade the range of Australian agrifood exports to Japan has increased (Table 11.10). For example, in 1995, in terms of value, Australia was Japan's largest supplier of sheep meat, dairy products, rice and sugar; the second largest supplier of beef, malts, flour and starch, ice cream and asparagus; and the third largest supplier of beef jerky, tinned fish, raisins, chocolate confectionery and pet food. Australia's exports of these and similar products have more than doubled in value since the mid-1980s. For example, between 1986 and 1996, fruit juice exports increased 88-fold in value.

Table 11.8

Wide Range of Big Earners

Australia's Agrifood Exports to Japan Valued over US$50 Million in 1995
US$ Million

Commodity	1993	1994	1995	Percentage change 1993-1994	Percentage change 1994-1995
Total	**2 674.0**	**3 199.2**	**3 234.7**	**19.6**	**1.1**
Beef	1 023.9	1 236.5	1 240.9	20.8	0.3
Raw sugar	224.9	202.2	253.8	-10.1	25.5
Wheat	219.4	244.1	250.8	11.3	2.7
Pet food	93.5	106.9	145.3	14.3	35.9
Shrimps and prawns	115.9	122.3	134.1	5.5	9.6
Rock lobsters	104.3	129.0	128.5	23.7	-1.4
Cheese and curd	98.9	109.1	123.7	10.3	13.4
Barley	83.6	89.7	74.1	7.3	-18.4
Sheep meat	70.9	61.9	70.3	-13.7	13.6
Tuna	24.8	44.6	64.5	79.8	44.6
Beef offal	32.4	33.0	55.0	1.8	66.7

Source: Japan External Trade Organisation, 1995, p. 11; Japan External Trade Organisation, 1994, p. 8.

Table 11.9

Imports Japan Values Most

Japan's Ten Largest Agrifood Imports According to 1995 Value
US$ Million

Commodity	1993	1994	1995	Percentage change 1993-1994	Percentage change 1994-1995
Total	**40 158.4**	**47 118.0**	**51 491.0**	**17.3**	**9.3**
Shrimp and prawns	3 237.9	3 680.4	3 941.1	13.7	7.4
Pork (including offal)	3 568.0	2 926.4	3 756.0	14.0	27.8
Beef	2 465.4	2 856.4	3 262.2	15.9	14.2
Corn	2 131.1	2 248.7	2 376.7	5.5	6.2
Bonito and tuna	1 673.5	1 809.9	2 006.6	8.2	6.6
Soybeans	1 374.2	1 395.1	1 372.6	1.5	-1.6
Crabs	878.6	1 207.9	1 363.8	37.5	12.9
Wheat	1 138.0	1 348.4	1 341.2	18.5	-0.5
Chicken (including offal)	703.0	948.2	1 251.5	34.9	32.0
Coffee beans (raw)	510.7	949.6	1 105.0	85.9	16.4

Source: Japan External Trade Organisation, 1995, p. 6; Japan External Trade Organisation, 1994, p. 4.

Table 11.10

Australia Supplies Vast Range of Products

Japan's Agrifood Imports: Australia a Top Supplier
By Value; 1995

Table 11.10a
Commodities where Australia has LARGEST share of the value of Japanese imports

Commodity	Total value (US$m)	Percentage change 1994-1995	Australian share (per cent)	Second largest share (per cent)	Third largest share (per cent)
Sheep meat (including offal)[a]	126.5	16.8	**55.8**	NZ (43.3)	USA (0.7)
Dairy products and eggs	921.6	23.4	**19.3**	NZ (16.9)	USA (13.5)
Cheese and curd[b]	458.7	19.4	**26.9**	NZ (22.9)	Denmark (12.3)
Rice[c, h]	20.8	-98.5	**77.0**	US (15.3)	Thailand (3.8)
Sugar and prepared sugar products	857.2	19.7	**30.0**	Thailand (26.6)	Cuba (7.2)
Raw sugar[d]	607.8	24.0	**41.7**	Thailand (33.6)	Cuba (10.2)

Table 11.10b
Commodities where Australia has SECOND LARGEST share of the value of Japanese imports

Commodity	Total value (US$m)	Percentage change 1994-1995	Largest share (per cent)	Australian share (per cent)	Third largest share (per cent)
Live animals	33.6	14.0	USA (39.7)	**22.5**	UK (17.5)
Cows[e]	19.2	18.0	USA (43.4)	**39.0**	Canada (17.5)
Beef[a]	3 262.2	14.2	USA (57.7)	**38.0**	NZ (3.0)
Beef offal[a]	605.7	46.0	USA (85.4)	**9.0**	Canada (3.6)
Ice cream[b]	85.3	16.4	USA (46.6)	**23.4**	NZ (23.3)
Malts, flour, starch[f]	446.9	22.8	Canada (20.6)	**12.8**	Germany (12.2)
Oranges	191.3	4.0	USA (93.7)	**3.7**	South Africa (2.3)
Lemons	137.1	14.1	USA (94.1)	**3.9**	South Africa (1.3)
Asparagus	120.3	8.1	USA (27.3)	**21.5**	Mexico (17.6)
Canola	629.8	0.3	Canada (95.6)	**2.8**	USA (1.3)

Table 11.10c
Commodities where Australia has THIRD LARGEST share of the value of Japanese imports

Commodity	Total value (US$m)	Percentage change 1994-1995	Largest share (per cent)	Second largest share (per cent)	Australian share (per cent)
Meat and prepared meat products	9 859.6	23.9	USA (36.0)	Taiwan (18.0)	**14.3**
Beef jerky[a]	29.1	37.5	USA (57.7)	Argentina (20.1)	**12.7**
Clams and oysters	364.9	14.3	ROK (42.9)	China (40.1)	**6.9**
Tinned fish	152.2	12.9	Thailand (36.4)	Russia (21.9)	**17.3**
Cereals and prepared cereal products	5 534.1	-16.0	USA (64.6)	Canada (11.1)	**8.7**
Cereal[f]	4 471.9	-21.7	USA (76.8)	Canada (11.6)	**7.9**
Wheat[c]	1 341.2	-0.5	USA (52.6)	Canada (28.6)	**18.6**
Barley[c]	289.0	26.5	Canada (39.0)	US (35.3)	**25.6**
Prepared cereal products[f]	615.2	20.1	USA (15.8)	Singapore (12.4)	**11.4**
Raisins	45.1	2.7	USA (89.0)	South Africa (6.3)	**2.2**
Chocolate confectionery	138.0	14.5	USA (30.9)	Belgium (11.8)	**10.3**
Prepared cocoa products	175.0	27.4	Singapore (25.9)	NZ (14.4)	**12.9**
Prepared feed products	2 242.4	19.1	USA(40.6)	Chile (11.4)	**9.2**
Hay[g]	566.2	11.5	USA (77.5)	Canada (18.0)	**2.5**
Pet food[g]	568.3	28.4	USA (39.1)	Thailand (25.6)	**25.5**
Beef Tallow	51.3	78.2	USA (54.1)	Canada (43.4)	**2.3**

Notes: a. Subcategory of meat and prepared meat products; b. Subcategory of dairy products and eggs; c. Subcategory of cereals; d. Subcategory of sugar and prepared sugar products; e. Subcategory of live animals; f. Subcategory of cereals and prepared cereal products; g. Subcategory of prepared feed products; h. Due to the timing of minimum access rice tenders late in 1995, mostly first shipments of these imports did not enter Japan until the first three months of 1996. Therefore the figure in this table mainly represents SBS tenders under which Australia did very well in 1995 (see section on Policies in this chapter). In contrast, Australia's share of total rice imports on a 1995 Japanese financial year basis is 24.5 per cent, behind the USA with its 50.7 per cent share.

Source: Japan External Trade Organisation, 1995, pp. 18-22.

Developments in the Trade Relationship

Australia's position as a leading agrifood supplier to Japan reflects its strong comparative advantage in agricultural production: its clean natural resource base, skilled work force, advanced research and development capabilities, sophisticated infrastructure, and technologically advanced and highly competitive farming systems. However, as discussed, access to Japan remains tightly controlled by tariff and nontariff barriers. Japan's minimum risk quarantine policy and procedures, for example, have posed particular problems for Australia.[26] Recent developments in

[26] Particular problems have been onerous research requirements before any lifting of quarantine bans can be considered; costly operational arrangements which are often imposed on the trade once import approval has been granted; and plain delaying tactics.

conjunction with APEC and Uruguay Round implementation, and the 1996 MAFF *Annual Report* (MAFF, 1997b), reflect a positive change in approach taken by the Japanese Government, especially MAFF quarantine officials.

Despite access difficulties, the Japanese agrifood product market is very attractive. The high internal sales price plus the large size of the market can make it very profitable.[27] Chapter 10 - *Regions*, for example, shows that *each* of the eight largest regions in Japan has higher per capita incomes than Singapore, Hong Kong or Australia. However, success depends on properly researching the Japanese market, making a long-term commitment, and guaranteeing reliable supply and consistent high quality product. (See Chapter 8 - *Market Access*.) Japanese consumers have exacting standards, wide choice, and a bias toward domestically produced foods.

Exporters must also be conscious of food safety and food quality issues. Over the past two years, concerns over these issues have reduced consumer confidence in the safety of imported food. Between April 1996 and January 1997, for example, Japanese beef consumption fell 8.3 per cent and household expenditure on beef fell 12 per cent, due largely to the E-coli food poisoning scare in Japan and wide publicity of the UK's 'mad cow' disease. Additionally, health consciousness, long a concern in Japan, is increasing with growing life expectancy and the ageing population.

Australian producers are exploring opportunities in the Japanese market. Some, such as Premium Chestnuts Australia, responded to the interest of Japanese importers, while others, such as the Australian Rice Growers Cooperative and the Queensland Citrus Exporters Committee, identified an opportunity and pursued it relentlessly. (See box - *Australian Branded Rice on Japanese Supermarket Shelves?* and Appendix 11.2.) Some Australian companies also are benefitting from Japanese investments in Australian agriculture and food industries (Table 11.14). (See Chapter 6 - *Internationalisation.)* Such investment also increases Japanese confidence in Australia as a reliable supplier of high quality and safe agrifood products to Japan.

Potential exporters can also benefit from Australian Government programs. In Japan, the most high profile of these is the Australian Trade Commission, or Austrade, which has offices in Tokyo, Osaka, Fukuoka, Nagoya, Sendai and Sapporo, as well as throughout Australia. (See *Information for Companies* after Chapter 15.) The 'Supermarket to Asia Council' is a recent Commonwealth Government initiative launched by the Prime Minister in September 1996. It aims to remove barriers to export, develop a more aggressive export culture and promote the profile of Australian agrifood products in Asia.[28] Another important government body is the Processed Foods Market Access Committee which is represented by government and industry officials and which recently commissioned an important scoping study on market access for processed foods in Asia.[29]

....

27 This assumes that exporters, rather than the Japanese Government or distributors, receive the difference between world market prices and internal prices.

28 The Supermarket to Asia Council work programme is carried out by its eight working groups: 1. Quality and Safety; 2. Business Competitiveness; 3. Asian Marketing; 4. Small to Medium Enterprises; 5. Market Access; 6. Communications; 7. Transport and Logistics; 8. Research, Technology and Innovation. (The Agrifood Industries Strategy was a similar previous initiative which was discontinued.)

29 *Expanding Processed Food Exports - Priorities and Strategies for Joint Action by Government and Industry* prepared by International Trade Strategies Pty Ltd, Melbourne. It is also available from the Department of Foreign Affairs and Trade.

Table 11.14

Japan Provides Good Opportunities in Australia

Japanese Investment in Australian Agrifood Industries Since Financial Year 1992

FY	Project and description	Investment (A$m)	New jobs	Exports (A$m)	State
1992	**Snow Brand/Tatura Milk** Snow Brand and the Australian company, Tatura Milk, signed a A$30 million joint venture to produce powdered milk and baby foods for export to Indonesia	25.0	50	75	VIC
	Yakult Honsha Major Japanese food producer invested in a A$10 million fermented milk and juice products production plant	30.0	60[a]	na	VIC
	Yamasa Kamaboko Japanese food processing company invested in a greenfield project to produce a rubbery kind of fish cake	23.0	45	7	VIC
1993	**Sakata Beika** Invested in a new rice-cracker manufacturing plant for the Australian market and later for export to the USA and EU. Australia was chosen over the USA	6.0	30	1	VIC
1994	**Taiko Saiko** Agreement with an Australian firm to jointly farm 45 tonnes of Southern Bluefin Tuna annually	1.6	6	5	SA
1995	**Asahi Industries** This agricultural equipment and steelmaker entered into a joint venture with JT Johnson and Sons for a hay dumping and processing plant for oats and hay	2.0	na	7	VIC
	Meiji Milk Meiji Milk Japan (40 per cent), Murray Goulburn Cooperative (40 per cent) and Mitsubishi (20 per cent) formed a joint venture company to produce infant formula	47.0	80	40	VIC
1996	**Nozaki and Co Ltd** Established a chain of innovative sushi robot restaurants in Australia. Expects to establish 15 shops in the next five years	0.7	20	0	na

Note: Data in this table reflect projects that Austrade was involved in through the Investment Promotion and Facilitation Program. na. not available; a: Eventually 300 jobs; VIC: Victoria; SA: South Australia.

Source: Austrade, 1997.

State governments also work closely with agrifood businesses to encourage and assist them to enter the Japanese market. One particularly successful example is the Tasmanian Government's Japan strategy. (See Appendix 11.3.) Furthermore, the Australian Government, through its Embassy in Tokyo, is involved in ongoing negotiations to facilitate Australian agrifood exports to Japan. The Japanese government also has various programs to assist foreigners do business in Japan. (See Chapter 8 - *Market Access* and *Information for Companies* after Chapter 15.)

SIMPLIFIED IMPORT PROCEDURES FOR AUSTRALIAN PROCESSED FOODS

In 1993, Australia made a submission to Japan's Trade and Investment Ombudsman (OTO) annual inquiry into standards and certification problems in the Japanese market. As a result of OTO follow-up and pressure from other countries, the Ministry for Health and Welfare introduced a precertification system for imported foods. Some success was achieved in 1995 when persistent pressure from the Australian Government facilitated the acceptance within five months of eight detailed applications from an Australian dairy producer under the precertification scheme.

Australian standards equal and fulfil the requirements of Japan's Food Sanitation Law. However, the system does not recognise equivalence of Australian inspection and certification for a range of products, particularly dairy and processed seafoods. Moreover, Australia's other food quality assurance systems (that is, food laws and export legislation, established tolerances for food additives and pesticide residues, parameters for testing of product for microbiological hazards and labelling requirements) are not recognised. The Australian Quarantine and Inspection Service (AQIS) currently is negotiating a Recognition Agreement with Japanese authorities to address these issues.

Source: Department of Foreign Affairs and Trade, 1996.

PROSPECTS FOR AGRIFOOD REFORM AND TRADE

The conflict between the reality of rising food imports and the desire to reduce the fall in self-sufficiency will continue beyond 2000. On the one hand, food imports will continue to grow in both scope and scale. On the other, conservative forces will continue to exert pressures to protect and assist Japan's agriculture sector, citing food security and cultural heritage arguments. However, concerns over maintaining a certain level of food self-sufficiency are misplaced, given the high costs associated with ensuring domestic supplies of overpriced goods and the dependence on imported energy and raw materials necessary to sustain domestic production.

Despite recent Japanese initiatives making it easier to export agrifood products to Japan and Prime Minister Hashimoto's declaration that agriculture will not be spared from the reform drive, the farm vote will continue to influence Japanese political processes. Until recently, changes in Japan's agriculture sector have largely reflected international pressures rather than major government initiatives. However, domestic pressures are becoming more important due to the continuing demand for food imports, new competitive pressures in Japan's economy, changing lifestyles, the ageing of the farm workforce and the relative decline of agriculture as the economy grows. The revision of Japan's Agricultural Basic Law will be very important for the future of Japanese agriculture and agrifood suppliers such as Australia.

The 1996 fall in the value of Australian beef exports to Japan due to extraneous factors adversely affected agrifood exports to Japan. However, increasing diversification should at least partially compensate for fluctuations in the value of traditional agrifood exports in the future.

Japan is unlikely to become an 'easy' market. As it progressively opens, competition will intensify. Rising consumer purchasing power will ensure continued strong demand for high-quality products. Australia must remain a competitive and reliable producer of such products in order to maximise the potential gains from the Japanese market for food and agricultural producers.

Appendix 11.1

JAPAN'S AGRICULTURAL PROTECTION

According to the OECD Producer Subsidy Equivalent (PSE),[30] Japan not only has a much higher overall rate of agricultural protection than its major trading partners, but its percentage PSE has increased as the OECD average has decreased (Appendix Figure 11.1). Japan's 1995 PSE of 77 per cent means that, on average, farmers received income from assistance and protection measures equivalent to a subsidy of 77 per cent of the value of production. The total cost of these measures was ¥4 640 billion, or US$49.3 billion (OECD, 1996, p. 160). Government policies especially support crop producers (Appendix Table 11.1). In 1995, Japanese wheat producers, for example, received assistance and protection equivalent to a subsidy of more than 100 per cent of production value.

These high levels of assistance and protection mean that farmers receive prices well above international levels, as shown by the producer Nominal Assistance Coefficient (NAC)[31] (Appendix Table 11.2). While average OECD farmers were paid 1.6 times the world price in 1995, Japanese farmers received on average 3.4 times the world price, with wheat producers receiving eight times the world price and rice farmers seven times the world price. Furthermore, the trend in Japan is upward (Appendix Table 11.1).

The high protection and support of agriculture, largely by market price support measures, has resulted in Japanese consumers facing very high food prices. In 1995, as measured by the percentage Consumer Subsidy Equivalent (CSE),[32] 51 per cent of the price consumers paid for agricultural products represented a tax over and above the world price (Appendix Figure 11.2). In other words, consumers paid approximately twice the world price for their agricultural products (as illustrated by the consumer NAC[33] - Appendix Tables 11.1 and 11.2). The greatest discrepancy between domestic prices and world prices was for rice, which was more than six times the world price, followed by milk and pork at four and three times the world price, respectively.

....

30 The PSE measures the value of the monetary transfers (beyond the free market price) to agricultural production from taxpayers and consumers resulting from a given set of agricultural policies in a given year (OECD, 1996, p. 227). It calculates the percentage subsidy which would be the equivalent of the value of these transfers.

31 The OECD's producer NAC is the ratio of the effective domestic price received by producers (including all assistance) to the world price.

32 The CSE measures the value of the monetary transfers (beyond the free market price) to agricultural consumers from a given set of agricultural policies in a given year (OECD, 1996, p. 219). When negative, as in Japan, it represents the implicit tax imposed on consumers by agricultural policy.

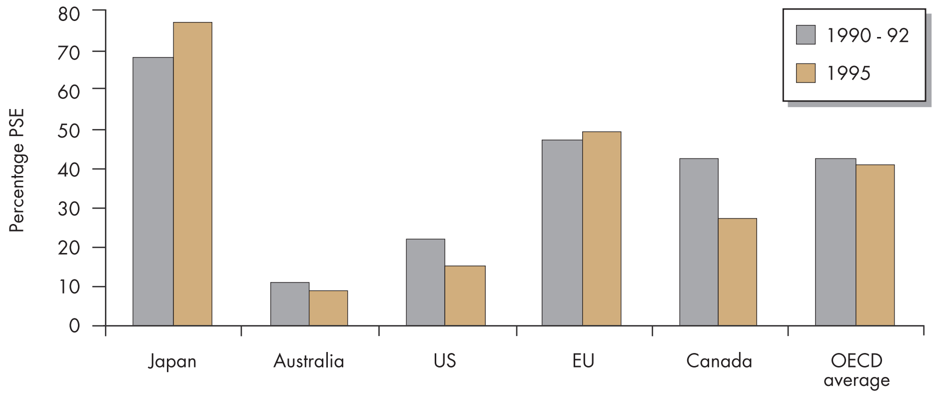
33 The consumer NAC is the ratio of the effective domestic price paid by consumers (including all consumer transfers) to the world price.

Furthermore, Japan has been slow to change its approach to agricultural policies. The relatively strong dependence on market price support discourages market-based decisions and results in higher food costs.[34] Despite a small shift to direct income support in the 1995 budget, market price support through, for example, administrative prices, still accounted for most assistance (Appendix Table 11.3). Other OECD countries have generally shifted more towards less distorting direct income payments.

Appendix Figure 11.1

Japanese Agriculture: Growing Protection

Protection and Assistance to Agricultural Producers
Per Cent Producer Subsidy Equivalent



Note: For technical definitions see footnotes or glossary.

Concerning the EU: EU-12 for 1990 to 1992; EU-15 for 1995; from 1990 EU includes ex-GDR

Source: Organisation for Economic Cooperation and Development, 1996.

34 Market price support includes policies such as tariffs, import quotas, administered prices and trade licensing arrangements which artificially inflate domestic producer prices, raising retail prices. Direct income payments are payments made directly by the government (from the budget) to producers, thereby having a smaller impact on final consumer prices. Direct income payments are increasingly favoured as a means of supporting agriculture because they are more transparent; provide direct support to farm incomes; and as they are unrelated to production levels, they distort production decisions less.

Appendix Table 11.1

Huge Subsidies to Producers; High Prices for Consumers

Protection of Agricultural Commodities in Japan

	Protection of producers				Costs to consumers			
	Percentage PSE		Producer NAC		Percentage CSE[a]		Consumer NAC	
	1990-92	1995[b]	1990-92	1995[b]	1990-92	1995[b]	1990-92	1995[b]
Wheat	97	103	7.3	8.3	-56	-49	2.3	2.0
Rice	88	97	5.6	7.2	-80	-84	5.3	6.4
Oilseeds	46	35	1.8	1.4	-	-	1.0	1.0
Sugar[c]	69	71	2.8	2.8	-65	-59	2.9	2.5
Total crops	***88***	***96***	***5.3***	***6.7***	***-59***	***-58***	***2.5***	***2.4***
Milk	86	90	5.2	5.7	-73	-74	3.8	3.9
Beef and veal	35	46	1.5	1.8	-30	-32	1.4	1.5
Pigmeat	52	67	2.2	3.1	-52	-69	2.2	3.2
Poultry	12	13	1.1	1.1	-10	-11	1.1	1.1
Eggs	20	19	1.3	1.2	-19	-18	1.2	1.2
Total livestock products	***46***	***53***	***1.8***	***2.0***	***-38***	***-42***	***1.6***	***1.7***

Note: For technical definitions see footnotes or glossary.
a: A negative figure represents a tax on consumers; b: Provisional figures; c: Refined equivalent;
PSE: Producer Subsidy Equivalent; CSE: Consumer Subsidy Equivalent; NAC: Nominal Assistance Coefficient.
Source: Organisation for Economic Cooperation and Development, 1996.

Appendix Table 11.2

Prices Paid and Received About Double the OECD Average

Agriculture Sector Protection in Japan and Selected OECD Countries

	Producer NAC		Consumer NAC	
	1990-92	1995[a]	1990-92	1995[a]
Japan	2.8	3.4	2.0	2.0
Australia	1.1	1.1	1.1	1.1
USA	1.3	2.0	1.1	1.1
EU[b]	1.9	1.9	1.7	1.5
Canada	1.6	1.3	1.3	1.2
OECD average	1.7	1.6	1.5	1.4

Note: For technical definitions see footnotes or glossary.
a: Provisional figures; b. EU-12 for 1990 to 1992; EU-15 for 1995; from 1990 EU includes ex-GDR;
NAC: Nominal Assistance Coefficient.
Source: Organisation for Economic Cooperation and Development, 1996.

Appendix Table 11.3

Japan Slow to Change Type of Protection Measures

Composition of Assistance to Agriculture
Per Cent of Total Measures

	Market price support		Direct payments	
	1986-88	1995	1986-88	1995
Japan	85	82	7	6
Australia	39	49	6	0
USA	42	51	36	10
EU[a]	98	68	8	25
Canada	46	33	28	30
OECD average	79	64	18	23

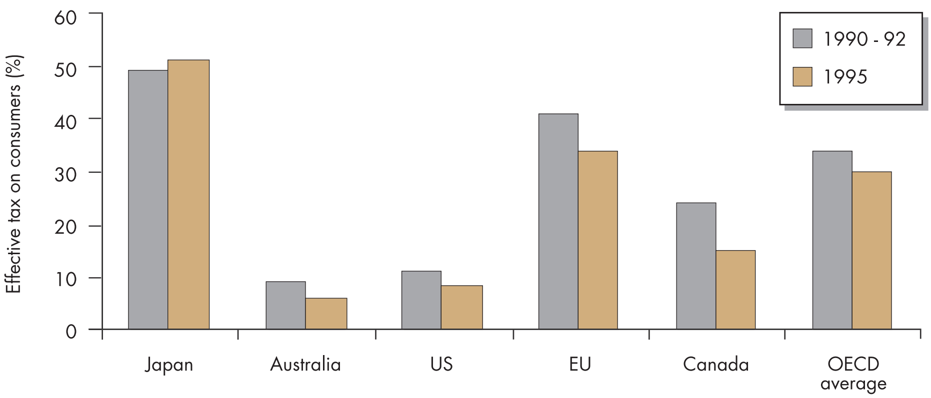
Note: For technical definitions see footnotes or glossary.
a: EU-15 for 1995; from 1990 EU includes ex-GDR. In 1986 to 1988 EU assistance totals more than 100 per cent due to the negative values of some other components of assistance not listed here.

Source: Organisation for Economic Cooperation and Development, 1996, p. 195.

Appendix Figure 11.2

Consumers Pay a High Price for Protection of Agriculture in Japan

Agricultural Protection: Effective Tax on Consumers
Per Cent



Note: For technical definitions see footnotes or glossary. These taxes are based on OECD calculations of Consumer Subsidy Equivalents (CSEs). Concerning the EU: EU-12 for 1990 to 1992; EU-15 for 1995; from 1990 EU includes ex-GDR.

Source: Organisation for Economic Cooperation and Development, 1996.

Appendix 11.2

CITRUS LEADS THE WAY

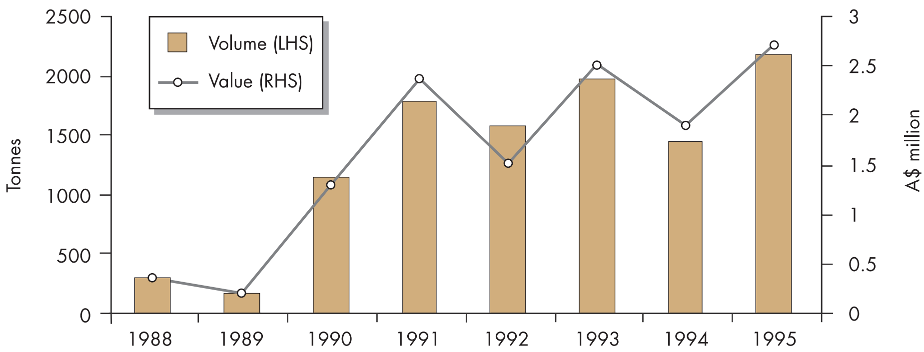
In the early 1960s, the Queensland Citrus Industry identified an opportunity to sell oranges to Japan.[35] Twenty years later, after concerted efforts by the Queensland Citrus Exporters Committee (QCEC), the Queensland Department of Primary Industries (DPI), the Commonwealth Scientific Industrial Research Organisation (CSIRO) and the Australian Quarantine and Inspection Service (AQIS), the first commercial shipments of valencia and navel oranges occurred in 1983 and 1984, respectively. By 1995/96 the trade was worth almost A$2.7 million (Appendix Figure 11.3), with strong growth expected to continue. Southern Australia followed Queensland's lead and now exports significant quantities of oranges and lemons to Japan. The long period before Queensland's exports began was due mainly to:

- the underdeveloped Queensland-Japan trade relationship
- Japanese attitudes to imports tended to be much more negative than now
- industry and government were operating in unfamiliar areas with untried strategies.

Appendix Figure 11.3

Dramatic Increase in Value and Volume from Queensland

Queensland's Exports of Orange Products to Japan



Note: Orange products include valencia and navel oranges, fresh or dried, and orange juice, not fermented nor spirit added, and not frozen. Figures are rounded.

Source: Queensland Government Statistician's Office, 1996.

Furthermore, alteration to the import status of fresh fruit, including citrus, requires changes in Japanese legislation. As part of this process, MAFF must hold public hearings to discuss the changes. These hearings are subject to influence from local lobbies, including powerful rural-based groups.

35 The information in this case study was provided by the Queensland Department of Primary Industries (DPI).

THE FRUIT FLY PROBLEM

The major constraint for fresh horticultural trade between Australia and Japan is insect pests, the most prominent being fruit flies (especially Mediterranean fruit fly, or Medfly, and Queensland fruit fly, or Qfly). Although Medfly is generally confined to Western Australia, MAFF's quarantine authorities view Australia as one geographical area requiring effective treatment against both Medfly and Qfly.

The first shipments were treated with ethylene dibromide (EDB). Japanese authorities insisted on low levels of residue but strong dosage rates with EDB to ensure that fruit would be pest free. Extensive research was required to develop a treatment that satisfied Japanese authorities, placed minimum stress on the fruit and was commercially viable. Technical discussions then took place between Australia and Japan, and a protocol was agreed upon.

By the late 1980s, EDB was banned for citrus fumigation. The next method developed was the use of cold treatment. Another lengthy process of research, testing, technical negotiations and protocol discussions was undertaken. New infrastructure was also required for fruit undergoing cold treatment. From the 1988 season, all shipments were cold treated. Lemons now have market access, and negotiations to allow easy-peel citrus fruit (for example, mandarins) are progressing, with the final trial planned for mid-1997. A major project is underway to facilitate a more efficient provision of higher-quality fruit to Japan by developing a wider range of treatment options for the Australian citrus industry.

A COSTLY PROCEDURE WITH STRICT SECURITY REQUIREMENTS

Initial MAFF requirements for quarantine purposes were exacting and costly. As well as market specifications and fumigation, strict security was applied to ensure that oranges could not be exposed to Qfly:

- each piece of fruit had to carry a PQ (plant quarantine) sticker
- cartons had to be sealed
- fruit cartons required fly-proof mesh on the ventilation holes to prevent reinfestation
- cartons had to be clearly marked that they had been packed for Japan and carry information about post-harvest treatment of fruit written in Japanese
- a Japanese inspector and AQIS staff (both paid for by the commercial operators) had to supervise fumigation and inspect fruit following disinfestation.

Requirements in the late 1990s are still strict; however, some changes have made the trade more economically viable:

- individual fruit no longer have to carry a PQ sticker, although importers and retailers often require stickers for identification and promotion
- instead of meshing carton ventilation holes, inspection and container loading now can take place within a meshed room
- quality requirements are not quite as strict, allowing a greater packout yield.

Additionally, 40 foot refrigerated containers are replacing 20 foot models, thereby reducing freight costs.

Appendix 11.3

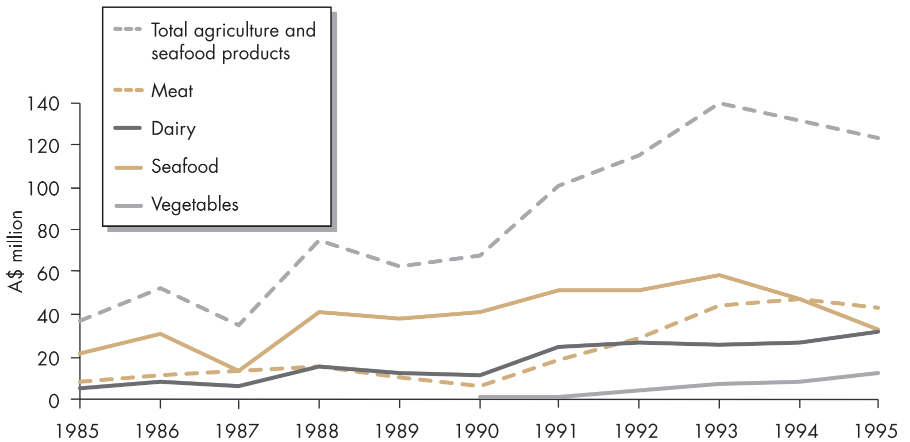
TASMANIA'S FOOD EXPORT STRATEGY

In 1994, the Tasmanian Government released its 'Decade of Growth' strategy for industry development.[36] One of its five key objectives is to increase total annual exports to A$3.5 billion (A$1.67 billion in 1995/96). Japan, as Tasmania's largest trading partner, is a key focus of this export drive. In the last ten years, Tasmanian agriculture and seafood exports to Japan grew from A$37 million to A$122 million or over 200 per cent (Appendix Figure 11.4); and their share in the value of Tasmanian exports to Japan grew from 11 to 24 per cent.

Appendix Figure 11.4

A Decade of Growth for Tasmanian Agrifood Exports

Tasmania's Agriculture and Marine Product Exports to Japan (1985 to 1995)



Source: Tasmania Development and Resources, 1997.

QUALITY ATTRACTS PREMIUM PRICES

Market research in the mid-1980s indicated that Tasmania's high-quality agricultural and seafood products would attract premium prices in Japan. Tasmania's Japan food export strategy therefore prioritised establishing Tasmania as a producer of premium quality agricultural and seafood products. The key elements of this strategy are:

- to develop a Tasmanian brand awareness in Japan based on Tasmania's natural advantages, including its unpolluted water and air, fertile soils and disease-free status

[36] The information for this case study was provided by Tasmania Development and Resources (TDR). All years referred to in this case study are financial.

- to promote widespread adoption of best practice, sustainable development and commitment to consistent quality among Tasmanian export businesses.

An important episode in positioning Tasmania in the Japanese market was the feature film *Tasmania Monogatari*, or 'The Tasmania Story', made by the Fuji Sankei Group (a large Japanese communications conglomerate) and released in 200 Japanese cinemas in 1990. The film originated from an article about the Tasmanian Tiger in a Japanese newspaper. It portrayed Tasmania as an island wilderness of outstanding beauty and environmental purity. The impact of the film was dramatic, with research indicating that in 1990 the name 'Tasmania' was recognisable by approximately 60 per cent of Japanese aged from five to 65.

GOVERNMENT AND PRIVATE SECTOR INTERACTION

The key government service providers in Tasmania's Japan food export strategy are Tasmania Development and Resources (TDR), the Tasmanian Department of Primary Industries and Fisheries (DPIF), Austrade, and the Commonwealth Departments of Industry, Science and Tourism, and Foreign Affairs and Trade. These agencies work closely with industry associations, companies and other government agencies to ensure that export access and market development issues are identified and appropriate strategies implemented.

In Japan, the Tasmanian government has contracted a consultancy firm to provide representation, interpretation and translation, field inquiries about market conditions and trends, and act as a liaison point for visiting trade missions. Over the past decade, the Tasmanian Government has also cultivated a network of senior Japanese business people known as 'Friends of Tasmania'. These relationships provide Tasmanian export interests access to a range of sympathetic Japanese companies.

The Marketing and Export Development section of Tasmania Development and Resources (TDR) supports Tasmanian companies interested in the Japanese market by providing:

- specialist Japanese marketing advice and facilitation of marketing networks
- provision of Japanese market intelligence, statistics and trends
- facilitation of inward Japanese buyer missions to Tasmania
- coordination of representation at overseas trade exhibitions
- planning itineraries for trade missions to Japan
- business planning, quality management and benchmarking.

One way these services are delivered is by working closely with the Japan External Trade Organisation (JETRO). Each year a joint program of company visits and seminars is arranged by TDR and JETRO for export-focused Tasmanian companies to improve their marketing skills and highlight the latest trends and opportunities in Japan. Austrade complements this with regular briefings and meetings with visiting Trade Commissioners.

The Tasmanian DPIF liaises closely with growers and exporters, assisting industry to:

- test the suitability of new crops
- develop production systems to meet specifications of the Japanese market
- develop appropriate quarantine protocols for export items
- implement procedures in anticipation of potential barriers.

The DPIF Quarantine Service undertakes quarantine controls and pest and disease monitoring, both of which provide confidence and assurance that Tasmania is pest and disease free. The quarantine services also provide the formal certification for export products. The Health Department manages the health assurance program for shellfish, such as oysters.

The private sector works effectively with different levels of government. For example, a group of Tasmanian vegetable growers is developing products for export to Japan. A marketing skills trip to Japan, initiated by growers and supported by government, provided a useful insight into Japanese consumption behaviour. A marketing skills consultant was made available to the group through the Commonwealth Department of Primary Industry and Energy's Marketing Skills Program. Networking between industry and government is strengthened by programs such as the Australian Export Awards. Tasmania received the primary produce Exporter of the Year Award for 1993, 1994 and 1995. The winners were Vecon, Australia's biggest exporter of onions; Tassal, Australia's largest exporter of farmed salmon; and Blue Ribbon Meats, a beef exporter.

The private sector also is proactive in its own marketing efforts. Over the past five years, the Tasmanian apple industry, for example, intensified efforts to gain access for Fuji apples. They conducted their own trade missions to establish a positive relationship with growers opposed to Tasmania gaining access to Japan's A$2.5 billion apple market. The Tasmanian industry also invited Japanese apple growers and associations to experience first-hand Tasmania's pristine growing environment and develop information and technology exchange. As a result, Tasmanian apples are expected to gain access to Japan in 1997, only the third region in the world to do so.

TRADE ASIA PROGRAM

During 1995-96, 12 companies participated in 'Trade Asia', a TDR program designed to introduce small to medium-sized manufacturers to key overseas markets. Trade Asia was designed for fresh and processed food companies and involved participation at selected major trade events under the 'Taste of Tasmania' banner. At Foodex 1996, Japan's premier annual food exhibition, TDR assisted the six Tasmanian companies represented by preparing brochures in appropriate languages, products for display and sampling, media kits and press releases. TDR staff were also available to represent companies, handle sales inquiries and follow-up sales leads and appointments after the exhibition.

TRADE MISSIONS

Since 1994, the Tasmanian Premier and senior government ministers have led regular trade missions to Japan. These aim to improve market access for Tasmanian companies, enhance existing business partnerships and develop new relationships. The active participation of leaders of companies with strong export prospects is an important element of these missions. Austrade offices in Japan assist by providing market research, facilitating trade exhibitions and promotions, interpreting and translating, and scheduling itineraries and appointments.

These missions typically include meetings with senior Japanese trade officials to discuss progress on particular market access issues, such as quarantine restrictions. The Premier and government representatives also visit principle customers of Tasmanian companies. This is an important tactic for creating a positive image of Tasmania and developing business relationships and distribution agreements.

THE KEYS TO TASMANIA'S SUCCESS

Tasmania's market-driven food export strategy is paying dividends and, as a result, is being used for other markets, such as Taiwan and Hong Kong. According to Tasmania's experience, success in Japan depends on:

- product consistency: Japanese consumer expectations are exacting. It may take up to three years of demonstrating consistent and reliable product quality before Japanese buyers place their first order. Packaging issues, such as size, weight, product seals and opening mechanisms, require close attention
- market visits: many Japanese companies will not sign contracts without personally meeting counterparts. Japanese companies often return the visit as a sign of goodwill and relationship building
- ongoing communication: close contact with customers and distributors is a key to success. During contractual negotiations, communication is often on a daily basis
- trade promotions: These are important for market research and relationship building and are good introduction to marketplace dynamics, particularly if sourcing a distributor, agent or market representative
- product volume: Tasmanian companies often find it difficult to achieve the critical mass of product required to win orders in Japan. Sizeable product volume is also important to reduce shipping and production costs
- dealing direct: selling direct to retailers and wholesalers (rather than through a trading house) often increases sales volumes and profit margins. It also makes it easier for companies to establish their own brand. However, some companies have attempted to make direct contact, only to be referred back to a particular trading house
- strategic alliances: such alliances have greatly assisted some Tasmanian companies to gain market acceptance and have even guaranteed demand for their products.

REFERENCES

Austrade, 1997, *Investment Promotion and Facilitation Program*, Austrade Statistics, Canberra.

Australian Bureau of Agricultural and Resource Economics (ABARE), 1988, *Japanese Agricultural Policies - a Time of Change*, Policy Monograph No. 3, ABARE, Canberra.

____ and Department of Foreign Affairs and Trade 1996, *Food Security: An Historical Perspective*, ABARE, Canberra.

Australian Rice Growers Cooperative, 1996, East Asia Analytical Unit interview, Leeton.

Boonekamp, L., 1995, *Agriculture in Japan: Current Issues and Possible Implications of the Uruguay Round Agreement*, National Research Institute of Agricultural Economics, Ministry of Agriculture, Forestry and Fisheries, Tokyo.

Department of Foreign Affairs and Trade, 1997, STARS data base, DFAT, Canberra.

Financial Review, various issues.

Financial Times, various issues.

General Agreement on Tariffs and Trade (GATT), 1995, *Trade Policy Review Mechanism Japan - Report by the Secretariat*, GATT, Geneva.

George-Mulgan, A., 1996, 'Political Restructuring in Japan: The Changing Context of Agrarian Power', forthcoming in *Political Studies*.

Hankyu Department Store, 1996, East Asia Analytical Unit interview, Osaka.

Japan Productivity Centre for Socioeconomic Development, 1995, *International Comparison of Labour Productivity*, Japan Productivity Centre for Socioeconomic Development, Tokyo.

Japan External Trade Organisation (JETRO), 1995, *Statistics of Japan's Food Imports - 1995*, AG-59, Japan External Trade Organisation, Tokyo.

____ 1994, *Statistics of Japan's Food Imports - 1994*, AG-56, Japan External Trade Organisation, Tokyo.

Johnson, D.G., 1995, 'Agricultural Trade Liberalisation and the APEC Process', *Journal of Northeast Asian Studies*, Vol. 14, No. 4, Winter.

Management and Coordination Agency, 1996, *Japan Statistical Yearbook 1996*, Management and Coordination Agency Statistics Bureau, Tokyo.

Ministry of Agriculture, Forestry and Fisheries (MAFF), 1997a, *Japan's Food Balance Sheets*, Ministry of Agriculture, Forestry and Fisheries, Tokyo.

____ 1997b, *Summary of the Annual Report on Japanese Agriculture*, *FY1996 - Food Agriculture and Rural Communities in the Changing Life of the Nation*, Provisional Translation, Ministry of Agriculture, Forestry and Fisheries, Tokyo.

____ 1996a, EAAU interview, Tokyo.

____ 1996b, *Poketto Norinsuisan Tokei [Pocket Agricultural, Forestry and Fisheries Statistics]*, Ministry of Agriculture, Forestry and Fisheries Statistics and Information Bureau, Tokyo.

____ 1996c, 'The Long-Term Prospects for Demand and Production of Agricultural Products', *Japan's Agricultural Review*, Vol. 25, March.

____ 1996d, *The 71st Statistical Yearbook of MAFF - Japan 1994-95*, Statistics and Information Department, Tokyo Association of Agriculture and Forestry Statistics, Tokyo.

____ 1995, *An Outline of the Staple Food Law - The Law for Stabilisation of Supply-Demand and Price of Staple Food*, Ministry of Agriculture, Forestry and Fisheries, Tokyo.

____ 1994, 'The Direction of Policy Development in Japanese Agriculture in a New International Environment', *Japan's Agricultural Review*, Vol. 23, October.

____ 1992, 'The Basic Direction of New Policies for Food, Agriculture and Rural Areas', *Japan's Agricultural Review*, Vol. 21, Ministry of Agriculture, November.

Nikkei Weekly, various issues.

Nikko Research Centre, 1996, *Analysis of Japanese Industries for Investors 1996*, Nikko Research Centre, Tokyo.

Organisation for Economic Cooperation and Development (OECD), 1996, *Agricultural Policies, Markets and Trade in OECD Countries - Monitoring and Outlook in 1996*, Organisation for Economic Cooperation and Development, Paris.

Ohmae, K., 1995, *The End of the Nation State - The Rise of the Regional Economies*, Harper Collins, London.

Premium Chestnuts Australia, 1997, East Asia Analytical Unit interview, Canberra.

Queensland Department of Primary Industries, 1997, *No Time for Complacency - Citrus Leads the Way*, Queensland Department of Primary Industries, Brisbane.

Tasmania Development and Resources, 1997, *Tasmania's Food Export Strategy to Japan*, Case Study, Tasmania Development and Resources, Hobart.

FURTHER READING

Komiya, R., 1996, 'APEC as Seen from the Eyes of a Japanese Economist', International Economics Association Roundtable Conference: International Trade Policy in the Pacific Rim, Sydney, 15-17 July.

Organisation for Economic Cooperation and Development (OECD), 1995, *Agricultural Policy Reform and Adjustment in Japan*, Organisation for Economic Cooperation and Development, Paris.

Chapter 12

THE ENERGY SECTOR

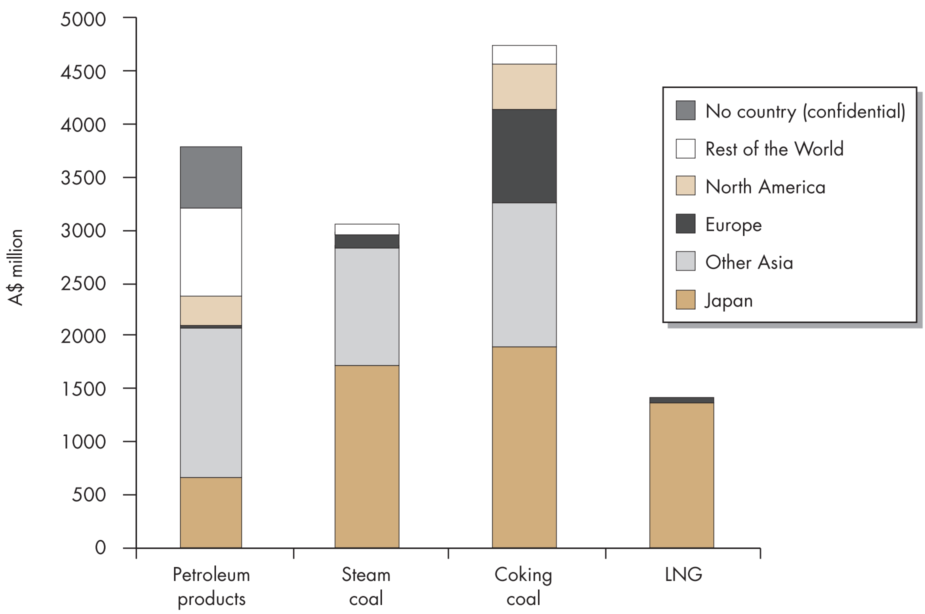
Japan is by far the largest market for Australia's energy exports, taking 42 per cent in 1996, including 46 per cent of coal exports and virtually all liquefied natural gas, LNG, exports (Figure 12.1). Australia also supplies much of Japan's energy imports; 56 per cent of Japan's coal imports and 15 per cent of Japan's LNG imports.

In recent decades Australia has helped meet Japan's growing energy demand and reduce Japan's heavy reliance on Middle Eastern oil. While rapid growth in energy exports to other Asian markets will see Japan's share of Australia's energy exports decline, Japan will still remain a very important market for the foreseeable future.

Figure 12.1

Japan Is Australia's Major Energy Market

Value of Australia's Energy Exports, by Destination, 1996



Source: Australian Bureau of Agricultural and Resource Economics, 1997.

One key factor influencing energy supply and demand will be Japan's energy policies, summarised as 'the three E's':

- energy security
- economic efficiency
- environmental concerns (Ministry of International Trade and Industry/Agency of Natural Resources and Energy, 1996).

While energy security remains a cornerstone of Japanese energy policy, two new influences are Japan's commitment to reduce greenhouse gas emissions and deregulation of energy markets to reduce energy costs. The process of deregulation is in its early stages; some major reforms were implemented during 1996.

These changes will create new opportunities and challenges for energy exporters like Australia. This chapter will review recent and expected changes in the structure of energy supply and demand, then examine the implications of these new policies.

ENERGY DEMAND AND SUPPLY OUTLOOK

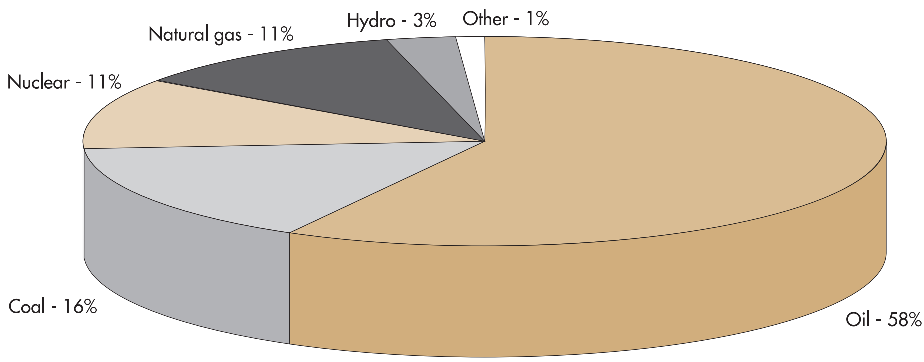
Japan is the fourth largest energy consumer in the world, after the USA, Russia and China but the largest energy importer. It lacks indigenous energy resources and depends on imports to meet over 80 per cent of its total energy needs. While oil remains the major form of primary energy consumed, over the last decade, gas and nuclear energy have increased their share at oil's expense (Figure 12.2). Oil also dominates final energy consumption (Figure 12.3).

Although the manufacturing sector dominates as a final energy user, its share has declined markedly since the 1970s (Figure 12.4). This is primarily a result of the improved energy efficiency of manufacturing (Figure 12.10) and, more importantly, a shift to less energy-intensive industries.

Figure 12.2

Oil Still Dominates Primary Energy Market

Total Primary Energy Consumption, by Fuel, 1994

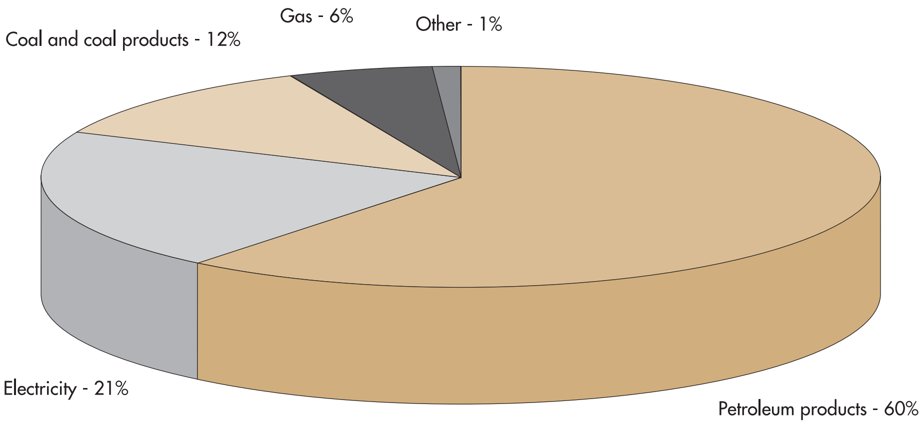


Source: Institute of Energy Economics, Japan, 1996, p. 18.

Figure 12.3

Continuing Oil Dependence

Final Energy Consumption, by Fuel, 1994

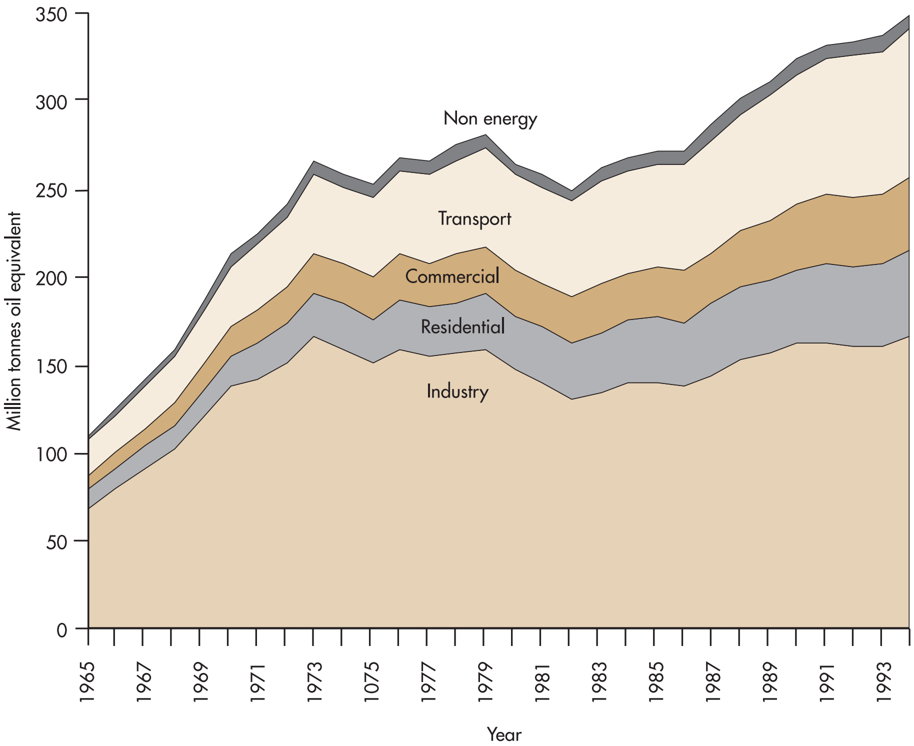


Source: Institute of Energy Economics, Japan, 1996, p. 18.

Figure 12.4

Manufacturing Main Consumer

Total Energy Consumption, by Sector, 1965 to 1994 (Million Tonnes of Oil Equivalent)



Note: Nonenergy consumption includes lubricants, greases, bitumen and solvents.

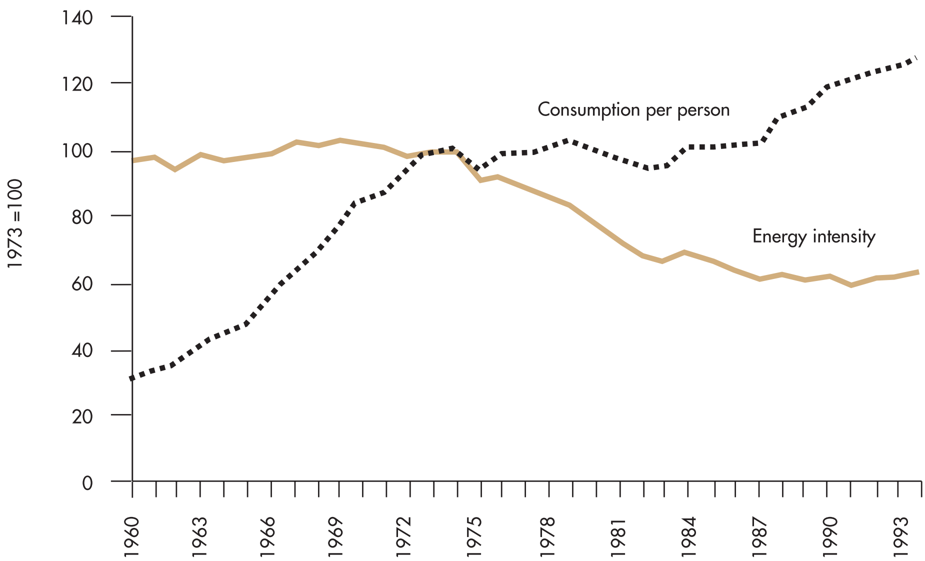
Source: Institute of Energy Economics, Japan, 1996, p. 18.

These factors have produced a steady decline in Japan's energy intensity, the amount of energy consumed per unit of gross domestic product which is now among the lowest in the developed world (Figure 12.5). However, during the 1980s energy intensity levelled off but since 1990 has begun to increase marginally.

Figure 12.5

Energy Consumption Per Capita Rising

Energy Intensity and Consumption Per Person, 1960 to 1994



Source: Institute of Energy Economics, Japan, 1996.

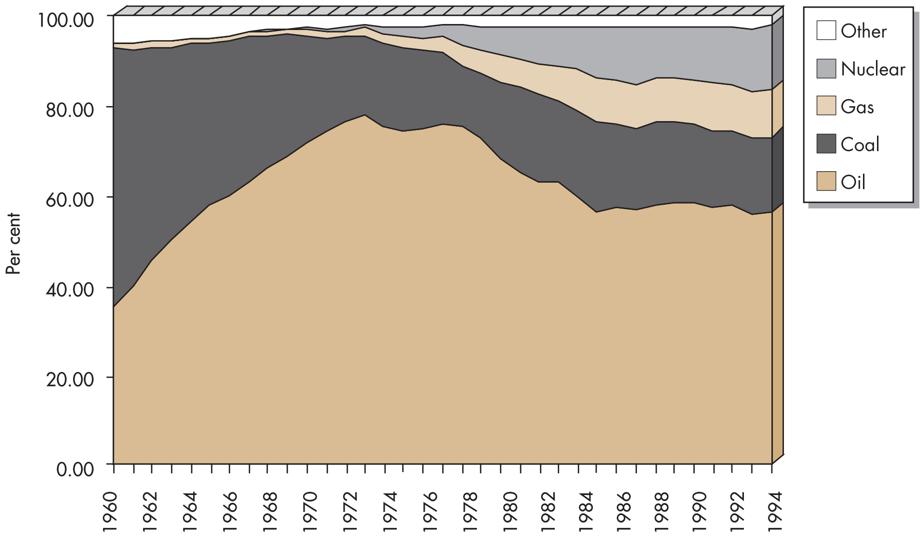
Per capita energy consumption has risen continuously due to increased per capita production and to higher living standards increasing demand for household appliances and air conditioning. In the transport sector, more passenger vehicles per capita, increased traffic congestion and more recently, larger, more luxurious vehicles contribute to this trend.

The energy mix has changed considerably since the 1970s, a result of the significant effort to shift out of oil to alternative fuels, largely gas, coal and nuclear power after the oil price shocks (Figure 12.6).

Figure 12.6

Oil's Share Stabilises

Shares in Total Primary Energy Consumption, 1960 to 1994



Source: Institute of Energy Economics, Japan, 1996.

Oil

After the oil price shock, Japan increased nonoil electricity generating capacity, eventually facilitating a significant fall in oil imports. Since the mid-1980s, however, oil imports have increased steadily as oil prices stabilised, then declined.

While Japan seeks to reduce the proportion of its oil imports coming from OPEC countries, they still supply 75 per cent of Japanese oil imports.

Gas

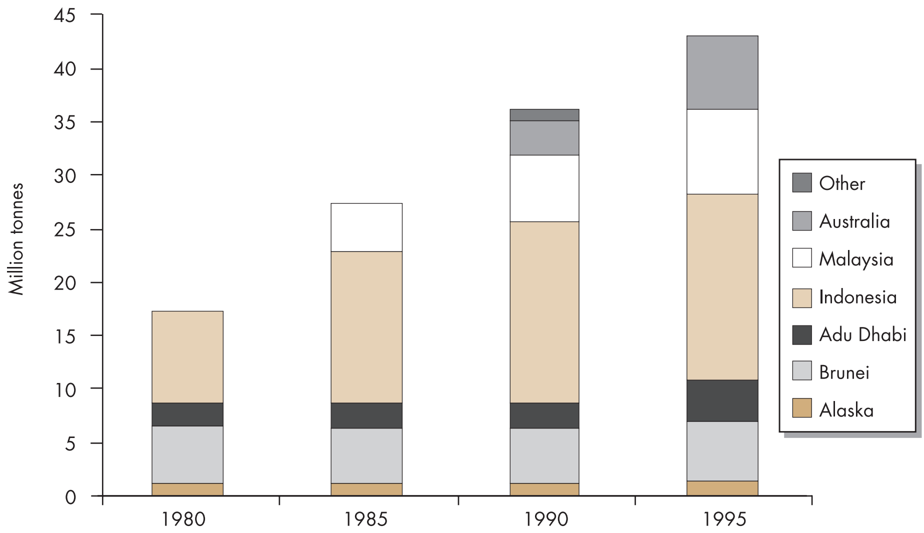
Japan sources the bulk of its gas requirements, including LNG, from competitive suppliers in the Asian region; Indonesia is the largest source (Figure 12.7). Since the North West Shelf project off northern Western Australia started production in the late 1980s, Australia has increased dramatically its gas exports to Japan. In 1996, Australia supplied 16 per cent of Japanese gas imports.

As a result of Japan's oil substitution strategy, imports of liquefied petroleum gas (LPG) have grown strongly over the past few decades. By 1994, imports represented 75 per cent of Japan's total LPG requirements.

Figure 12.7

Australia's Gas Exports Rising

Japan's Gas Imports by Source Country, 1980 to 1994 (Million Tonnes)



Source: Institute of Energy Economics, Japan, 1996.

Coal

With only minimal domestic coal production, Japan imports around 95 per cent of its total coal requirements. Japan therefore consumes imported coal for much of its electricity generation and steel making. In 1995, Japan imported 65 million tonnes of coking coal and 59 million tonnes of steaming coal (Institute of Energy Economics, Japan, 1996).

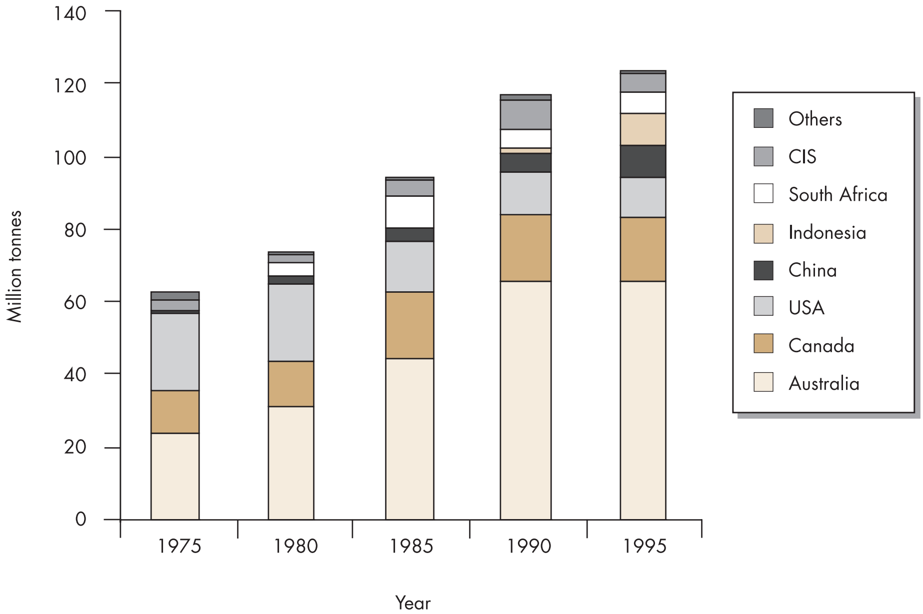
Japan's steaming coal consumption rose very rapidly after the first oil shock because steaming coal was substituted for oil to generate electricity and produce cement. Over the past 25 years, coking coal imports also have expanded in line with demand for steel products due to economic growth in the region. Australia's cost advantage over key competitors including the USA and Canada, makes it the dominant coal supplier to Japan, accounting for over half of total imports (Figure 12.8).

However, recent entrants into the Japanese coal market, such as Indonesia and China, can export high quality coal, with high calorific value and a low ash content, at a lower landed cost than Australian coal. (See box.)

Figure 12.8

Australia Still Dominant Coal Exporter

Japan's Coal Imports by Source Country (Million Tonnes)



Source: Australian Bureau of Agricultural and Resource Economics, 1996.

Electricity and Nuclear Power

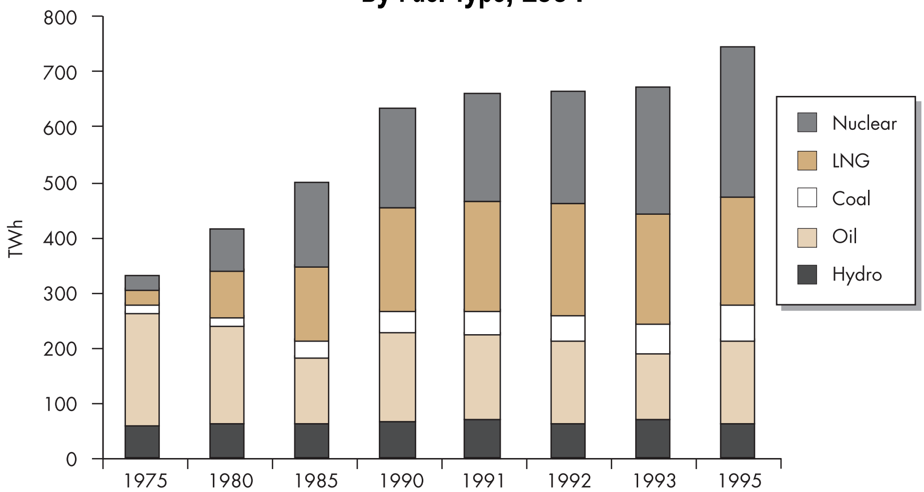
The installed capacity of Japan's ten electricity utilities has nearly doubled since 1975 and fuel shares have changed significantly (Figure 12.9). These utilities hold 90 per cent of the 221 gigawatts of installed electricity capacity (Institute of Energy Economics [IEA], 1996; Ministry of International Trade and Industry/Agency of Natural Resources and Energy [MITI/ANRE], 1996); the rest is supplied by automakers. While the absolute level of oil fired capacity has remained fairly constant, its share has declined dramatically from 63 per cent in 1975 to 20 per cent by 1995, with other fuels, particularly LNG and nuclear generation, taking up its share.

In line with its policy of decreasing oil dependency, the Government has banned the construction of new oil fired power plants. However, since oil prices have been relatively low over the last few years, oil is still extensively used to satisfy peak demand. Oil fired generation often replaces hydroelectric generation during droughts; this occurred during the Japanese summer of 1995.

Figure 12.9

Non-Oil Generation Steadily Growing

Electricity Generation of the Ten Major Electric Utilities By Fuel Type, 1994



Note: Twh: tera watt hours, 10^{12}KWH.

Source: Australian Bureau of Agricultural and Resource Economics, 1996.

On the other hand, gas, coal and nuclear power generation have grown significantly over the last 20 years. Gas fired electricity generation is emerging predominantly as a consequence of growing environmental concerns, greater availability of LNG and the government's fuel diversification policies. While coal use has grown at an average annual rate of over 11 per cent since 1980, it still only generates about 9 per cent of electricity. Coal is an economical fuel; it has a secure and stable supply with an established international market; and it is abundant in the Asia Pacific region. However, environmental concerns constrain demand growth.

Nuclear power increased from around 5 per cent in total electricity generation in the early 1970s to 37 per cent in 1995. This rapid growth is largely attributed to the oil shocks of the 1970s and is the key element in the Government's strategy to increase energy security, displace oil, and address carbon dioxide emissions (International Energy Agency [IEA], 1995a).

New and Renewable Energy

Hydropower contributed about 2.5 per cent of total primary energy supply and 8 per cent of electricity production in 1995. New energy forms (including geothermal) accounted for 1.2 per cent of total supply in 1994. The Japanese Government is keen to develop new and renewable energy sources, particularly to meet future electricity demand. Strategies, such as the Sunshine Program, promote new energy technologies, including solar photovoltaic, fuel cells, wind power, waste heat systems and alternative fuel vehicles. Despite major research and development efforts and a variety of financial incentives, the relatively high costs (given the falling real prices for conventional fuels) remain a major obstacle to the wider introduction and use of these energy sources.

MAJOR INFLUENCES ON DEMAND AND SUPPLY

Key factors determining energy demand and supply are:

- government energy policies, including supply diversification
- industrial restructuring
- economic and population growth
- changes in relative fuel prices
- market deregulation
- environmental concerns
- technological developments
- competitiveness of new suppliers.

Anticipated changes in each of these areas will be discussed briefly below.

Government Energy Policies

The key aspects of the government's vigorous energy policy, developed after the 1970s oil price shocks, are energy conservation, and supply security and diversity. Policy mechanisms include subsidising loans for investments in fuel switching and conservation, providing grants for private sector research and development in these areas, ensuring rigorous regulations govern vehicle, appliance and building efficiency, and administering direction and cooperation between government and industry to set energy conservation goals.

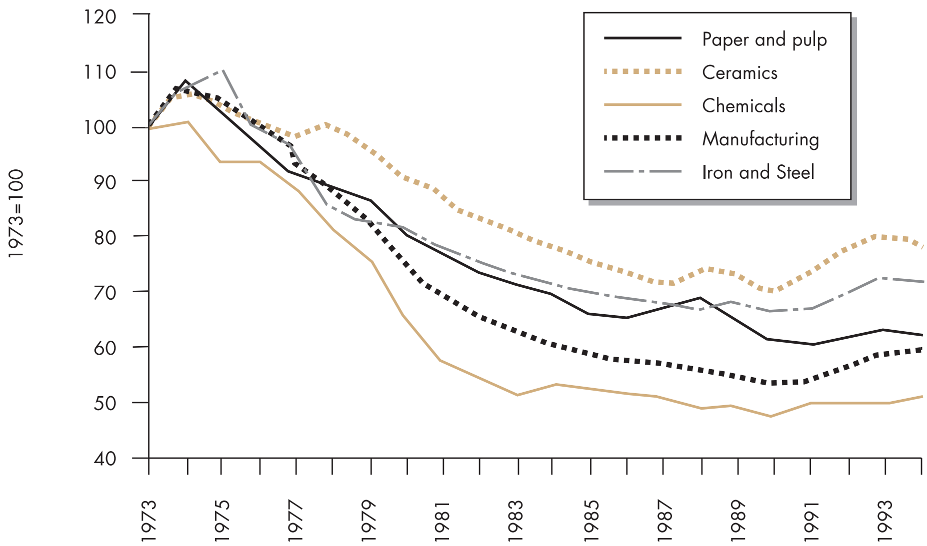
In 1993, many energy conservation measures were strengthened and new legislation emphasised emissions control, efficiency standards and fuel diversification. Major investments in conservation and restructuring in energy intensive industries are almost complete (Figure 12.10) and future, more modest, energy savings should be achieved by combining new technology and improving operating practices (IEA, 1995a).

The Japanese Government has pursued vigorously strategies to diversify supply because of Japan's perceived vulnerability, due to its dependence on energy imports, and these policies should continue to affect fuel import shares. Supply diversification involves strategically allocating market shares between competing suppliers to maximise the security of supply and to assist buyers in influencing market outcomes, particularly prices, to their advantage. Such strategies are employed successfully, not only to oil, but also to coal and LNG. However, the pressures of maintaining Japan's export competitiveness will ensure that the costs and benefits of this policy will be subject to continuing scrutiny.

Figure 12.10

Energy Efficiency Gains Stabilised in 1990s

Energy Consumption per Unit of Production
Selected Industries, 1973 to 1994



Source: Australian Bureau of Agricultural and Resource Economics, 1996.

The use of supply diversification strategies to influence price outcomes is particularly prevalent in Japan's coal trade. Despite the lower price and higher quality of Australian coal (US$48.87 per tonne, cif, in 1995), Japan still buys coal from other countries, such as the USA, at a much higher cost (US$52.65 per tonne).

Japan also ensures both supply security and price by assuming equity interests in mines and transport infrastructure. For example, Japanese owned interests account for approximately 17 per cent of Australia coal production (Taylor, 1994).

Supply diversification also affects the source of gas imports to Japan. Japanese gas buyers have become equity investors to ensure the availability of supplies and prevent producers entering long-term commitments with competing regional buyers, particularly the Republic of Korea and Taiwan.

Industrial Restructuring

The 1970s oil shocks caused a major restructuring of Japanese industry. Established in an era of low oil prices and stable supply, postwar industry was dominated by energy intensive, export oriented basic industry. Higher energy prices (and expected rises) resulted in a significant shift out of such industries. This restructuring was assisted by a range of government subsidies. By the early 1980s, high value added, knowledge and human capital intensive industries, such as electrical machinery, precision instruments and motor vehicles, became the major growth industries.

In the 1990s, the maturing Japanese economy, coupled with the appreciating yen and high labour costs, has begun to force offshore some domestic heavy industries, like iron and steel, and their customers (car and appliance makers). Nevertheless, early next century Japan and the European Union should export most of the gap between their projected steel consumption and production to Asian countries (Labson et al, 1994).

Income and Population Growth

Historical estimates over the past 30 years indicate that for every 1 per cent growth in GDP, Japan's energy consumption will increase by 0.3 to 0.35 per cent, (Daniel, 1995). However, the recent levelling off in energy intensity indicates that the relationship between energy consumption and economic growth may now be stronger than this historical estimate suggests. Population growth also significantly affects energy demand, particularly as energy consumption per person has increased 2.7 per cent per year over the last decade (Figure 12.5).

Energy Prices

In the 1990s, the steadily appreciating yen and declining oil prices reduced the inflation adjusted, yen-denominated price of oil to about the same as before the 1973 oil shock. However, the significantly decreased share of oil in total primary energy consumption (from 77 to 58 per cent from 1973 to 1995) was achieved by investing in more energy efficient production processes using alternative fuels, as a result of actual and expected oil price rises and volatility. In addition, government energy policies encouraged and subsidised the shift out of oil-fired capacity.

The price responsiveness of most energy forms increased during the 1980s in relation to the fuel mix of overall energy demand (Perkins, 1994). Both market forces and government energy policies increased willingness and capacity to shift between fuels, except for electricity which has become less price responsive. This trend is evident throughout developed countries where electricity increasingly is used in applications for which there are few acceptable substitute energies.

Over the long term, ABARE projects coal and gas prices will decline relative to other energy commodities, thus increasing their competitiveness in electricity generation (Fok and Donaldson, 1996; Stubbs, 1996). However, the marginal cost of electricity generation using different fuel types dictates its competitiveness, and the significantly lower capital costs of oil plants mean new oil is considerably cheaper than coal or LNG-fired power stations (Toichi, 1994).

As oil-fired facilities are gradually phased out, replacement facilities will be increasingly LNG-fired. However, the high capital costs of LNG plants mean LNG is really only competitive as a base load fuel.

An alternative peak load fuel is LPG. Although LPG is not a cheap fuel due to its handling and transport costs, its capital cost is relatively low: it is readily substituted in the rapid switching, peak load environment of oil-fired generation; and it has the same environmental advantages as LNG.

Environmental Concerns

Concerns about global environmental issues started to influence Japanese energy policies in the early 1990s and now form one of the cornerstones of Japan's energy policies (MITI/ANRE 1996).

To reduce fossil fuel consumption, Japan has adopted a target of stabilising total and per capita carbon dioxide emissions at 1990 levels by 2000. However, since 1990, total carbon dioxide emissions in Japan have increased by 1.8 per cent per year, while per capita emissions have increased by 1.5 per cent per year; this indicates this goal will be difficult to achieve.

If Japan does meet this stabilisation target, one analyst estimates electricity generation would fall 0.8 per cent and iron and steel output would drop 7.9 per cent. This would affect adversely Australia's energy exports to Japan, particularly of coking coal, and reduce significantly iron ore exports. However, real output is not expected to decline if fossil fuel emission targets are met because of off-setting uses in output in non-fossil fuel intensive sectors like services (Australian Bureau of Agricultural and Resource Economics, 1995). Policy tools include subsidies; tax credits and low interest loans; promotion of nuclear, LNG and hydro power; wind and fuel cell development; support for cogeneration; introduction of low emissions vehicles; and promotion of public transport (IEA, 1995a).

Environmental concerns also influence some specific industry policies, most notably coal. For example, the Japanese Government financially supports investment in clean coal technologies to reduce emissions of carbon dioxide, sulphur dioxide and nitrous oxide. Local government coal cleanliness requirements are rising, particularly for electricity generators.

The community is resisting increasingly the siting of new power stations, whether thermal or nuclear. In the case of nuclear power, the public reaction has been severe enough to slow the growth rate of the share of nuclear power in electricity generation. The implications for the energy supply outlook are discussed in the following section.

Technological Developments

Research and development of new technologies focus on efforts to increase fuel efficiency and reduce the environmental impact of production processes. Technological changes affecting the use of coal in steel production and electricity generation should affect dramatically energy demand over the medium to longer term.

In steel production, the increased use of electric arc furnaces (EAF), pulverised coal injection (PCI) and direct reduction production processes will reduce both the quality and quantity of coal required in Japan. EAFs use electricity to melt scrap steel to produce processed steel products, eliminating the need for coal and offering greater operational flexibility than integrated steel plants. Although the proportion of Japanese steel produced via EAF technologies increased from 25 per cent in 1980 to 32 per cent in 1995 (Labson et al, 1994), the high cost of Japanese electricity could moderate the growth of the EAF sector (Figure 12.12).

PCI reduces the quantity and quality of coal required to produce steel. The share of PCI coal to total coal used by Japanese steel mills should be around 24 per cent by 2001 (Manson et al, 1996).

The import share of steaming coal also will be influenced by technology changes to electricity generation, including researching power station design to optimise coal use efficiency, expanding the range of coal qualities used and minimising environmental impact (Australian Coal Research Ltd, 1996). For example, research on pressurised fluidised bed combustion may eventually reduce the coal quantity and quality required to produce a given output. However, the results of trial plants so far have been disappointing. These technological developments should reduce overall coal requirements and prices for higher quality coals.

Competitiveness of New Suppliers

WILL INDONESIA AND CHINA DISPLACE AUSTRALIA?

Indonesia's share of Japan's coal imports has expanded rapidly, from just 1 per cent in 1980 to 7 per cent in 1994. Indonesian coal has a high calorific value and low landed cost, indicating its potential to displace some of the market share of Australia (or possibly higher cost suppliers like the USA and Canada).

China's share of Japanese coal imports has also increased to almost 7 per cent. China is the world's largest producer of hard coal, producing 1 360 million tonnes in 1995 compared to Australia's production of 193 million tonnes in the same year. China is obviously a major potential player. Ongoing energy price reforms will improve the Chinese economy's relatively low energy efficiency and could free up more coal for export. Productivity improvements in the coal and transport sectors could lower China's costs relative to other producers and significantly increase export potential (Feng et al, 1996, p. 13). The ability of Chinese coal to compete for export markets may be constrained by its lower energy and higher sulphur content compared to Australian coal, although additional washing procedures could address this problem.

The high transport costs of bringing coal from China's northern coal fields to China's rapidly growing south eastern coastal zone may result in coal being exported from the north of China into Japan and the Republic of Korea, and being imported into the south of China from Australia, inter alia (East Asia Analytical Unit, 1995).

Indonesia's dominance of Japan's LNG market appears to have peaked, at least temporarily. By 1994, Indonesia's LNG exports to Japan had risen to 18.5 million tonnes (44 per cent of Japan's LNG imports), up from 8.7 million tonnes in 1980. In 1995 and 1996 these exports had eased to 17.3 and 18.5 million tonnes respectively, around 40 per cent of Japan's market for LNG. Japan is engaged in long term baseload contracts with existing LNG facilities in Indonesia, Malaysia, Brunei, Australia and Abu Dhabi for up to the next 20 years (Wawn et al, 1996, p. 16). In addition, Japan appears prepared to ensure secure supplies by signing contracts with greenfield projects, including in Qatar, Oman, Alaska and Yemen that are more expensive than Indonesian or Australian supplies (Raschke, 1995).

LONG-TERM SUPPLY AND DEMAND OUTLOOK

After extensive consultations with energy users and producers, MITI prepares official Japanese forecasts of energy demand. While traditionally these outlooks encouraged energy conservation and fuel switching, they currently have less influence because of low and stable energy prices and energy sector deregulation. Alternative forecasts are prepared by the Institute for Energy Economics, Japan (IEEJ). In this section, both sets of forecasts are presented and evaluated. Both MITI and IEEJ forecast Japan's final energy demand will grow steadily in the medium and long term, although the magnitudes differ considerably (Table 12.1). Most of the divergence in the two agencies' short term forecasts is explained by MITI's unrealistically low assumption regarding the responsiveness of energy consumption to a 1 per cent change in income up to 2000, just 0.27 per cent, compared with 0.58 per cent assumed by the IEEJ (*International Coal Report*, 23 July 1996, p. 7). Between 2000 and 2010, MITI assumes responsiveness is significantly higher, at 0.35, compared to the IEEJ forecast of 0.56. The IEEJ forecasts therefore appear more realistic.

Table 12.1

Alternative Energy Demand Growth Scenarios

Final Energy Demand Forecasts, Growth to 2015

Source	Period	Base case per cent per year	Additional measures per cent per year
Ministry of International Trade and industry [a]	1994-2000	0.8	0.5
	2000-2010	1.3	0.9
Institute of Energy Economics, Japan [b]	1994-2005	1.5	na
	2005-2015	0.9	na

Notes: a. Economic growth assumed to be 3.0 per cent per year to 2000, then 2.5 per cent per year from 2000 to 2010.
b. Economic growth assumed to be 2.5 per cent per year to 2005, then 1.9 per cent per year from 2005 to 2015.

Source: Ministry of International Trade and Industry/Agency of Natural Resources and Energy, 1996; Kibune and Kudo, 1996.

Both forecasts also anticipate that the share of industry in final energy demand will continue to decline and that of the residential and transport sectors will grow (Table 12.2).

Table 12.2

Industrial Energy Use Set to Fall

Forecast Sectoral Shares in Final Energy Demand

Sector	Share in: 1994 (actual) per cent	2010 (MITI) per cent	2010 (IEEJ) per cent	2015 (IEEJ) per cent
Industry	47.6	46.0	42.2	41.2
Residential / Commercial	25.8	30.5	30.2	31.4
Transport	24.2	23.5	25.1	25.3
Other	2.4	0	2.5	2.1
Total	100.0	100.0	100.0	100.0

Source: Ministry of International Trade and Industry / Agency of Natural Resources and Energy, 1996; Kibune and Kudo, 1996.

Fuel Mix Forecasts

Forecasts of the fuel mix of final energy demand have not been publicly released by MITI. However, the IEEJ projects that the use of gas and electricity will increase at the expense of oil and coal, continuing the trends observed in the early 1990s (Table 12.3).

Table 12.3

Oil and Coal Shares Set to Fall

IEEJ Forecast Fuel Shares in Final Energy Consumption

Fuel	Share in: 1994 (actual) per cent	2005 per cent	2015 per cent
Oil	60.8	59.2	57.6
Coal	11.5	9.5	8.1
Gas	5.5	7.2	8.4
Electricity	21.0	22.9	24.7
Other	1.3	1.1	1.1
Total	100.0	100.0	100.0

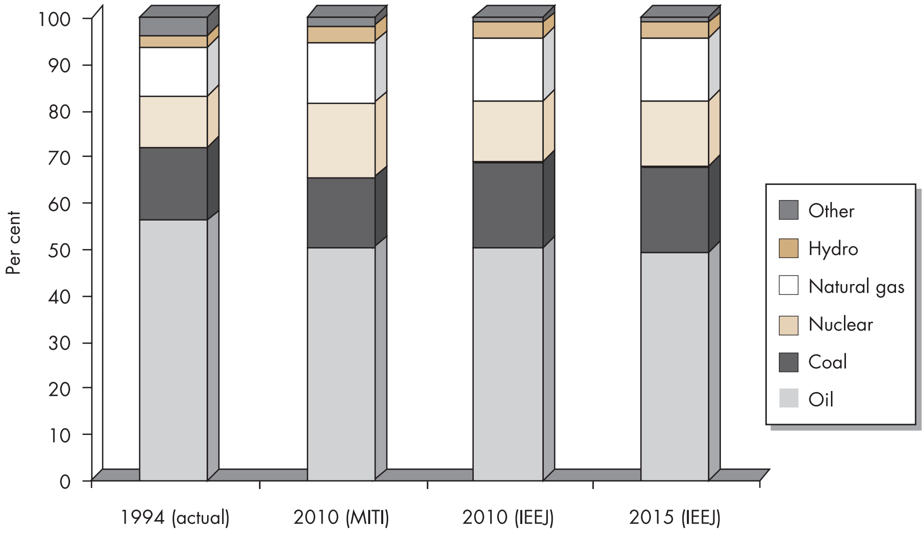
Source: Kibune and Kudo (1996, p. 56)

MITI and the IEEJ also prepare alternative forecasts of the total level and fuel mix of primary energy supply which mirror those for end use demand (Figure 12.11). Once again, MITI forecasts a larger drop in fossil fuels' share and a higher growth in nuclear power's share than the IEEJ.

Figure 12.11

Oil's Share Will Fall; Nuclear and Gas Will Rise

Forecast Fuel Shares in Total Primary Energy Supply



Source: Ministry of International Trade and Industry/Agency of Natural Resources and Energy, 1996; Kibune and Kudo, 1996.

Nuclear

The Japanese Government intends nuclear power should constitute 40 per cent of total electricity generation by 2010, up from 31 per cent in 1995 (IEA, 1995a). This will require the construction of 18 to 23 additional nuclear power stations to complement the 49 existing ones. However, significant community opposition makes this planned rate of expansion almost certainly overly optimistic (Hagan, 1996).

Gas

Both MITI and the IEEJ expect LNG to contribute more to primary energy supply in future, mainly due to its use in multifuel power stations, its higher thermal efficiency relative to other conventional fuels and its relatively low levels of greenhouse gas emissions. Given the emerging problems with the expansion of nuclear capacity, LNG may play an even greater role in meeting electricity production requirements, subject to infrastructure constraints.

Piped gas from Asia could displace imports of LNG. LNG tankers are more cost effective than pipelines for transporting gas over long distances. If, however, gas were found in commercial quantities in the region for example, in the East China Sea or the Sakhalin Islands (off Pacific Russia), then this would increase significantly the prospects for gas being piped directly to Japan. A number of Japanese multinational companies involved in oil and gas production have entered into an agreement with Russia to develop the Sakhalin oil and gas fields.[1]

Coal

While MITI expects the share of coal in total primary energy supply to diminish in the longer term, IEEJ projects that its share will actually increase. This divergence is primarily due to the projected rate of nuclear power growth. Both agencies concur that the technological developments in steel production will reduce the demand for coking coal. This trend should accelerate early next century as the steel industry replaces obsolete coke ovens and blast furnaces with coal saving technologies.

Oil

Both sets of forecasts project that the share of oil in total primary energy supply will continue to decline, from 57 per cent in 1994 to around 50 per cent in 2010, mainly due to a further halving of oil's contribution to electricity generation.

However, if oil real prices remain low and stable (as ABARE forecasts suggest), the share of oil may not decline so steeply. In addition, deregulation of the oil, gas and electricity markets will influence relative fuel prices and the fuel mix.

In summary, growth in energy demand in Japan may be stronger than officially forecast by MITI. Income and population growth will drive demand growth, creating less scope for further energy efficiency gains. However, further hollowing out of industry may be expected, possibly including parts of the energy intensive iron and steel sector if some new plants follow steel customers offshore. On the other hand, the industry may instead export more of its output to these and other growing steel markets. Energy demand by the residential, commercial and transport sectors is therefore likely to dominate the future pattern of Japanese energy use, as a result of 'post-industrial' lifestyle changes and increased commercial activity. A commitment to meet greenhouse gas emission targets may also lead to measures being imposed to reduce energy consumption, offsetting the stronger demand growth from these sectors.

The shares of nuclear power and gas in the fuel mix of primary energy supply will continue to grow at the expense of oil, and possibly coal, although the extent and pace of this restructuring is uncertain.

REGULATORY ENVIRONMENT AND ENERGY POLICIES

With many major competitors and trading partners deregulating their petroleum, electricity and gas markets, Japan has come under pressure to liberalise its energy markets. In each of the major energy markets, government involvement and deregulation proposals are assessed in order to identify implications for Australia.

1 However, the well head price of Sakhalin gas is expected to be several times higher than other currently operating and potential new gas sources (BHP briefing, Canberra, August 96). Furthermore sensitivities regarding foreign exploitation of domestic energy resources could slow approval for the project from Moscow (East Asia Analytical Unit, 1996). In 1997 some progress was made on Sakhalin development.

Electricity Supply Industry

The Japanese Government represented by MITI has played a major role in the electricity supply industry, controlling market entry and exit, regulating tariffs, influencing fuel choice, implementing safety regulations and monitoring investment planning (Hayashi, 1992).

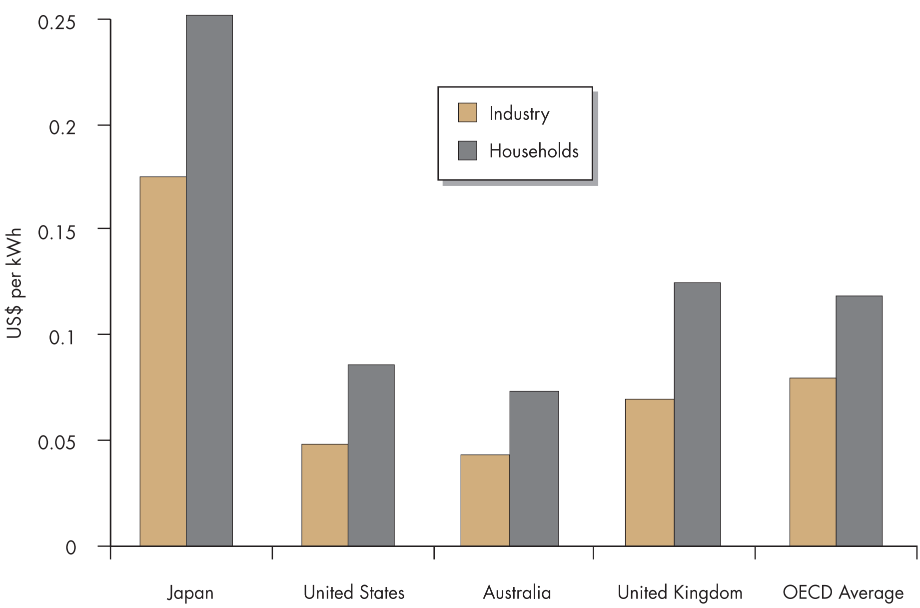
Ten privately owned and operated, vertically integrated power companies representing the major regions dominate the electricity supply industry.[2] Each electricity utility generates, transmits and distributes electricity and monopolises electricity supply in its designated service area.

There is little to motivate the utilities to reduce their costs, as tariffs are determined by a fair-rate-of-return on investment formulae (cost plus pricing) with regulatory control resting with MITI. As a result, Japanese electricity is very expensive compared to other developed economies (Figure 12.12). It is more than US$0.10 per kilowatt higher than the average tariffs in Asian economies (*Power in Asia*, 1996).

Figure 12.12

Tariffs Very High

Electricity Prices for Industry and Households, 1994



Source: International Energy Agency, 1995b.

---

2 Hokkaido, Tohoku, Tokyo, Chubu, Hokuriku, Kansai, Chugoku, Shikoku, Kyushu and Okinawa.

Electricity Industry Deregulation

Amendments to the Electricity Utility Industry Law in 1995 were designed to promote competition through the limited lifting of barriers to entry of independent power producers (IPPs). They were also designed to encourage cost efficiency by improving price regulation and rationalising safety regulations.

A bidding and tender system was introduced so that the general electric utilities will in future procure a (still small) proportion of power resources from independent producers and access to transmission grids (wholesale wheeling) will be introduced, allowing new suppliers to enter the market using the transmission lines owned by the existing utilities. Wholesale suppliers in the service area of a given general electric utility now can supply their output directly to others and power producers with transmission capacity must publish their wheeling conditions and provide access to other producers (MITI/ANRE, 1996).

Since the amendments were adopted, six of the ten regional companies have announced they will issue solicitations for around 2 650 MW of long term power supply to IPPs, with deliveries between 1999 and 2002. However, even if all the IPPs go to plan, by 2002, they will still generate less than 1.5 per cent of total 1994 installed electricity generating capacity.

Industries with in-house generating capacity and existing infrastructure are the most likely potential entrants to the electricity supply industry. Gas and coal are likely to be the preferred fuels of IPPs.

In the long term, liberalisation of the Japanese electricity market is expected to reduce electricity costs, and therefore prices, increasing demand for stable and competitively priced fuel supplies. Australia needs to maintain its close relationship with Japan as a reliable supplier of relatively low cost coal and LNG to take advantage of the opportunities emerging with deregulation.

Natural Gas Industry

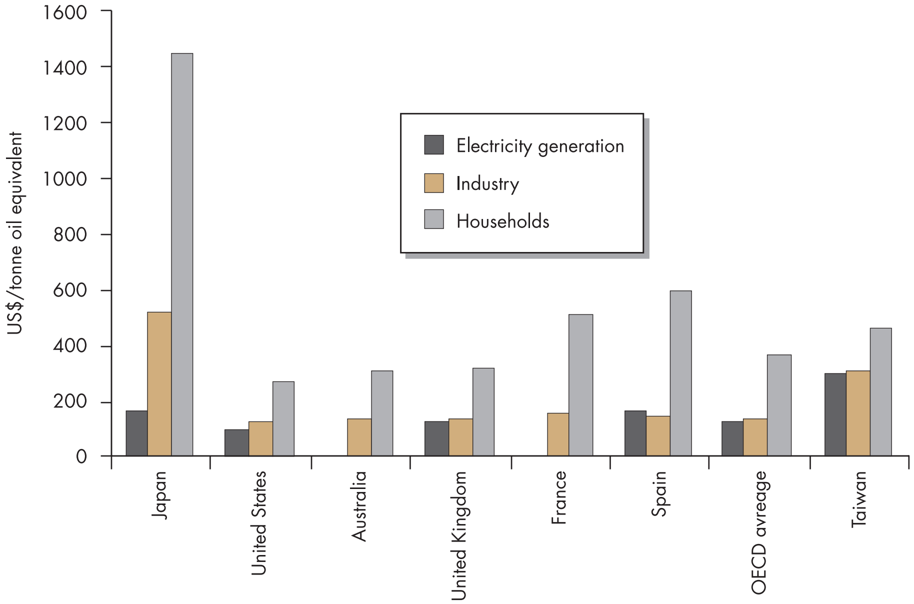
The Japanese natural gas industry traditionally has been subject to similar tariff formula, entry regulations and monopoly supply rights for vertically integrated suppliers as the electricity industry. Limited market competition has resulted in extremely high gas tariffs by international standards (Figure 12.13).

An absence of locally piped natural gas supplies cannot be blamed for these high tariffs, because while industrial and household tariffs are well above those in other countries, prices of gas for electricity generation are in line with international levels. This is presumably because the electricity utilities buy LNG directly from exporters (five electricity utilities have contracts with Australian LNG suppliers) while industrial and household consumers must buy their gas from the utilities.

Figure 12.13

Japan Has High-Cost Gas

Natural Gas Prices, 1994



Note: toe: tonnes of oil equivalent. Prices are on a net calorific value basis.
Source: International Energy Agency, 1995b.

Natural Gas Market Reforms

The high price of natural gas put pressure on the government to deregulate the market and allow existing utilities and potential new entrants to compete. Lower gas prices should increase the use of gas.

The resulting 1995 amendments to the Gas Industry Utilities Law allow large gas buyers and sellers to negotiate directly and compete freely to secure the best terms for gas sales.[3] Existing and new suppliers will be allowed to supply gas directly to these large customers in any service area (MITI/ANRE, 1996). Arrangements for supply to small customers will remain unchanged and continue to be regulated by MITI.

While the reforms were only introduced in early 1996, by March two major gas suppliers had started to supply outside their previously authorised supply region, and an oil company had entered the market to supply gas. In addition, existing gas suppliers have signed over 600 individual contracts with large customers (MITI/ANRE, 1996).

However, at this stage no detailed policy prevents the major suppliers restricting access to their pipelines as a means of limiting competition from alternative suppliers. Australia, the UK, the USA and Canada have used various models to

[3] Defined as those with an annual demand of more than 2 million cubic metres.

overcome this problem, including strictly regulating pipeline access terms and conditions, and 'ring fencing' (or separating) pipeline and gas sales parts of vertically integrated enterprises. MITI has merely stated that existing vertically integrated suppliers should be 'encouraged' to offer gas transport services to new entrants (MITI/ANRE, 1996). However, the form of this encouragement and the likely impact on competition, prices and gas demand is unclear.

The extent to which competition intensifies, gas prices fall and demand rises also depends on the development of gas supply infrastructure. Only 20 per cent of Japan's urban areas are served by piped gas (*Gas World International*, 1995). The Japanese Government is expected to play a key role in providing financial assistance for gas infrastructure investment.

Petroleum Industry

Due to its sense of vulnerability from relying heavily on imported oil, the Japanese Government traditionally played a major role in the country's petroleum markets. Since the oil price shock in 1973 and the introduction of the emergency oil laws, the Government has increased its level of intervention, including imposing price controls and restrictions on oil product imports, controlling investment in refining capacity, restricting entry into petroleum retailing, and encouraging investment in offshore oil developments.

Japanese firms, with government assistance, participate in more than 100 oil exploration and production projects in 30 countries around the world, including large equity interests in 10 exploration projects in Australia.

The high price of Japanese petroleum and oil products largely reflects the high degree of protection in the Japanese market. The competitive position of Japanese manufacturing is thus being compromised by the high cost of energy inputs, creating pressure for deregulation of the market.

Petroleum Industry Reforms

The Tokuseki Law (repealed in April 1996) restricted the import of petroleum products to those with their own refining capacity and three months of storage facilities; however, the repeal should increase competition between domestic and imported refined products. Since the reforms were introduced, petrol prices have dropped by as much as 30 per cent for large customers and 5 per cent for retail buyers, pushing up petrol demand by 4 per cent (*Financial Review*, 2 December 1996, p. 12).

Measures are also being introduced to facilitate competition in the heavily regulated retail gasoline market. The Designated Area System, which limited the number of service stations in many areas has been relaxed and MITI's Petroleum Council has recommended that site restrictions be totally abolished by 1997. The Council also recommended that previously banned self-service petrol stations be trialed (Japan Petroleum and Energy Trends, 1994). These reforms are expected to cause a major rationalisation in the oil refining and distribution industries, with several refiners and up to 40 000 service stations disappearing (*Financial Review*, 2 December 1996, p. 12).

Coal Industry

In recent decades, in the domestic coal industry the Government has mainly focused on improving efficiency and guiding its downsizing, from 55 million tonnes in 1961 to under 7 million tonnes in 1994 (MITI/ANRE, 1996). Imports have provided all coking coal requirements since 1992. Remaining domestic production is steaming coal, used solely for electricity generation.

The industry's production costs are extremely high and the industry would have disappeared decades ago if market forces had been allowed to operate fully. They have not because the Government's coal plans have pursued a mix of regional income maintenance, employment and energy security objectives. Although all coal mines are privately owned, they receive substantial government subsidies paid for by a tax on crude oil and a toll on electricity (Daniel, 1995).

The new 10-year coal policy introduced in 1992 aims to secure stable coal imports, continue development of clean coal technologies and promote international cooperation in addressing coal related environmental concerns. Additional measures should facilitate more radical structural adjustment of the coal industry, including the phase out of subsidies in 2001 (IEA, 1995b).

Uranium

Japan's policy of developing nuclear power generating capacity to match and ultimately replace its oil-fired capacity has high priority since the oil shocks and more recent environmental concerns about greenhouse gas emissions.

In response to local resistance to the siting of new nuclear stations, MITI has encouraged electricity utilities to expand and improve the usage rates of existing reactors and to develop new ones which can use recycled fuel. In pursuit of the latter objective, Japan is promoting domestic uranium enrichment operations and an independent recycling program (despite current surplus global capacity).

Japan also continues to ensure supply security for conventional uranium fuels through long term contracts with suppliers in Canada, UK and Australia, and promote exploration and development activity.

IMPLICATIONS FOR ENERGY DEMAND AND SUPPLY

Energy policy changes, shifts in the type and source of fuel mix, and changes in the bargaining power of energy buyers and sellers due to deregulation all will influence future energy supply and demand, with implications for Australia.

Growth in Energy Demand

Deregulation of electricity, gas and petroleum markets could lead to generally reduced prices for these fuels and increased demand. Given that the transport sector accounts for about 40 per cent of oil consumption, if the deregulation of crude and products imports and gasoline marketing leads to major price falls, these could significantly stimulate oil demand in Japan.

Lower prices for gas and electricity could also stimulate consumption of these, although the extent to which competition develops, and which parts of the market will benefit most, are uncertain. On the other hand, if more stringent environmental measures are introduced to reduce the growth in emissions, growth in greenhouse energy demand, greenhouse oil and coal is likely to be dampened.

In summary, while MITI forecasts a slowdown in the rate of growth of energy consumption over the next 15 years, the changes in energy policy direction, coupled with the existing influences on energy demand growth, indicate stronger than forecast growth for nongreenhouse fuels.

Changes in the Fuel Composition

Electricity market reforms are likely to increase LNG's role in electricity generation; five of the current eight contract buyers of Australian LNG are electricity utilities. ABARE projections, based on the IEEJ forecasts of installed electricity generating capacity, indicate that Japan will require an additional 16 to 42 million tonnes of LNG by 2010 (Wawn et al, 1995). LNG demand is likely to be at the higher end of this range, or may indeed exceed it. More stringent policies to reduce greenhouse gas emissions could result in significant declines in steaming and coking coal exports and will favour LNG over coal and oil. Furthermore, LNG is likely to be an alternative fuel if the plans for the growth in nuclear generating capacity are not realised, as appears likely.

Electricity market reforms and environmental policies also will influence the demand for coal. ABARE projects steaming coal demand for electricity generation will grow by 30 million tonnes to 2010, based on IEEJ installed electricity generating capacity forecasts (Stuart et al, 1996). Coal demand is expected to be relatively insensitive to environmental policies, due to the mandatory installation of scrubbers on coal fired power plants and the development of clean coal technology. Like LNG, coal probably would meet the capacity shortfall if the nuclear program is delayed or if electricity demand grows more rapidly than MITI's relatively conservative forecast.

In electricity generation, the share of oil is expected to halve, while that of nuclear energy should rise by about 30 per cent, although this is likely to prove optimistic.

Changes in Fuel Sources

New and anticipated changes in energy policies are likely to result in increased imports of petroleum products (replacing crude), greater competition for LNG and coal suppliers by IPPs and others, and increased emphasis on price in sourcing gas and coal imports.

Competitive pressures on electricity suppliers are likely to reduce their ability and willingness to buy expensive domestic coal, or pay a substantial premium for supply diversity. Similarly, gas utilities facing increasing competition will emphasise price when securing their gas supplies. While MITI may still seek to influence the fuel source mix, it is likely that (except for oil) increasingly price will become the primary factor influencing sourcing of energy imports.

Bargaining Power of Energy Importers and Exporters

Reduced barriers to entry to key energy markets will create more energy buyers and sellers. For exporters of energy to Japan, this is likely to result in more flexibility in setting contract prices and conditions and more opportunities for spot sales, especially of coal and LNG.

The deregulation of the Japanese electricity market is producing downward pressure on coal prices, a greater reliance on spot markets and increased sensitivity to coal qualities other than calorific value (Klingner, 1996; Yamada and Doi, 1996). As IPPs emerge, multisupplier arrangements, annual price negotiations and relatively weak price-quality relationships characteristic of the traditional approach of Japanese utilities to formulating steaming coal prices may be replaced by other institutional arrangements and processes.[4]

A deregulated Japanese gas market could create new opportunities for LNG spot sales. However, since Australia already supplies LNG under contract to eight buyers in Japan, the addition of a few new entrants is unlikely to alter significantly the balance of bargaining power or LNG contract terms and conditions.

The steady decline in Japan's dominance of Asian energy markets will influence the bargaining power of energy importers and exporters. For example, only Japan currently buys LNG under contract from Australia. The opportunity to sell to other countries as their demand for LNG grows and their supply infrastructure is developed, could place Australian exporters in a stronger bargaining position. On the other hand, a number of competitive gas suppliers in the region also wish to increase their exports.

IMPLICATIONS FOR AUSTRALIAN ENERGY EXPORTS

- The progressive deregulation of the gas and electricity markets in Japan, the projected shortfall in nuclear power capacity and strong growth in energy demand, should increase the demand for natural gas. Imports of LNG are projected to rise and Australia is well placed to meet some of this demand. Australia has reasonable proximity to the Japanese market, substantial resources of natural gas, a relatively stable policy regime and a reputation as a reliable LNG supplier. The eight Japanese gas and power utilities have expressed interest in the proposed expansion of the North West Shelf joint venture through a 'letter of indication' to purchase an additional 6.4 million tonnes of LNG per year.
- The planned halving of oil use in electricity generation could reduce Australian crude oil exports. However, Australian could receive similar prices for its oil in other markets.

4 Because of the importance that IPP financiers attach to minimising risk, the institutional and contractual relationships that IPPs form with fuel suppliers are different from those with regulated utilities. An IPP typically establishes a firm, long term relationship with one or a few fuel suppliers to ensure secure and cost-effective supply arrangements. Methods include establishing binding long term contracts with fuel suppliers, vertical integration in the fuel supply chain and including fuel supply companies in IPP consortia (Blake, et al, 1995; Eves, 1996; Klingner, 1996; Raschke, 1996).

- The outlook for Australia's exports of coal to Japan is mixed. With respect to steaming coal, the expected shortfall in projected nuclear power capacity may well increase the need for coal fired power stations. As a result, the volume of Australia's exports of steaming coal to Japan is projected to increase from 34 million tonnes in 1995 to around 44 million tonnes by 2002. However, Australia's share of the Japanese steaming coal market is projected to decline by around 1 per cent over the period to 57 per cent in 2002, partly as a result of the continuing supply diversification policy of the Japanese Government (which is expected to result in increased imports from South America, USA and China), but also because other suppliers are producing and marketing competitive products.

- In relation to coking coal, technological developments, including pulverised coal injection and electric arc furnaces will reduce the amount of coking coal needed for each tonne of steel produced and broaden the range of coals used. Over the next 10 to 15 years, the steel industry will have to decide whether to replace aging capital stock providing the opportunity to expand the share of electric arc furnaces or relocate offshore. While this may have an impact on Australian coking coal exports to Japan, export opportunities to other countries in the region are likely to expand to compensate for any reduction in Japanese demand.

- Japan purchased 37 per cent of Australia's uranium production in 1995, and is expected to continue to do so in the interests of supply diversification and security. Although Australia still produces a small proportion of the world's uranium despite its extensive resources, its export capacity will increase following the recently liberalised production policy. The share of production going to Japan should be maintained, particularly as the world market is expected to tighten later in this decade. Direct implications for Australia's uranium exports of slower than planned growth in Japan's nuclear power generation are likely to be only minimal.

- In summary, most of the emerging changes in the structure of Japanese energy supply and demand are likely to have positive effects on Australian energy exports to Japan. Expectations of relatively strong growth in energy demand, coupled with economic and policy induced changes to the supply side of the energy sector will create an environment in which Australia can continue to take advantage of its energy resource endowments, high production efficiency and proximity to Japan. The major negative influence will be the need to reduce greenhouse gas emissions and possible new policies to achieve this objective.

REFERENCES

Australian Bureau of Agricultural and Resource Economics, 1997, 'Japan's energy sector', Update.

____ 1996, 'Japan's energy sector', consultancy report for East Asia Analytical Unit.

Australian Coal Research Ltd, 1996, *Australian Coal Association Research Program Report: Coal Nitrogen*, Issue No. 1, January.

BHP briefing, 1996, Canberra, August.

Daniel, M., 1995, *Asian Coal Prospects to 2010*, IEA Coal Research, London.

East Asia Analytical Unit, 1995, *Iron and Steel in China and Australia*, Department of Foreign Affairs and Trade, Canberra.

East Asia Analytical Unit, 1996, *Pacific Russia - Risks and Rewards*, Department of Foreign Affairs and Trade, Canberra.

Eves, C., 1996, 'Regional Cooperation for Power Infrastructure: Emerging Trends in Business Investment', in Proceedings of ABARE's National Agricultural and Resources Outlook Conference, Canberra, 6-8 February, *Outlook 96*, Vol. 3, *Minerals and Energy*, pp. 378-84.

Feng, L., Schneider, K., Tulpule, V. and Fisher, B.S., 1996, 'Outlook for energy in APEC: the role of China', paper presented at the Meeting on Energy Policy, Pacific Economic Cooperation Council, Minerals and Energy Forum, Sydney, 26–27 August.

Financial Review, various issues.

Fok, G. and Donaldson, K., 1996, 'The Outlook for the World and Australian Oil Markets', in Proceedings of ABARE's National Agricultural and Resources Outlook Conference, Canberra, 6-8 February, *Outlook 96*, Vol. 3, *Minerals and Energy*, pp. 405-15.

Gas World International, 1995, 'New Zeal for Gas in Japan', March, pp. 8-10.

Hagan, R. E., 1996, 'Nuclear Power in the Asia Pacific Region', in Proceedings of ABARE's National Agricultural and Resources Outlook Conference, Canberra, 6-8 February, *Outlook 96*, Vol. 3, *Minerals and Energy*, pp. 520-23.

Hayashi, T., 1992, 'The Energy Industry in Japan: Concerns and Prospects', *Osaka Economic Papers*, Vol. 42, No. 1-2, September, pp. 34-44.

International Coal Report, 23 July 1996.

Institute of Energy Economics, Japan, 1996, *EMDC Handbook of Energy and Economic Statistics in Japan*, *1996*, The Energy Data and Modelling Center, The Institute of Energy Economics, The Energy Conservation Center, Japan.

International Energy Agency (IEA) 1996, *Coal Information – 1995*, OECD/IEA, Paris.

____ 1995a, *Energy Polices of IEA Countries 1994 Review*, OECD/IEA, Paris.

____ 1995b, *Energy Prices and Taxes, Fourth Quarter 1995*, OECD/IEA, Paris.

____ 1994, *Natural Gas Transportation: Organisation and Regulation*, OECD/IEA, Paris.

Japan Petroleum and Energy Trends, 1994, 'Council Recommends Further Deregulation Measures under Certain Conditions to Realise Efficient Oil Supply System in Japan', *Japan Petroleum and Energy Trends*, Vol. 29, No. 26, 23 December, pp. 2-3.

Klingner, D., 1996, 'Coal Marketing in Asia – Opportunities and Challenges', in Proceedings of ABARE's National Agricultural and Resources Outlook Conference, Canberra, 6-8 February, *Outlook 96*, Vol. 3, *Minerals and Energy*, pp. 444-51.

Kibune, H. and Kudo, H., 1996, 'Changes in Japan's Economic/Social Structures and Long-Term Energy Supply-Demand Perspectives', *Energy in Japan*, No. 138, March, pp. 50-61.

Labson, S., Gooday, P., Dwyer, G. and Manson, A., 1994, *Adoption of New Steelmaking Technologies*, ABARE Research Report 94.1, Canberra.

Manson, A., Maurer, A., Kicic, A. and Gooday, P., 1996, 'Outlook for Steelmaking Raw Materials', in Proceedings of ABARE's National Agricultural and Resources Outlook Conference, Canberra, 6-8 February, *Outlook 96*, Vol. 3, *Minerals and Energy*, pp. 85-99.

Ministry of International Trade and Industry/Agency of Natural Resources and Energy, 1996, *Energy in Japan: Facts and Figures*, MITI/ANRE, Tokyo

Perkins, F., 1994, 'A Dynamic Analysis of Japanese Energy Policies: Their Impact on Fuel Switching and Conservation', *Energy Policy*, Vol. 22, No. 7, pp. 595–607.

Power in Asia, 1996, 'Bids scandal adds hiccup to SingPow share delay', No. 195, 19 February, pp. 1–3.

Raschke, M., 1996, 'The Implications of Power Sector Trends for Fuel Choice and Fuel Markets', in Proceedings of ABARE's National Agricultural and Resources Outlook Conference, Canberra, 6-8 February, *Outlook 96*, Vol. 3, *Minerals and Energy*, pp. 391-402.

____ 1995, 'Competition from gas in Asia', paper presented at the Eighth World Coal Outlook Conference, Sydney, 13–14 September.

Stuart, R., Schneider, K., Fok, G. and Kicic, A., 1996, 'Fuelling Electricity in APEC Economies to 2010: The Regional Future for Coal' in *1996 Australian Coal Conference Proceedings*, Vol. 1, pp. 3–22.

Stubbs, D.G., 1996, 'Uranium', *Australian Commodities*, Vol. 3, No. 2, June, pp. 178–79.

Taylor, R., 1994, *Study of the Australian Black Coal Industry (Queensland and New South Wales)*, Report to the Australian Coal Industry Council, Canberra.

Toichi, T., 1994, 'LNG Development at a Turning Point and Policy Issues for Japan', *Energy Policy*, Vol. 22, No. 5, May, pp. 371-77.

Wawn, L., Stuart, R. and Weston, L., 1995, 'Asia Pacific LNG demand to 2010', paper presented at 1995 AGA Convention, Sydney, 5–8 November.

Yamada, S. and Doi, T., 1996, 'Japan's Generating-Use Steaming Coal Procurement Forms Now and Future', Occasional Paper, Institute of Energy Economics Japan, Tokyo.

Chapter 13

TRANSPORT REFORM VITAL TO ECONOMY

The rapid development of the Japanese economy has placed considerable pressure on transport infrastructure. Despite such leading-edge developments as the Shinkansen 'Bullet Train', Japan's heavily regulated, high-cost transport and distribution systems and their restrictive administrative and industrial practices remain a serious constraint to growth.

In an effort to overcome some of these constraints, the Japanese Government is encouraging a modal shift[1] in domestic distribution systems, including greater utilisation of the rail and coastal shipping networks. However, these are constrained by regulatory frameworks which engender a chronic lack of capacity and poor responsiveness. Road transport companies face driver shortages, congestion and a variety of restrictive regulations, including limitations on the size of vehicles, cargoes and service areas. Deregulation packages consistently contain measures designed to lower barriers to entry and increase competition and productivity in transport; however, these often provide only partial solutions that leave the major problems unresolved. Achieving the desired objectives in a reasonable timeframe may require more radical approaches.

This chapter examines how the Japanese Government and business are addressing the major issues in the road, rail, shipping and aviation sectors, and highlights the costs and benefits for companies doing business with Japan. It also briefly reviews aviation's key role in tourism and business between Japan and Australia, and sets out a number of issues that could affect future growth. (For major roads, rail routes, seaports and airports, see maps in Chapter 10 - *Regions*)

ROAD TRANSPORT

Road freight makes up 2 per cent of business sector GDP, 2.9 per cent of business sector employment and more than half of total domestic cargo transport (Organisation for Economic Cooperation and Development [OECD], 1996a). Its share of freight haulage has increased steadily in recent decades, mostly at the expense of rail.

Japan's road transport sector is less efficient, has a larger workforce and is more heavily regulated than other OECD countries. While network density and capacity utilisation are high, labour productivity is among the lowest in the OECD (OECD, 1996a). This reflects in part the relatively small size of trucks, the large number of vehicles needed to service just-in-time (JIT) deliveries, and the relatively short distances travelled. Licences mostly limit firms to a particular district. By not allowing return freight from other districts, in most cases, companies cannot operate

[1] Modal shift means to use different modes of transport.

at capacity on interdistrict trips, negatively affecting efficiency and costs.[2] Depending on the region, companies must own at least five to ten trucks.

More than 99 per cent of Japan's 45 000 trucking firms are small, with less than ¥100 million capital, or less than 300 employees (*Transport Yearbook*, 1996). Faced with a weak bargaining position and strong price competition, many smaller firms are entering into cooperative arrangements for development of trucking terminals, marketing and fleet sharing. Larger firms are developing a high-quality 'total service' approach, offering customers services ranging from door-to-door deliveries to international multimodal transport and global networks. The major international air express and courier companies are active in this market.

Regulation and Reform

Overall responsibility for Japan's road network rests with the Ministry of Construction, with devolution of administration to other bodies according to the type of road (for example, national, prefectural, local, highway, toll road). Three separate jurisdictions administer the various road transport laws: the Ministry of Transport (MOT), the Ministry of Construction (MOC) and the Public Safety Commission (Police).

The Motor Trucks Business Law of 1990 significantly deregulated the trucking industry, including relaxing entry and pricing provisions and the separation between long-haul and regional operations. The Japanese Government's March 1996 and March 1997 deregulation packages also included measures gradually reducing the minimum number of vehicles trucking firms must own to a uniform five throughout the country and easing supply-demand adjustment regulations. Although MOT retains safeguard clauses to protect against 'market disorder', only a few of the average 1500 new-entrant applications are rejected each year.

Nevertheless, considerable scope remains for further reform. MOT, for example, can still intervene to address oversupply and 'unreasonable' charges. Administration of such provisions is not always fully transparent. Furthermore, a considerable body of regulations remains in place to cover such matters as categories of shippers, types of vehicle, and types and boundaries of service. For freight forwarders and brokers, provisions such as notification of charges are in effect regulations. In addition, Japanese regulations on vehicle dimensions and gross weight limits are quite restrictive compared to its leading trading partners (Table 13.1). For example, B-Double-type rigs (truck plus trailer), which are widely used in Australia and other countries to increase hauling efficiency, are regarded as one unit in Japan and exceed permitted limits. Australia has raised the trailer-load issue with the Office of the Trade Ombudsman.

2 In practice, some private companies have overcome these restrictions (OECD, 1996b, p. 27).

Table 13.1

Japanese Trucks Smaller than Most

International Comparison of Dimensions and Gross Weight Limits Single Trucks

	Weight	Length	Height	Width
Japan	20.0t	12.0m	3.8m	2.5m
US	27.1t	18.3m	4.4m	2.7m
Australia	27.5t	11.0m	4.3m	2.5m
UK	25.0t	12.0m	3.8m	2.5m
Germany	24.0t	12.0m	4.0m	2.5m

Source: Kogawa, 1996.

However, in the interests of international trade, companies can request 'conditional carriage beyond legal limits'. A general exception is made for standard 20-foot and 40-foot shipping containers[3] provided they are used solely for export or import cargoes and employ a specially approved type of semi trailer.

Infrastructure and Innovation

The Eleventh Five-Year Road Development Plan (1993 to 1997) provides for expenditure of ¥76 trillion (US$633 billion). Under the plan, the country will have 9 000 kilometres of high-standard trunk roads by 2000 and 14 000 kilometres by 2015, compared with 6 000 in 1995. This will place almost all communities within 60 minutes of a trunk interchange (Kogawa, 1996). The Ministry of Construction is also planning a system of three ring roads around Tokyo, supported by nine spokes to facilitate travel from suburb to suburb without passing through the centre. The final stage is to be completed around 2005.

The industry is seeking to improve efficiency by developing or more effectively utilising:

- specialised road transport contractors, facilitating road freight consolidation
- joint door-to-door delivery from retailers to consumers
- joint supply systems connecting manufacturers, wholesalers and retailers.

However, resistence to these systems may arise if they affect the combination of prompt service and frequent small-lot deliveries to which Japanese have become accustomed.

....

3 20-foot = 6.058m x 2.438m x 2.591m; 40-foot = 12.192m x 2.438m x 2.591m

SMALL-VOLUME DELIVERIES ADD TO CONGESTION

Vehicles on national roads average around 38 kilometres per hour, and just 20km/hour in certain parts of Tokyo. While new roadworks may alleviate congestion on interurban routes, towns and cities will not enjoy major improvements, mainly because fast growing very small-volume deliveries are straining urban roads. Door-to-door delivery services have grown steadily since Yamato Transport entered the market in 1976 and, along with other newcomers, gradually displaced the less efficient former Japan National Rail and the Post Office. Sixty per cent of Yamato's door-to-door business involves noncorporate customers and has expanded to fresh and refrigerated foodstuffs. Japanese manufacturers' and retailers' increasing dependence on just-in-time delivery of inputs and finished goods also requires large volumes of small deliveries. However, the increasing trend toward outsourcing such deliveries to more efficient specialised logistics contractors may mitigate the impact on road congestion (Table 13.2).

Table 13.2

Outside Contractors Expanding Rapidly

Carriage of Goods by Commercial Contract and Private Trucks
Billion Tonne Kilometres

	1987	1988	1989	1990	1991	1992	1993	1994
Commercial contractors	155	171	184	194	204	205	205	210
Private dedicated fleets	71	75	79	80	80	77	71	71
Total	226	246	263	274	284	282	276	281

Note: Private fleets account for more than half of truck freight by weight and about one fourth by tonne kilometres; by law, they may not carry third-party goods.

Source: Ministry of Transport, 1995a.

RAIL TRANSPORT

While Japan's rail passenger services are highly developed and compete effectively with airlines on major trunk routes, rail freight's market share is on the decline due to regulatory and operational problems that will require considerable political will to overcome. Some of these are discussed below.

JNR Debts a Major Constraint to Development

Japan's largest rail network, the state-owned Japan National Railway (JNR), was split up in 1987 into JR Freight and six Japan Rail companies, four on Honshu and one each in Hokkaido, Shikoku and Kyushu.[4] The JNR Settlement Corporation was

[4] Only East Japan Railway and West Japan Railway have been publicly listed to date. Central Japan Railway (JR Tokai) is scheduled to be listed as well. Privatisation is proceeding slowly.

established to privatise JR Group assets and handle creditors' claims. The government-owned Corporation is the central shareholder of the JR companies. The sluggish economy has made it difficult to dispose of assets, and accumulated debt amounted to around ¥28 trillion (US$233 billion) in 1996. If the Ministry of Finance is unable to realise plans to settle the debt through a special levy on JR passengers, the planned extension of the Shinkansen network (see maps in Chapter 10 - *Regions*.) will be affected.[5] Absorption of the debt by the community at large would entail an impost of ¥200 000 (US$1 667) per person.

Since 1984 more than 35 local companies have been set up to take over loss-making JNR/JR rural lines. These are known as third-sector companies (*daisan secta kaisha*) due to their combination of public and local community finance.

JR Freight Constrained by Limited Track Access

The former JNR's inefficient and strike-prone freight division was turned into a specialist company and renamed JR Freight in 1987. It provides nationwide freight services over track owned by the six JR Group companies and has interests in warehousing, insurance, travel agency, advertising, car parts and motor vehicle repairs.

JR Freight enjoyed a temporary boom during the bubble economy (1987 to 1991) when road freight could not cope with demand. However, the recession and competition from road transport companies rapidly cut into its uplift from 1992, although its container business remains relatively stable (Table 13.3). JR Freight is mainly constrained by a lack of dedicated tracks, limited access to passenger rail networks, no access to Shinkansen tracks and no direct access to ports. Rail is disadvantaged by trucking firms' greater flexibility in door-to-door services and in raising fees (truckers only have to notify MOT, whereas JR must secure prior approval).

Table 13.3

Road Freight Continues to Grow

Japan Rail and Road Freight

Ten Million Tonne Kilometres

	1987	1988	1989	1990	1991	1992	1993	1994	1995
JR Freight	200	230	247	267	267	262	250	241	247
Wagon	79	81	82	82	78	74	66	61	55
Container	121	149	165	185	189	189	184	180	192
Road Freight	2264	2461	2629	2742	2838	2816	2759	2806	2946

Source: Ministry of Transport, 1995a.

5 The extension is to be jointly financed by JR companies (50%), the central government (35%) and local governments (15%). Shinkansen trunk routes are the main source of profits for the three interurban Japan Rail companies: East Japan Railway, JR Tokai and West Japan Railway.

JR Freight has more than 500 wagon services per day carrying mostly raw materials such as petroleum products, coal, cement, limestone, machinery and paper/pulp (Ministry of Transport, 1995b). Large-scale shippers of these items generally maintain exclusive tracks from their own premises to the nearest rail lines and often use their own rolling stock.

JR Freight also operates about 400 container services each day from specialised container depots across Japan. The main cargoes are food, chemicals and alcoholic beverages, and shippers and consignees usually load and unload containers at their own facilities. Average interurban transit times are two days, although a container can take three days to move from one end of the country to the other.

While JR Freight is equipped to handle sea containers, in addition to its own 12-, 20-, and 30-foot models, no major seaport has port-rail terminals with direct links to JR container depots. Rather, trucks normally move containers from ports. This is more expensive, in part due to the restrictions on truck-trailer combinations.

Regulation and Reform

The Japan National Railway Law (covering the former JNR) and the Local Railway Law (covering private rail companies) were merged into the new Railway Business Law in 1987. MOT grants licences to operate rail businesses on the basis of a perceived equilibrium of supply and demand. Fares and freight charges are subject to MOT approval and are based on MOT's assessment of 'standard costs plus appropriate profit'.

MOT has announced that the supply-demand adjustment for freight will be abolished once the JR privatisation is complete and that it will liberalise prices for freight by moving from prior approval to a notification system. Rail companies may already discount passenger fares and freight charges by up to 50 per cent for marketing purposes, upon notification.

In 1994, JR Freight developed a re-engineering program called *Freight 21*, designed to put its operations on a profitable basis by 2003. The program addresses three major issues: the cost of replacing old facilities, the cost of the high average age of employees, and the need to develop more attractive services. Delayed by the Kobe earthquake, the *New Freight 21 Project* recommenced in April 1997.

Having reached agreement that the rail freight network should be maintained, MOT is now seeking to lock the transport industry into the arrangement by encouraging road transport firms to buy JR Freight shares and inject expertise to revive Japan Rail's freight operations. Freight trains will be extended to 32 and eventually 60 cars. JR is also examining various road-rail innovations to allow combined use of road and rail equipment.

Railway companies traditionally comply with political interventions and avoid conflict with the Ministry of Transport or politicians influential in transport policy making. Indeed, senior MOT officials occasionally move to executive positions in railway companies. As in many countries, politicians actively seek rail routes (especially Shinkansen) for their constituencies. However, local governments are reluctant to bear the construction costs, and local JR companies are unwilling to make the huge investments necessary to establish full-standard (that is, 260km/hr) Shinkansen services. Recently the JR companies have adopted a more independent stance, insisting that business planning should reflect economic realities more than other considerations. However, unless the JNR Settlement Corporation is more successful in its efforts to complete the JR privatisation, the public rail system will remain subject to the political influence and bureaucratic intervention that impede efficiency.

SEA TRANSPORT

Six major ports (Tokyo, Yokohama, Shimizu, Nagoya, Osaka and Kobe) handle at least 85 per cent of Japan's international container traffic, or 7.3 million '20-foot equivalent units' (TEUs) in 1995.[6] Japan's shipping industry is seeking to improve competitiveness by improving multimodal diversification (including better sea/road connections), reducing port and coastal shipping costs, improving labour productivity and flexibility, introducing new technology, and enhancing terminal and support facilities. If MOT realises its plans for multimodal connections, 90 per cent of Japan will be within a 12-hour return truck journey of a local port within 10-15 years, and 80 per cent by 2000 (Ministry of Transport, 1995c). The major issues are discussed below.

Shifting Trade Patterns

Economic developments in East Asia, changing trade patterns and competition have led to Asian ports predominating in worldwide container trade (Table 13.4). (See Chapters 5 - *Trade* and 6 - *Internationalisation*.)

Table 13.4

Asian Ports Predominate

Top 10 Container Terminals in 1995

Rank	Port	Millions TEUs*
1 (1)	***Hong Kong***	11.3
2 (6)	***Singapore***	10.6
3 (4)	***Kaohsiung***	5.2
4 (2)	Los Angeles/Long Beach	5.1
5 (3)	Rotterdam	4.8
6 (5)	**Tokyo/Yokohama**	4.1
7 (7)	**Kobe/Osaka**	3.9
8 (9)	***Pusan***	3.9
9 (12)	Hamburg	2.7
10 (11)	Tacoma/Seattle	2.4

Note: Figures in parentheses indicate ranking in 1987.
*TEU: '20-foot equivalent unit' (standard container measurement).
Earthquake damage reduced Kobe's throughput in 1995.

Source: *Containerisation International Yearbook*, 1989, 1995.

....

6 Japan has 45 container ports.

Uncompetitive Practices and Costs

Shipping lines are reluctant to use Japanese ports as regional transit container hubs. While other major Asian ports operate around the clock virtually every day of the year, only one major Japanese port, Shimizu, offers 24-hour service (Ministry of Transport, 1994). Although Japan's terminal facilities are among the world's most modern, militant unions and rigid cost structures, rules, regulations and industrial practices place them among the world's most expensive, undermining their ability to reach their full potential (Fossey, 1996). For example, handling charges, averaging US$350 per 40-foot container, are the highest in the region. Hong Kong comes closest at US$290, while Kaohsiung, Pusan and Singapore have much lower rates (Ministry of Transport, 1995c).[7] High overtime charges and waterfront workers' reluctance to work Sundays further motivate shipping lines to avoid Japanese ports outside the normal workweek.

Dissatisfaction among major shipping companies led the European Union in September 1995 to make formal representations calling for the abolition of the 'prior consultation' scheme[8] and of the mandatory requirement to weigh all export containers. The US Federal Maritime Commission also launched a fact-finding investigation on a variety of issues, including prior consultation, Sunday work, mandatory weighing and measuring, and anticompetitive harbour practices (American Chamber of Commerce in Japan, 1997). The Japanese Government has since announced that mandatory weighing will be phased out by 2001.

Customs and Quarantine Process Frustrates Shippers

Customs and Quarantine services lag the regional standard at both seaports and airports. Shippers complain about the lack of after-hours and Sunday operations, and the inconsistent application of administrative procedures and interpretations of regulations from one port to another. Also, while shippers, shipping lines, freight forwarders and customs brokers have electronic information networks in place, Customs and Quarantine regulations continue to require original documents. Even when data are submitted early, faster clearance does not occur. Moreover, import clearance for many commodities requires approval from a variety of agencies, and while some customs procedures have been automated, the requirements of other agencies have not been fully integrated. Due to this poor coordination, the speed of import clearance is controlled by the slowest agency (United States Trade Representative, 1996).

Customs clearance in Japan takes four days on average, while in Singapore the process takes eight minutes, including queuing time (Ministry of Transport, 1995a). Shippers and governments are encouraging Japanese authorities to give urgent priority to the widespread introduction of electronic lodgement of documents and preclearance by Customs. While Japan has expressed a commitment to reduce import clearance time to 24 hours, and processing of customs paperwork has indeed reached this level, overall processing time from arrival at port to release by Japanese Customs exceeds four days for sea cargo and 1.7 days for air cargo.

7 Exchange movements in the interim may have lowered this rate in US dollar terms.

8 Prior consultation arose out of the need to achieve consensus among waterfront workers for labour reductions with the advent of container and car vessels which required less stevedoring than older ships.

Shortage of 15-Metre Berths

While Singapore and Kaoshiung have berths with the 15 metres depth necessary to accommodate modern container vessels, Japan has only two at Port Island, Kobe. However, it expects to have 18 such berths in place by 2005 (Table 13.5).

Supporting Infrastructure To Face Further Strain

To cope with the huge increase in container traffic on the Asia-Europe and Asia-US trunk routes, shipbuilders are introducing a new generation of 'post-Panamax' container vessels designed to carry more than 6 000 TEUs of containers. Just five years ago, the mainline east-west routes featured mainly 3 500 to 4 500 TEU vessels.[9] Now, vessels with 8 000 TEU capacity are on the drawing boards. These ultralarge ships will have a dramatic impact on shipping and port operations, and will place significant pressure on supporting infrastructure. In Japan, for example, serious congestion may result because container terminals are cleared almost exclusively by truck, and road systems in major centres are already under strain. This increases the urgency of developing rail links to container terminals.

PORT COMPETITORS

The Port of Singapore is considered by many to be a model of best practice. It averages just 36 seconds turnaround per container and 30 seconds gate processing time per truck. (Container turnaround is two minutes in Japan and up to four minutes in Australia.) Its 24-hour online electronic document processing offers additional efficiency. Singapore is an important shipping hub for the Asia-Pacific region, with major lines consolidating and deconsolidating shipments from and onto regional feeder lines. This trend will see ultralarge container vessels plying the trunk routes, serviced by feeder vessels of 1000-2000 TEU capacity (Maunsell, 1996b).

Japanese ports' nearest competitor is Pusan's 24-hour port, which has a reputation for greater efficiency and lower costs than Japan. However, it has experienced congestion in recent years, due partly to increased transhipments from China, Russia and Western Japan. A major extension and upgrading program is under way, including an electronic data system covering all aspects of port and customs operations.

Kaohsiung, Taiwan, provides additional competition to Japanese ports, with its 24-hour operations, lower transhipment costs and flexible access to berths. A number of major lines have established dedicated berths there.

9 Mainly vessels with 1 000-TEU and 2 000-TEU capacity serve Australia (Department of Transport and Regional Development, 1997).

Table 13.5

New Capacity to Handle Large Container Ships

Major Asian Container Terminal Developments

	Port	Completion	Depth & No. of Berths
Japan	Osaka: Yumeshima	***1998***	15m x 3
	Kobe: *(15m x 2 already)*	***1998***	15m x 2
	Kobe: Rokko Island South	***2005***	15-16m x 4
	Shimizu: Shin Okitsu	**2003**	15m x 2
	Yokohama: M.Honmoku	***2000***	15-16m x 4
	Tokyo: Aomi	***2000***	15m x 1
Korea	Pusan	1997	15m x 4
Taiwan	Kaohsiung	1998	15m x 3
Hong Kong		1999	15m x 4
		2000	15m x 4
Singapore		1998	15m x 5
		1999	15m x 3

Source: Ministry of Transport, 1994 (amended with updated information).

Expensive Coastal Freight Favours Pusan Feeder Lines

Small operators predominate in coastal shipping, with vessels of less than 500 tonnes accounting for more than 80 per cent of the domestic fleet; more than 94 per cent of enterprises are capitalised at less than ¥100 million (*Transport Yearbook 1996*). Coastal vessels do not normally carry general freight, but rather, like rail, bulk cargo such as oil products, minerals, metals, cement, gravel, sand and stone. Perishables account for less than 1 per cent of coastal cargoes.

Japan's coastal shipping is very expensive, for many of the same reasons that finally are producing reform in Australia (entrenched work practices and regulatory protection). According to Mitsubishi Logistics, shipping a 20-foot dry container from Kobe to Tomakomai, Hokkaido (less than 2000 kilometres) costs around ¥200,000 (about US$1670), considerably more than from Kobe to Rotterdam (US$950).

As a result, new shipping patterns are emerging. Manufacturers outside the largest centres can save up to 30 per cent by transhipping through Pusan, Republic of Korea, instead of using domestic operators to feed into major Japanese ports. Enjoying growing demand, Korean feeder lines service an increasing number of Japanese ports. As Korean feeder services are considered 'international routes', no restrictions exist.

Regulation and Reform

Most Japanese public container terminals belong to the port management bodies of individual cities. MOT maintains heavy involvement, sometimes through secondments of senior personnel. To assist modern container terminal development, the Japanese Government set up five Public Port Corporations, at Tokyo, Yokohama, Osaka, Kobe and Nagoya. These corporations operate independently of the port management bodies and are permitted to issue bonds, borrow commercially and fix leases. The public port corporations lease terminals to shipping lines, normally for 10-year periods.

SHIPPING LINES

Conference lines handle about 60 percent of freight volumes between Australia and Japan, and nonconference lines 40 per cent (*Shipping Gazette*, 1996). In 1996, this amounted to 615 862 tonnes to Australia, worth A$5 billion, and 2.4 million tonnes to Japan, worth A$4.5 billion (Department of Transport and Regional Development, 1997b). Conferences allow international shipping lines to pool vessels for economies of scale, increased service frequencies and other benefits. They normally distribute revenues among members in proportion to their share of fleet and uplift. Conferences negotiate periodically with large shippers on freight rates and service frequency. Two conference groupings provide scheduled services on the Australia-Japan route:

1. the Australia Northbound Shipping Conference (Anscon), comprised of Australian National Line, Kawasaki Kisen Kaisha, Mitsui OSK Lines, P&O Swire Containers, Orient Overseas Container Line, Nippon Yusen Kaisha, Knutsen Line, Zim Israel Navigation Co and Yang Ming Marine Transport
2. operating agreements between Maersk and Blue Star Line and between Blue Star Line and Cho Yang Shipping.

ANL connects Melbourne, Sydney and Brisbane with Yokohama, Osaka, Nagoya and Yokkaichi on a weekly basis, plus Hakata (Fukuoka), Pusan and Adelaide fortnightly (Department of Foreign Affairs and Trade, 1996).

Nonconference lines operate independently of conference arrangements and set their own freight rates. Their services and ports of call depend more on demand than on strict schedules. Nonconference lines on the Australia-Japan route include Wilhemsen Lines and China Ocean Shipping Company. In addition, a variety of lines offers transhipment services in the Australia-Japan trades, with transhipment at such ports as Singapore and Hong Kong.

Fierce competition is blurring the contrast between conference and nonconference lines. Criticised for poor service in the past, several nonconference carriers have upgraded their fleets and adopted strategic pricing policies, rather than simply undercutting conference operators. Conference lines, too, discount freight for high-volume commodities such as beef, dairy products, malt and wool; occasionally their rates are below those of nonconference lines.

Few Licensing Constraints or Price Controls

Apart from the normal requirements relating to safety and other aspects, operators with vessels less than 30 metres long can go into business by notifying MOT. Larger vessels require permits. Beyond this, domestic shipping lines have no regulatory constraints, nor are domestic ocean freight prices controlled. A few freight agreements, based on specific provisions of the Ocean Carriage Law, apply to tankers and routes such as Okinawa. MOT allows foreign-owned ships to be used in 'urgent' cases of coastal shipping, with prior application. As in other transport sectors, MOT retains residual safeguard powers over coastal shipping.

MOT to Encourage Coastal Shipping Improvements

In addition to abolishing the 'scrap-and-build' scheme,[10] MOT intends to relax restrictions on ports of call by coastal ships if they embrace multimodal shipping, and encourage small domestic lines to consolidate. However, coastal operators still need to overcome rigid, high cost structures if they are to become efficient, competitive means of transport. One idea is to allow them to use foreign crews.

Infrastructure and Innovation

A number of ports around Japan will be adding container handling capacity in coming years:

- Development of new port facilities in the Tokyo region (Tokyo and Yokohama) will increase capacity by 800 000 TEUs each by 2003. All will accommodate ultralarge container vessels.
- Ports serving the Osaka region will see major improvements, facilitating services by ultralarge vessels and adding further capacity of 1 million TEUs by 2005 at the new Rokko Island South in Kobe.
- Northern Kyushu will also have considerable port extensions, including large artificial islands for Hakata (Fukuoka) and Kitakyushu.
- Ports serving the Chubu (Nagoya) region will undergo major expansions, including upgraded berthing and handling facilities for ultralarge container vessels.

Techno Superliner: Shinkansen of the Sea?

The Techno Superliner, an air-cushioned aluminium vehicle/catamaran hybrid, has been designed to carry around 1000 tons of freight (10 times more than a 747-200F, the largest air freighter) at speeds of up to 50 knots, twice the speed of the fastest container ships currently in service. Such vessels would reduce the transit time between Tokyo and Hokkaido and Tokyo and Kyushu, for example, to around 10 hours, and would link Japan and most East Asian ports in one to two days. Trials of two reduced-scale prototypes, built by consortia of leading shipbuilders, have returned encouraging results. The Techno Superliner is expected to go into use by 2000. On some passenger routes, however, Australian fast ferries may be able to offer earlier, more effective solutions.

....

10 Under this scheme, a new ship for domestic service could only be built when an existing vessel was scrapped.

AUSTRALIAN FAST FERRIES

In recent years, the Australian shipbuilding industry has emerged as one of the world's leading producers of lightweight ferries. Australian strengths include efficient boat design, competitive capital and operating costs, low raw material prices and high safety standards. Although Australian companies manufacture about one third of all high-speed catamaran ferries sold worldwide, only five have been sold to Japan, which represents a A$200 million per year potential market for such exports.

Excessive regulation and a range of nontariff barriers have impeded imports of fast ferries into Japan from Australia and other countries. In 1996, the Australian Embassy and Austrade, on behalf of Australian shipbuilders, lodged a complaint to the Office of the Trade and Investment Ombudsman regarding guidelines and purchasing procedures of the public financing body, the Maritime Credit Corporation (MCC), which acted as a barrier to foreign shipbuilders. As a result of the complaint, MCC has substantially reviewed and amended its contract documentation and information requirements. This breakthrough, along with other changes arising from the Japanese Government's deregulation and reform program and Japan's recent accession to the OECD Shipbuilding Agreement, have brightened Australia's ferry export prospects.

AVIATION

Aviation plays a key role in Japanese trade and tourism flows. However, with many airports operating at or near capacity, their scope for expanding such flows will be limited until the authorities add new runways, resolve customs delays, improve productivity and technology, and ease regulation.

Tokyo's Narita Airport remains the main bottleneck, with just one runway handling 70 per cent of both outbound passengers and international air cargo. Tokyo will remain Japan's main gateway and its bottlenecks could become worse, affecting tourism flows to Australia (40 per cent of Japanese tourists to Australia depart from Narita). To compensate for this eventuality, Australia may need to more actively develop regional markets in Japan, particularly where Qantas has direct flights (Kansai, Chubu, Hokkaido and Kyushu; see Chapter 10 - *Regions*).

Major Issues

Japan's major airports rank among the world's busiest. Tokyo's Haneda, the main domestic hub, handled 22 million people in the first half of 1996, making it the sixth busiest passenger airport after Chicago O'Hare, Atlanta, Los Angeles, Dallas/Fort Worth and Heathrow. Narita was the fifth busiest cargo airport after Memphis, Los Angeles, Miami and New York JFK.

Air Cargo from Australia Constrained by Schedules, Customs Delays

Japanese outbound air cargoes are predominantly high-value manufactures such as electronics products; inbound cargoes include large amounts of perishables and time-sensitive items. More than 90 per cent of air freight on the Australia-Japan route is carried on passenger aircraft, with passenger movements determining schedules. The main gateway for air freight, Narita improved storage facilities in 1996, but customs clearance remains a problem, particularly for items requiring quarantine approval. Perishables commonly take 3.5 hours to clear at Narita, compared with 1.5 hours at Kansai and less than 1 hour in such small international airports as Sendai (Department of Foreign Affairs and Trade, 1995).

Strong International Growth Potential

International passenger traffic in and out of Japan, at well over 40 million travellers per year, accounts for more than 10 per cent of global movements and is rising rapidly. Moreover, only a fraction of the potential Japanese market has been tapped. Although 17 million Japanese went overseas in 1996, up 9 per cent from 1995, just 15 per cent were first-time travellers (Ministry of Transport, 1995b, 1995c).

....but Australia Must Work Hard to Remain Competitive

In 1996, 800 000 Japanese visited Australia, up 4 per cent. More than 90 per cent were tourists, accounting for one fifth of inbound tourists and spending approximately A$2 billion (Australia-Japan Economic Institute, 1996; Travel Journal International, 1995). As this represents only 5 per cent of the Japanese outbound travel market, considerable scope for expansion exists. However, Australia's share has been declining in recent years as competition from other destinations grows.

Highly Regulated Domestic Market

Japan's air transport system has been characterised by rigid fare structures and an oligopoly enjoying allocated market shares. Compared to other OECD countries, Japanese airlines have very high operating and capital costs, and low productivity. Costs and prices are twice as high as in countries which have deregulated domestic air services (US, UK, Canada, New Zealand), while operating revenues as a per cent of GDP are less than half the OECD average (OECD, 1996a).

The three companies that dominate the Japanese aviation industry: Japan Airlines (JAL), All Nippon Airways (ANA) and Japan Air System (JAS), are governed by strict centrally regulated fare structures similar to the rail industry. The profitable Sapporo-Tokyo-Osaka-Fukuoka-Naha trunk routes subsidise the nontrunk routes. JAL dominates international passenger and freight operations, while ANA controls the domestic market. However, boundaries will blur increasingly in coming years as JAL and JAS expand beyond their respective 25 per cent domestic market shares and ANA and JAS continue to develop international networks.

JAPANESE AIRLINES

Major Airlines	Subsidiaries
Japan Airlines (JAL) (listed company)	Japan Asia Airlines (Japan-Taiwan) Japan Transocean Airlines (Okinawa) Japan Air Charter (JAZ) J/Air (Niigata, Sendai)
All Nippon Airways (ANA) (listed company)	Nippon Cargo Airways (international air freight) Air Nippon (remote islands service)
Japan Air System (JAS, formerly Toa Domestic Airlines) (Tokyu Corp: 30%)	

Capacity Constraints

Market development in the Tokyo and Osaka areas, Australia's main sources of business and tourist traffic, is limited by physical capacity constraints. The Narita and Kansai airports, for example, have only one runway each, compared with three each in Sydney, London-Heathrow and Los Angeles (Table 13.6). Narita can handle only 28 movements per hour and Kansai 23, compared with 30-36 at Sydney. Narita is already operating at capacity, and Kansai is expected to reach capacity in 2003. Like Sydney, Narita is subject to a 11 pm to 6 am curfew. While Kansai, built on reclaimed land off Osaka, is open 24 hours a day in theory, it is in effect closed from midnight to 6 am for maintenance and because land transport does not operate during this period.

Table 13.6

Japan's Capacity Relatively Low

Comparison of International Airports

Airport		Area (ha)	Runways (metres)	Airport		Area (ha)	Runways (metres)
Japan	Narita	700	4,000 x 1	**US**	New York-JFK	2052	4,441 x 1
	Kansai	1510	3,500 x 1				3,460 x 1
Korea	Kimpo	732	3,600 x 1				3,048 x 1
			3,200 x 1				2,560 x 1
Hong Kong		289	3,390 x 1		Los Angeles	1451	3,685 x 2
Singapore		1667	4,000 x 2				3,135 x 1
Australia	Sydney	676	3,962 x 1				2,720 x 1
			2,400 x 1	**UK**	Heathrow	1197	3,902 x 1
			2,530 x 1				3,658 x 1
	Melbourne	**n.a.**	3,657 x 1				2,357 x 1
			2,286 x 1				

Source: Maunsell, 1996a; Travel Journal International, 1995

Narita the Key Impediment?

Almost 60 per cent of Japanese outbound passengers depart from Narita, with more than half originating outside the Kanto region. Similarly, approximately 70 per cent of international air cargo goes through Narita. While regional airports reduce some of the pressure, apart from New Kansai, they offer few nonstop flights to the most popular overseas destinations (see Chapter 10 - *Regions* for a detailed examination of linkages between Japan's regions and Australia). Unless Narita's capacity constraints and operating hours are successfully dealt with in the near term, pressures could build to the point that Kanto market growth could be severely affected.

Moreover, the combination of such constraints at Narita and Sydney, the two major gateways for Japan-Australia traffic, could potentially have an adverse impact on Japanese tourism to Australia. At present, with carriers on the Australia-Japan routes running on average only two thirds full, there is considerable room for expansion, except at peak holiday times. With Japanese tourism to Australia expected to rise from 800 000 visitors in 1996 to over 1 million in 2000, the industry is seeking ways to better balance inflows and outflows via other airports. Table 13.7 shows the origins of Japanese visitors to Australia in 1996, while Figure 13.1 highlights Narita's huge share of total outbound traffic.

Table 13.7

Three Quarters Depart from Tokyo and Osaka

Japanese Outbound Passengers To Australia by Airport CY1996

Origin	Per cent of total	Airport	Per cent of total
Hokkaido	**3.3**	**Shin-Chitose***	**2.1**
Tohoku	3.5	Sendai	0.4
Kanto	**40.3**	**Narita***	**50.5**
		Haneda	0
Chubu	**15.8**	**Nagoya***	**13.2**
Hokuriku	3.1		
Kansai	**19.2**	**New Kansai/Osaka****	**27.4**
Chugoku	4.6		
Shikoku	2.1		
Kyushu	**6.2**	**Fukuoka***	**5.0**
Okinawa	0.4	Naha	0.2
Other	1.6	Other	1.2

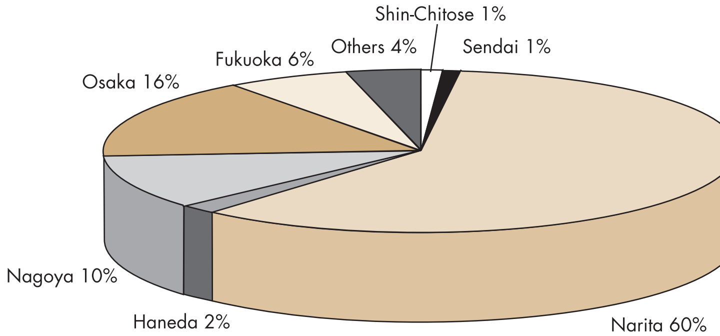
Source: Ministry of Justice, 1997.

Note: *Served by Qantas. **Served by Qantas and Ansett.

Figure 13.1

Narita Airport Dominates International Passenger Traffic

Total Outbound Passenger Departures by Region



Source: Travel Journal International, 1995.

High Charges

Landing fees at Narita and Kansai are more than three times higher than New York-JFK, and more than ten times higher than London-Heathrow. These costs are passed on to consumers, contributing to high fares.

Airport Development Costs

Narita airport expansion has been delayed for years by local residents' reluctance to sell their land. In the meantime, the cost of that land and of developing the planned additional runway and support facilities has risen considerably. Many of Japan's new (and planned) airports are built on reclaimed land, possibly the most expensive - but often the only - option. The extension of Haneda Airport in Tokyo Bay (adding two runways) will cost more than ¥1 trillion (US$8 billion). A totally new airport in Tokyo Bay (currently under discussion) would cost more than ¥4 trillion. Adding two new runways at New Kansai Airport will cost ¥2 trillion (Kogawa, 1996).

Shortage of Landing Slots a Barrier to Competition

Narita's dearth of landing slots is in effect a barrier to competition, as potential new entrants are rarely able to secure a place. A key contributing factor is the Japan-US Civil Aviation Agreement of 1952 which gives preferential treatment to incumbent carriers on the US-Japan route (United, Northwest, Federal Express and JAL) and allows them unlimited beyond rights.[11] With the Asia-Pacific region expected to account for half of global air passenger traffic by 2010 to 2020, US airlines have a strong interest in maintaining these preferential linkages. While other countries have terminated such agreements with the US with no negative impact, the Japan-US accord is a more complex issue.

....

[11] Japan, however, claims that United and Northwest abuse these rights by carrying more than the maximum 50 per cent Japan-originating traffic to points beyond. It suggests that 70-90% of passengers on United's US-Tokyo-Seoul and US-Tokyo-Bangkok routes, and on Northwest's US-Tokyo-Seoul route, join the flights in Tokyo (*Nikkei Weekly*, 12 March 1996). JAL exploits its 'fifth freedom' rights beyond the US by flying on to Brazil.

Competition

Domestic Air-Rail Competition

Rail and air fares are converging as airlines find themselves increasingly competing with Shinkansen services. The latter enjoy the advantage of central location, frequent departures and convenient bus and rail connections. Also, high-technology applications will allow the new 300km/hr 500 Series Shinkansen, for example, to link Tokyo and Osaka in just 2.5 hours and Osaka and Fukuoka in just 2.25 hours, virtually the same as airlines,[12] providing noise-abatement measures do not slow the trains down. While still in the experimental stage, the magnetic levitation, or Maglev, train, which has achieved speeds of 411km/hr in controlled trials, could connect Tokyo and Osaka in one hour, ensuring the predominance of rail on major trunk routes.

Airlines are responding to the challenge by further discounting fares, developing attractive package deals and bolstering marketing efforts. Although governments are building more centrally located airports on reclaimed land, the huge expense and long payback periods will continue to require high airport user charges.

Japan-Australia: Innovative Responses

The advent of code-sharing, whereby airlines bloc-reserve seats on other carriers, may offer improved access and efficiency where excess capacity exists (for example, on the Tokyo-Brisbane route: see box). Indeed, global alliances, including joint marketing arrangements, joint fares and coordinated schedules, and joint ground facilities and catering services, represent an effective response to regulatory and other market constraints. Australia-Japan examples are Qantas's arrangements with JAL and Ansett's with ANA.

QANTAS-JAL CODESHARING TO STREAMLINE SERVICES

In April 1997, Qantas and Japan Airlines began operating 14 weekly nonstop Brisbane-Tokyo and Cairns-Tokyo flights under a codesharing arrangement. JAL replaced its previous Tokyo-Cairns-Brisbane service with daily 747 flights direct to Brisbane, and Qantas now operates a daily 747 service between Cairns and Tokyo. Qantas will retain its Monday Narita departures to Brisbane-Sydney and Sydney departures to Brisbane-Narita.

The codesharing agreement developed from a close association formed during earlier codesharing of developmental route flights between 1986 and 1992. Qantas leased three 747s to JAL for three years, and the airlines strengthened their relationship through ground handling and other commercial arrangements. Under the new agreement, each airline will nominate the other as the preferred domestic carrier in their respective markets. The arrangement does not reduce the number of seats available and should, according to airline spokesmen, provide faster and more efficient services between Japan and Queensland.

12 The calculation includes a 30-minute city-airport and airport-city transfer at each end.

Other Asian Airports

Singapore and Korea compete with Japan in terms of both passenger and cargo hubbing. Indeed, Kansai would like to become a major business-oriented hub for North East Asia, as the airport that attracts the best combination of direct long-haul flights and local feeder routes is the most likely to attract regional headquarters. However, high landing fees may impede it from attaining hub status. Despite a traditional dislike for breaking journeys or for wasting part of their very short holidays in transit, price-sensitive Japanese tourists are travelling to Europe and the US through hub airports such as Singapore and Seoul. Both destinations are served out of regional airports, such as Fukuoka, allowing passengers to avoid the inconvenience of having to transit Narita or Kansai. As with seafreight, a number of Australian shippers are hubbing Japan-bound air cargo through Singapore, Taiwan and Korea.

COMPETITOR AIRPORTS

Singapore's Changi Airport operates around the clock with no congestion. Handling capacity is 66 movements per hour; actual throughput is 40. Passenger capacity is 45 million per year; throughput is about half that. With a growth rate of 7 per cent per year, Changi is being expanded to handle 64 million passengers and 3.3 million tonnes of cargo by 2012.

While Seoul's Kimpo Airport has two runways, it is constrained by a curfew from 11 pm to 6 am. The New Seoul International Airport, currently under construction on Yong Jong Island, will have no curfew. It will have a passenger capacity of 27 million people by 2000 and 100 million by 2020, and cargo capacity of 1.7 million and 7 million tonnes, respectively, over the same period. The new airport will be linked to Seoul by a dedicated rail line providing a 45-minute transit time.

Regulation and Reform

Under the Civil Aeronautics Law of 1952, companies require a licence and fare approvals from the MOT to commence operations. The industry remains highly regulated, with fares, routes and other elements set according to MOT's perception of supply and demand. Like rail, standard fares are calculated according to a formula of 'standard costs and appropriate profits'. Under the Cargo Transport Handling Business Law 1990, freight forwarders must seek permission from MOT to operate and and must notify MOT of their rates. Similarly, freight brokers must register with MOT and notify rates. Nominal international fares require MOT approval and are gradually approaching market rates.

International Air Service Agreements

Governments negotiate bilateral agreements covering market access, air routes, freedoms, capacity and flight frequency. Australian carriers are entitled to operate 77 B767-200 equivalent units of capacity to Japan, to be raised to 79 units on 26 October 1997. Of the 77 units, 19.2 can be operated to Kansai, with no more than 14 frequencies. The combined total of Qantas and Ansett operations will provide

71.2 units of capacity to Japan until July 1997, and 74.4 from July, including 19.2 units on 11 frequencies to Kansai. There are no frequency restrictions on points other than Kansai.

Austria, China, Germany, Lebanon, New Zealand and the US have rights to operate direct flights between Australia and Japan. Only New Zealand does so now, and a US airline flew between Japan and Australia for a short period a few years ago. Singapore Airlines, Cathay Pacific and Korean Air offer indirect flights, often at cheaper prices.

Reforms

Reforms are being implemented gradually. In 1986, MOT approved double and triple tracking, whereby more than one airline is allowed to operate on high-intensity domestic trunk routes.[13] In 1994, the Civil Aeronautics Law was amended to enable airlines to discount fares and freight rates by up to 50 per cent for ‘marketing purposes’ upon notification to MOT. This was followed by advance-purchase discounting in 1995. In 1996, a zone price system was introduced for normal, peak, and off-peak fares, enabling airlines to discount by up to 25 per cent. In 1996 the passenger number criteria for double- and triple-track routes were reduced by half; MOT expects this should eventually give 87 per cent of domestic passengers a choice in airlines (OECD, 1996b).

The situation should further improve as new competition is introduced. Not only are several new domestic airlines to be licensed, but they will have access to coveted slots at coveted airports, such as Tokyo’s Haneda, which is being expanded to raise its flight-handling capacity by one quarter by 1999. However, the extent of domestic competition will depend on further deregulation. International competition could increase if the authorities allocate more slots to nontraditional carriers at Narita and Kansai airports.

The OECD (1996b, p. 26) suggests that Japanese airlines could reduce costs substantially if they were allowed to use cheaper imported oil on domestic flights; hire foreign flight and cabin crews; institute productivity measures; further lower prices to increase load factors; introduce more innovation; and reduce surplus employment.

Multilateral Initiatives

Despite various attempts to incorporate aviation within the scope of the General Agreement in Trade in Services (GATS), only aircraft maintenance and some marketing services were eventually included. Currently, the APEC Transport Working Group is preparing an options paper on more competitive air services in the Asia-Pacific region. This initiative will address a broad range of issues, including concerted regional approaches to convertibility between passenger and freight entitlements, and delinking freight capacity from passenger entitlements.

....

13 In 1995, there were 27 double-track routes (exceeding 400 000 passengers annually) and 19 triple-track routes (exceeding 700 000 passengers per year) (Ministry of Transport, 1995c).

Infrastructure and Innovation

MOT is studying the impacts of the deregulation process in Europe and the US. Its conclusions on the costs and benefits of those experiences will help determine the pace and extent of future deregulation in Japanese aviation.

New and Expanded Airports

Over the next 10 to 15 years, new runways are planned for Narita, Kansai and Haneda, and new airports for Chubu, Fukuoka and Kitakyushu - and perhaps Tokyo (Table 13.8). The timing of Narita's planned expansion to three runways remains uncertain, given the protracted negotiations with local residents. Although Haneda, the country's busiest airport, will have five runways and a capacity of 230,000 flights per year by 1999, it will be operating at capacity again by 2008. To address this eventuality, MOT is conducting feasibility studies for a third domestic airport serving Tokyo.[14] The New Kansai Airport will expand from one runway to three by 2010. Nagoya's congestion problems should be resolved when the New Chubu Airport is completed on an artificial island in Ise Bay in 2005.

Smaller airports are also being expanded so that 40 per cent will have runways of at least 2500 metres and thus be able to handle large jet aircraft (30 per cent at present, Ministry of Transport, 1995c). This will enable more regional airports to establish direct flights to other Asia-Pacific destinations, easing some of the pressure on Tokyo and Osaka. Expansion of Shin-Chitose (Sapporo), for example, will provide Hokkaido with a transpolar gateway to and from North America and Europe. Shin-Chitose may also become an international cargo hub. The New Kitakyushu and New Fukuoka airports, both to be built on reclaimed land, are scheduled for completion in 2005 and 2010, respectively.

Table 13.8

New Airport Capacity

Airport	Runways	Completion
Narita	2,500m x 1	Unknown
	3,200m x 1	Unknown
Kansai	4,000m x 2	2010
	3,400m x 1	
Haneda	3,000m x 1	1996
	2,500m x 1	1999
Third Tokyo	Unknown	Unknown
New Chubu	3,500m x 1	2005
New Fukuoka	n.a.	2010
New Kitakyushu	n.a.	2005

Source: Ministry of Transport, 1995c

....

14 Local governments would like to see this airport serve Asian destinations, as well as domestic ones.

CONCLUSION: GRADUAL REFORM TO CONTINUE

Intensifying competition and external forces will continue to pressure the authorities to streamline the restrictive regulations and work practices that impede efficiency and cost cutting. However, as many of these barriers protect entrenched interests, they may not be easily overcome.

Domestic Freight

Road is the most expensive freight transport mode, but it offers the advantage of more efficient door-to-door service. Reforms to give truckers more flexibility in routing and pricing could make it less costly over the medium term. Future developments in rail freight will depend on the political will to extend rail services to ports (now served mainly by trucks) and to resolve Japan Rail's track access, innovation and profitability problems.

In coastal shipping, MOT is exploring ways to integrate small domestic shipping lines and ensure greater competition. Prototypes of the 'Techno Superliner' indicate that fast ferry-type vessels would compete favourably with road transport in terms of transit times, making sea/road/rail combinations more feasible. If coastal shipping could overcome its current cost barriers, it could become an efficient means of freight transport over the next 10 to 15 years.

International Freight

The major issues for exporters to Japan are lengthy and sometimes inconsistent customs and quarantine procedures, inflexible work practices, high charges at air and sea ports, and the high cost of domestic freight services. Ongoing reforms, capacity expansions and technological advances at Japanese air and sea ports should increase their efficiency and competitiveness over the next 10 years. However, greater efficiency and competition will only develop if the necessary infrastructure is built where it is most needed (that is, Tokyo and Osaka). Unless they incorporate active local market development and efficient connecting infrastructure, other strategies will be ineffective.

Ongoing Deregulation

The Ministry of Transport announced in March 1997 that it would:

1. abolish all transport-related supply-demand adjustment regulations, in principle within five years; and
2. establish the necessary environment and conditions to achieve that goal, while taking appropriate measures to protect users and ensure safety.

Specific measures include:

- Trucking: abolish supply-demand adjustment; expand operation zones gradually to regional economic blocs by JFY2000
- Aviation: abolish supply-demand adjustment in domestic passenger and cargo operations; set transparent and fair rules allocating slots at congested airports; set measures to maintain essential services

- Rail: abolish supply-demand adjustment for freight after JR privatisation is completed
- Harbours: take measures to ensure stable port operations
- Coastal Shipping: consider early end to tonnage adjustment arrangement.

Regarding price deregulation to accompany the supply-demand adjustment moves, MOT would make the prior approval system more flexible (but would probably maintain a price cap to protect users). It said it would move from the prior approval to a notification system in rail freight and other areas. The Review of the Deregulation Action Plan in March 1997 specified procedures.

IMPLICATIONS FOR AUSTRALIA

Roads

Congestion on Japanese roads and constraints on other methods of distribution can have a significant impact on exporters' costs and delivery times. Although import/export containers may be carried on Japanese roads, quite frequently import containers are deconsolidated upon arrival and repacked into smaller vehicles for distribution.

In future, relaxation of regulations and adoption of innovative solutions should give both foreign and domestic suppliers better access to a wider range of Japanese customers. Adoption of international standards on container weight and size, and expansion of inland container handling capacity (including allowing B-Doubles) would facilitate goods movement, reduce costs and delays, and contribute significantly to economies of scale.

As the Japanese distribution system becomes increasingly sophisticated, demand for high-technology logistics management services is growing rapidly. Some of the innovative solutions that Australian transport and logistics firms have developed may be applicable to Japan.

Rail

The rail freight system improvements outlined above may produce improved efficiency in distribution and consequent savings for companies, including exporters to Japan. In addition, Australian companies with experience in multimodal transport and logistics systems, and suppliers of rail equipment and services may be interested in exploring opportunities in Japan. The Australian Rail Industry Council, supported by Austrade, has already made some successful sales to Asia.

Shipping

The traditional pattern of primary products on the Australia-Japan leg and manufactures on the southbound leg remains. Shipping innovations are assisting exporters to reduce costs and become more competitive. For example, companies are dealing with the high proportion of refrigerated containers that returns empy from Japan by developing 'reefers' that can be converted to dry containers capable of carrying manufactures. They are also looking at fast-ship developments, which could facilitate exports of perishables to East Asia by eliminating the need to ship them by air.

In addition, further cargo consolidation in such gateway ports as Brisbane or Melbourne could have a major impact on steaming costs, idle time and port charges, and could reduce freight rates.[15] Additional economies might be realised by consolidating cargo to/from New Zealand as well. However, the potential for further cargo centralisation may be limited to adjacent ports by insufficient east coast rail infrastructure.

Improvements on international shipping will have only a minor impact on door-to-door transit time to Japan unless Japanese customs and quarantine procedures are streamlined to reduce clearance delays. Electronic preclearance is a basic first step. Other problems affecting shippers using both Australian and Japanese ports are operating hours, labour flexibility and productivity, and port charges. These are all being addressed on a government-to-government basis.

A number of Australian shippers are already transhipping into local Japanese ports through centres such as Singapore, Hong Kong and Pusan.

Aviation

Keeping Perishables from Perishing

Freight capacity from Australia to Japan (most of which is on passenger aircraft) is generally underutilised. This is due to passenger schedules and to the delays in clearing perishables at Narita airport. While some improvements are underway, governments and users should continue to press for international best practice in customs and quarantine clearance at Narita. For example, an express handling unit, similar to those used in Sydney and Singapore, could reduce clearance time at Narita from 3.5 hours to 1 to 2 hours (Kogawa, 1996).

Competing for Japanese Tourism

While Australia is a popular destination, competition for Japanese tourists is intensifying. The basic determinant is the total package value, not just the airfare. The Minimum Tour Price mechanism imposed by the Japanese Government is both an advantage and a disadvantage to Australia. It is a disadvantage because the airfare makes up a larger portion of Japan-Australia packages than of competing destinations, reducing packagers' ability to discount prices. It is an advantage in that its existence protects Australia to a certain extent. Because competition is intensifying and package prices may be further deregulated in future, governments and industry must work even harder to ensure:

1. that Australia remains a major destination for Japanese tourists; and
2. that Japanese tourism to Australia remains profitable for the travel industry in both countries.

---

15 Assisting cargo centralisation, the Australian National Rail Corporation operates special container trains between Brisbane and Sydney, and between Melbourne and Adelaide (international containers may also go on regular container trains). Road freight is also used. For example, some car-carrying vessels drop their cargoes in Brisbane to be transported elsewhere in Australia by specialist truckers.

Concerned over slowing tourism to Australia, Japanese and Australian travel industry and government representatives met in 1996 and 1997 to discuss ways of reversing the trend. This process, together with growing Japan-Australia industry collaboration, is critical in establishing the relationships necessary to ensure future tourism growth in both directions.

With Qantas serving Fukuoka, Osaka, Nagoya, Tokyo and Sapporo, and Ansett flying to Osaka, effective marketing strategies will be vital in raising awareness of Australia in regional Japan and of regional Japan in Australia. (See Chapter 14, Appendix 14.2: *Tourism Marketing*.)

REFERENCES

American Chamber of Commerce in Japan, 1997, *United States-Japan Trade White Paper*, Tokyo.

Australia-Japan Economic Institute, 1996, *Economic Bulletin Vol.4, No.7,* July, Sydney.

Bureau of Industry Economics, 1995, *International Performance Indicators - Aviation*, Canberra.

Containerisation International Yearbook, 1989, 1995.

Department of Foreign Affairs and Trade, 1996, *Country Economic Brief - Japan*, Canberra.

____ 1995, *Improving the Airfreight Chain for the Export of Perishables*, Canberra.

Department of Transport and Regional Development, 1997a, compiled from *Railway Directory 1996* (Railway Gazette International, Surrey), *Jane's World Railway* 1995-96 (Abbott, J.[ed], Surrey), *World Railway Equipment & Technology*, Update 1996-97 (Salveson, P. [ed], London).

____ 1997b, consultation, information provided to East Asia Analytical Unit.

Fossey, J., 1996, in *Containerisation International*, June, pp.40-43.

Japan Times, various issues.

Kogawa, M., 1996, consultancy for the East Asia Analytical Unit.

Maunsell Pty Ltd, 1996a, *APEC Transport Working Group, Congestion Points Study Phase 2, Final Report Volume 2: Air Transport*, Canberra.

____ 1996b, *APEC Transport Working Group Congestion Points Study Phase 2, Final Report Volume 3: Sea Transport*, Canberra.

Ministry of Justice, 1997, *Annual Report*, Tokyo.

Ministry of Transport, 1997, *Review of the Supply-Demand Adjustment Regulations in Transport Policy*, Tokyo.

____ 1995a, *National Transportation Statistics Handbook*, Tokyo.

____ 1995b, *Overseas Transport Statistics*, Tokyo.

____ 1995c, *White Paper,* Tokyo.

____ 1994, *White Paper*, Tokyo

Nikkei Weekly, various issues.

Organisation for Economic Cooperation and Development (OECD) 1996a, *OECD Economic Surveys 1995-96, Japan*, OECD, Paris.

____ 1996b, *Economy-Wide Effects of Regulatory Reform,* OECD, Paris.

Shipping Gazette, 1996, Japan Press, Tokyo, 23 December.

Transport Yearbook 1996, Kotsu Kyoryokukai, Tokyo.

Travel Journal International, 1995, *Japan Travel Blue Book 1994-95*, Tokyo.

United States Trade Representative, 1996, *National Trade Estimate: Japan*, Washington DC.

Chapter 14

SERVICES FOR THE FUTURE

The narrowly defined services sector within Japan's broad tertiary industry[1] will expand rapidly between now and 2010, with new segments emerging in response to growing demand for professional, business support, health, education, leisure and multimedia services. Because some areas are quite new, they face fewer traditional barriers and offer attractive opportunities for companies that can meet the needs of the world's most demanding customers.

A number of factors are driving services sector growth. Lifestyle and demographic changes foster new demand for a growing range of services. Manufacturers are outsourcing a variety of services functions to improve efficiency and competitive advantage as they adopt increasingly sophisticated applications and processes. In nonmanufacturing sectors, deregulation will contribute to growth and innovation by giving services industries more flexibility to develop new products and create new demand.

This chapter highlights key developments in the services sector and assesses its market attractiveness and growth potential. It examines competitiveness, efficiency and market access, and identifies trends and growth segments of interest to Australian companies. Services trade, such as travel, overseas students and other important foreign exchange earners for Australia, is discussed in Chapter 5 - *Trade*.

GROWING SHARE OF OUTPUT AND EMPLOYMENT

The services sector covered in this chapter is projected to account for 25 per cent of Japan's gross output and 43 per cent of employment in 2025, up from about 20 per cent and 30 per cent, respectively, in 1990 (Figures 14.1 and 14.2). Manufacturing, the main force driving the Japanese economy in the postwar era, will continue to account for just over 40 per cent of production, but its share of employment will decline from about 25 per cent in 1990 to 15 per cent in 2025. The services sector will absorb much of this employment, requiring changes in both mindset and skills among workers traditionally oriented toward manufacturing. This has important implications for the broader education system.[2]

....

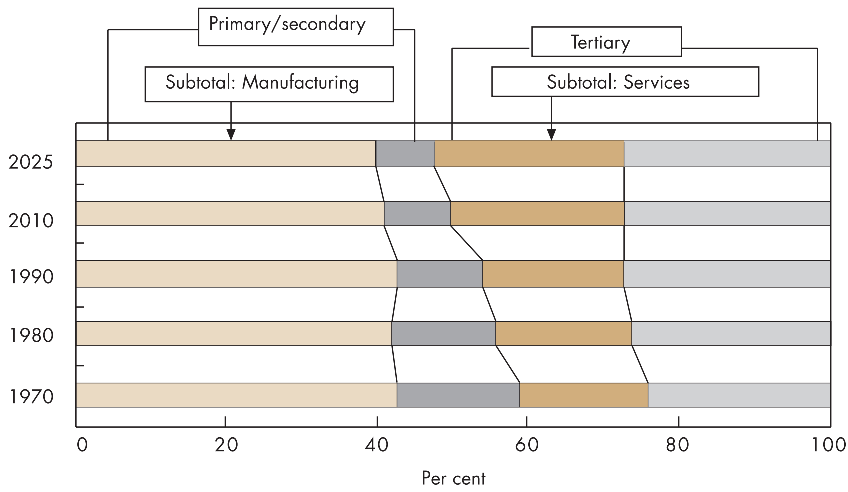
1 The services this chapter covers are the 'miscellaneous services' within the broader tertiary sector of the economy. They provided 86 per cent of employment expansion in 1991 to 1996 and accounted for 16 per cent of GDP in 1995. They include leisure; leasing; information industries (IT, multimedia); cleaning, catering and linen services; broadcasting; advertising; entertainment venues (such as theme parks, cinemas, sporting facilities); personal services (such as childcare, hair salons, housekeeping); professional services (such as legal, accountancy, consulting); business support services (such as temporary staffing, logistics, building maintenance, security); education and training; environmental management (such as waste disposal); health care; and pathology services. The broader tertiary sector, which comprised 54 per cent of Japan's 1995 GDP, includes wholesale/retail (13 per cent of GDP), real estate (11 per cent), transport/communications (6 per cent), finance (5 per cent), utilities (3 per cent) and miscellaneous (16 per cent) (Morgan, 1997).

2 As in many white collar areas, employment in the services sector is under pressure as companies seek to cut costs and improve efficiency. See Chapter 2 - *Socioeconomic Evolution* for an analysis of labour conditions and the educational system.

Figure 14.1

Services* Expanding Steadily

Gross Output Trends by Industry

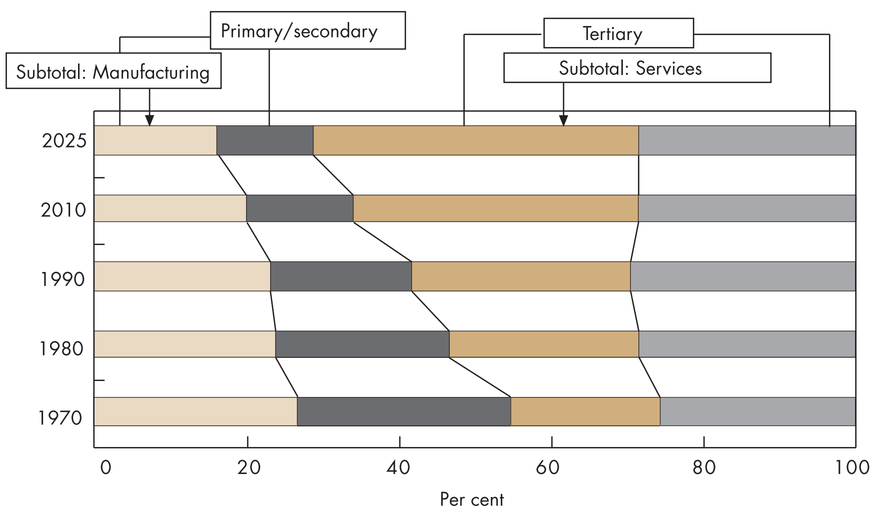


Note: Production value in1985 prices. *See Footnote 1 for explanation of 'services'.
Source: Economic Planning Agency, 1995.

Figure 14.2

Services Sector Major Job Creator

Employment Trends by Industry



Note: Production value in1985 prices.
Source: Economic Planning Agency, 1995.

LIFESTYLE, CORPORATE NEEDS CREATE NEW DEMAND

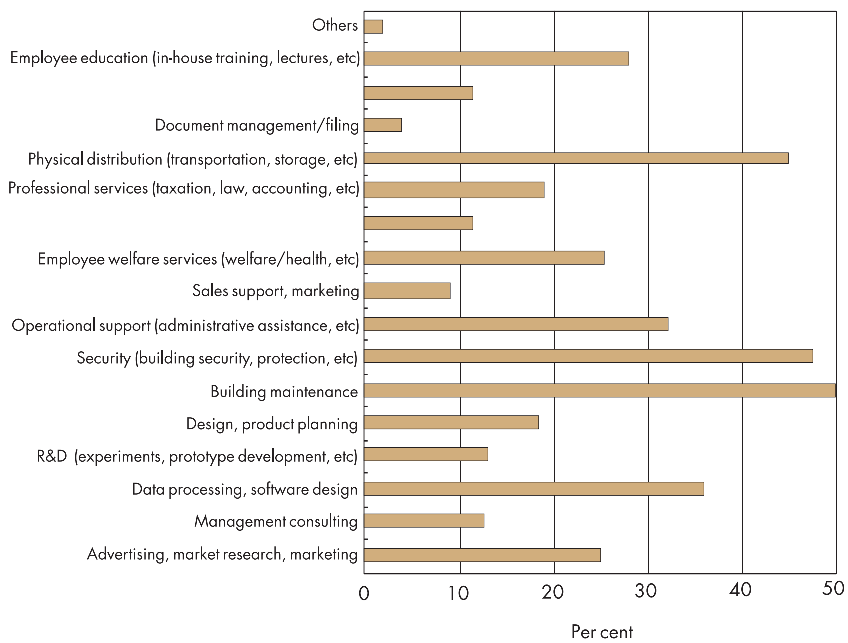
Income growth and more free time are leading to lifestyle changes. (See Chapter 2 - *Socioeconomic Evolution.)* Values are shifting from demand for material affluence to a desire for personal fulfilment, with increased consumption of education, recreation and tourism, dining out and communications. Also, the ageing population and rising participation of women in the workforce will intensify spending on health, lifestyle and household services (Figure 14.4).

The manufacturing sector will generate many new opportunities for services companies (Figure 14.3). Outsourcing of service functions such as research and development will increase, with good opportunities for offshore enterprises. Manufacturing companies also are moving into nonmanufacturing services such as marketing and consulting to add value to products and improve profitability. To increase flexibility, some manufacturers convert these new activities into separate companies or outsource them.

Figure 14.3

Cleaning, Security, Distribution Head the List

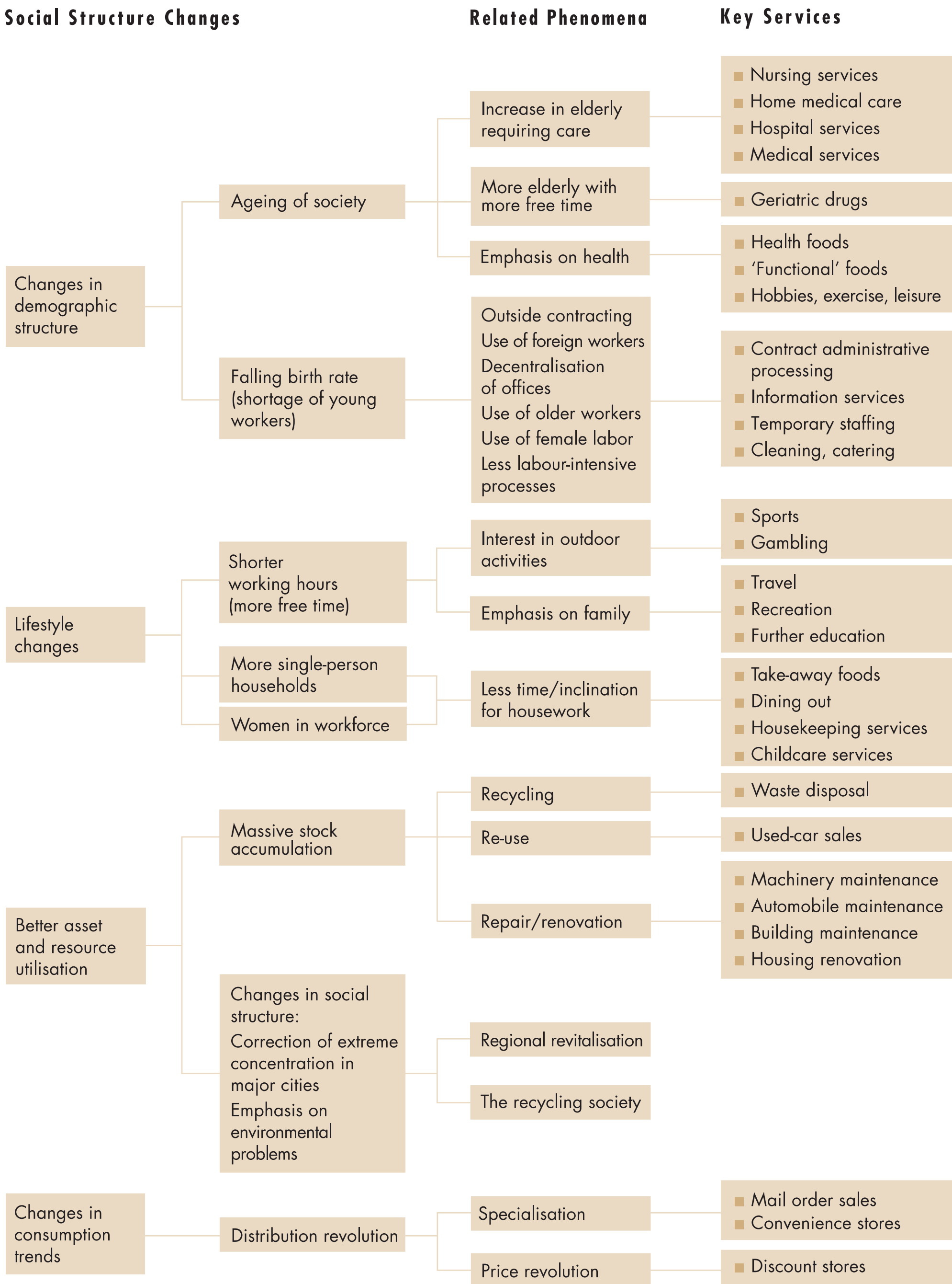
Services Manufacturers Want to Use in Future



Source: Ministry of International Trade and Industry, 1996.

Figure 14.4

Social Structure Changes and New Growth Sectors



Source: Sakura Institute of Research, 1996.

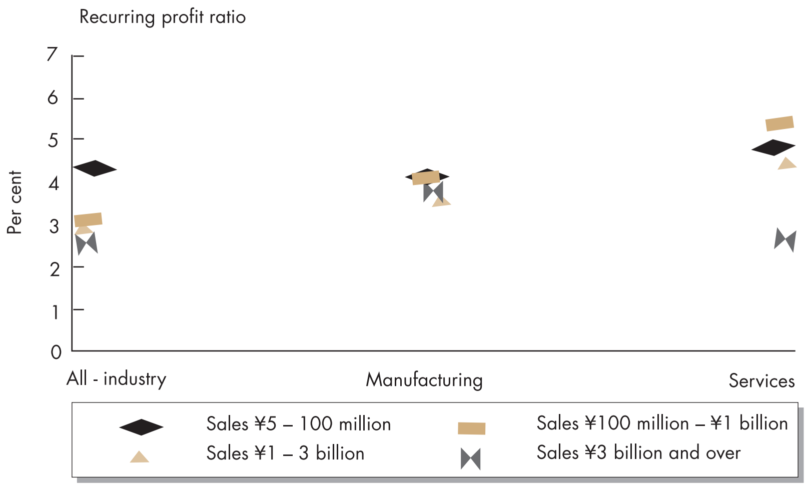
SMALLER COMPANIES PREDOMINATE

Most companies in the services sector are quite small in terms of both employment and sales. Of the 1.2 million service industry businesses, 73 per cent of have one to four employees, and almost 90 per cent have fewer than ten; almost 90 per cent have sales of less than ¥100 million (US$830 000), and nearly half have sales of less than ¥10 million (US$83 000) (Management and Coordination Agency, 1994). In general, services firms with sales of up to ¥1 billion (US$8.3 million) are more profitable than their counterparts in other industries (Figure 14.5), and much more profitable than the larger services firms. This may indicate the greater flexibility and responsiveness required in the many niche markets of the services sector. However, as with the distribution sector, new entrants and intensifying competition will probably lead to fewer tiny companies in future.

Figure 14.5

Smaller Services Companies Have Higher Profits

Recurring Profits-to-Sales Ratios by Company Size



Note: Only companies with positive results are included in the data.

Source: Management and Coordination Agency, 1994; TKC National Systems Committee, 1996.

FOREIGN INVESTMENT IN SERVICES

Foreign direct investment in Japan is fairly evenly divided between manufacturing and nonmanufacturing, with about 9 per cent being in the services sector (Table 14.1). FDI in the tertiary sector has gained importance since 1985, with the financial market a primary focus. (See Chapter 6 - *Internationalisation* for a detailed analysis of FDI in Japan.)

Table 14.1

Services FDI US$3 Billion

Foreign Direct Investment in Japan By Industry, Cumulative FY1950 to FY1994

Industry		Number of investments	Value (US$ million)	Per cent of total
Manufacturing		21 126	18 804	55.2
Nonmanufacturing	Commerce / trade	15 932	6 887	20.2
	Services	**8 086**	**2 994**	**8.8**
	Finance / insurance	417	2 423	7.1
	Real estate	586	1 239	3.6
	Telecommunications	215	352	1.0
	Others	4 463	1 388	4.1
	Subtotal	*29 699*	*15 283*	*44.8*
Total		50 825	34 088	100.0

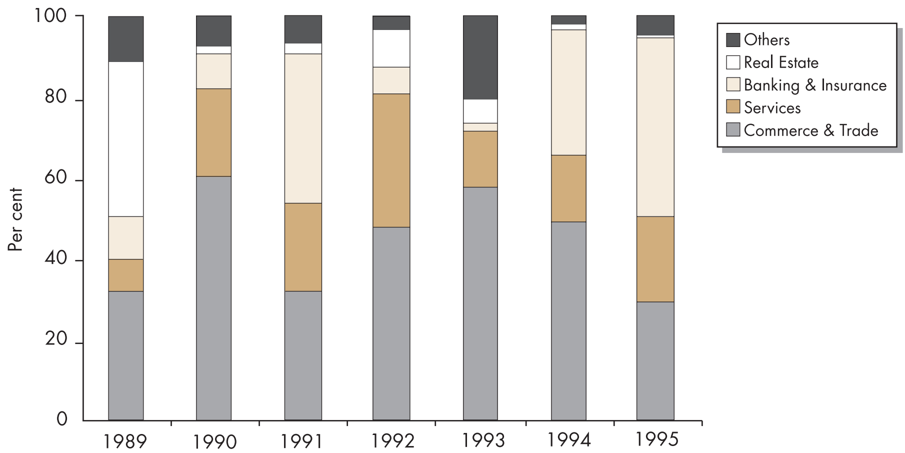
Note: Services include leisure, information services, advertising, health care, hotels and others. These figures differ from those used in Chapter 6 - *Internationalisation*, as they are based on Ministry of Finance data. Chapter 6 largely uses Bank of Japan balance of payments data, which give realised, rather than notified, investments and therefore are more accurate. However, these Ministry of Finance figures are the only ones to provide an industry breakdown.

Source: Ministry of International Trade and Industry, 1995.

Figure 14.6

Banking and Finance Resurge

Foreign Investment in the Japanese Nonmanufacturing Sector 1989 to 1995



Note: Yearly new FDI in nonmanufacturing in US$ millions: CY1989, 1.7; 1990, 1.2; 1991, 2.4; 1992, 2.5; 1993, 1.5; 1994, 2.2; 1995, 2.4.

Source: Ministry of Finance data from Ministry of International Trade and Industry, 1996.

Most foreign companies (including 81 per cent in the services sector)[3] are attracted to the size, growth potential and growing international prominence of the Japanese market. In the services sector, particularly in emerging areas, foreign and Japanese companies are less bound by tradition and increasingly are seen as desirable employers among bright and ambitious graduates. This should help overcome some of the recruitment problems foreign firms have faced in the past.

BUSINESS SUPPORT

Faced with a challenging business environment, Japanese companies are narrowing their business interests, spinning off some activities into separate companies, streamlining head offices and outsourcing services. This will expand the business support services sector supplying functions that are no longer justified or satisfied in-house, such as transport, warehousing and logistics, cleaning, security, research and development, legal, document storage and retrieval, and ad hoc needs such as temporary staff (Tables 14.2, 14.3 and 14.4).

Temporary Staffing and Recruitment Services

Changing attitudes to employment, company efforts to reduce labor costs and a growing need for outside expertise are heightening demand for temporary employees. However, this demand will only develop into an effective industry if appropriate employment systems and a more flexible labor market evolve. Deregulation is proceeding in the temporary staffing and recruitment sectors, allowing private agencies more latitude than in the past. (See Chapter 2 - *Socioeconomic Evolution*.)

Table 14.2

Market to Treble by 2010

Projected Growth of the Business Support Services Sector 1996 to 2010

	Current	2000	2010
Market size	¥3.6 trillion (US$30 billion)	¥6.6 trillion (US$55 billion)	¥11 trillion (US$82 billion)
Jobs	380 000	520 000	710 000

Note: Estimated figures.
Source: Ministry of International Trade and Industry, 1994.

[3] Company response to a 1994 survey by the Tokyo Metropolitan Government.

Table 14.3

Business Support Services with Growth Potential

Service segment	Development areas
Innovation, R&D, information technology, market intelligence	***Research and development*** • Technical information and applications services • Inspection and analysis services • Technical trading services (to intermediate intercompany transactions in technology, patents, etc) ***Information gathering and analysis*** • Think tanks, specialist consultants • Tailored information services • Intellectual property rights, clearing services, including clarifying rights and negotiating between owners of rights
Working environment, security, maintenance	• Security services, including office security • Satellite-office formats narrowing the gap between work and home • Building maintenance • Secure storage, retrieval systems for documents and magnetic tapes (records management)
Product safety and reliability	• Risk management, including liability management • Testing
Support for new activities	• Incubation centres providing low-cost serviced offices and R&D facilities

Source: Ministry of International Trade and Industry, 1994.

Table 14.4

Employment Industry to Burgeon

Projected Scale of Human Resources Market 1996 to 2010

	Current	2000	2010
Market size	¥1.3 trillion (US$11 billion)	¥6.3 trillion (US$52 billion)	¥12.6 trillion (US$105 billion)
Jobs	20 000	30 000	50 000

Note: Estimated figures. 'Human resources' is defined as temporary staffing, recruitment and training services.

Source: Ministry of International Trade and Industry, 1994.

PERSONAL SERVICES

As more women move into the paid workforce, demand for housekeeping, childcare, elderly parent care and other support services will increase. (See Chapter 2 - *Socioeconomic Evolution*.) Current forecasts indicate the childcare market will be worth ¥850 billion (US$7 billion) by 2000. Demand is expected to soar in temporary staffing for childcare facilities in department stores, cinemas, theatres and sporting venues. Competition should escalate as larger companies enter the market. The Ministries of Labour and of Health and Welfare both subsidise childcare facilities, but they may need to become more proactive in further developing and appropriately regulating the industry. Key priorities will be recruiting and training high-quality staff.

PROFESSIONAL SERVICES[4]

Demand is growing rapidly for professionals with the specialist knowledge and experience to service Japan's increasingly complex economy and society, and to assist companies with rapid technological progress and internationalisation. Professional services are growing faster than other industries (Table 14.5).

Table 14.5

Professional Services Grow Fastest

Trends in Numbers of Business Establishments 1991 and 1986

Industry	1991	1986	Variation (per cent)
All industries	6 753 853	6 708 759	0.7
Agriculture, forestry and fisheries	20 967	21 463	-2.3
Manufacturing	857 016	874 587	-2.0
Retailing	1 592 087	1 729 248	-7.9
Services	1 715 084	1 604 408	7.0
Law and patent offices	*10 626*	*9 674*	*9.9*
Notary/scrivener offices	*13 053*	*12 160*	*7.4*
CPA and tax accountancy practices	*30 612*	*26 786*	*14.3*

Source: Management and Coordination Agency, 1996a.

The growing demand for legal practitioners, particularly in international patent administration, and specialist researchers in advanced technical fields, reflects the need to protect intellectual property rights. Overseas expansion, corporate restructuring and increased merger and acquisition activity will generate strong demand for management consultancy, accounting, legal and other services (Table 14.6).

....

4 Professional services for the purposes of this report are activities that require official qualifications or advanced specialist knowledge, such as legal, medical, accounting and consulting services.

Table 14.6

Good Potential for Lawyers, CPAs

Selected Professional Service Providers

Service providers	Overview	Future potential
Lawyers	About 17 000 lawyers are registered with the Japan Federation of Bar Associations, and the number grows by 300 to 400 per year. Extensive restrictions on the types of business that foreign lawyers can handle have led to calls from various countries for liberalisation. In June 1992, the Ministry of Justice and the Japan Federation of Bar Associations established a group to consider responses to this issue, with no real progress yet.	Steady growth
Patent lawyers	Rapid technological development, the internationalisation of technology and intellectual property exchanges generate strong demand for the services of Japan's 4 000 patent attorneys.	Steady growth
Chartered public accountants (CPAs)	In recent years, accountancy has expanded into the internationalisation, administrative reform and auditing of state-owned enterprises, and support for companies undertaking public share floats and listings. In March 1994, Japan had just over 10 000 chartered public accountants, 3 000 assistant accountants and 15 foreign chartered public accountants. Accountancy firms are merging locally to strengthen their competitiveness and are internationalising through business tie-ups with major overseas accounting firms and membership of international organisations. Audit fees average around ¥15 million per corporation. Foreign firms form audit corporations or act as international divisions for Japanese audit firms.	Shortage of accountants, future potential
Management consultants	In recent years, consulting firms have expanded in line with the increasing diversity and sophistication of demand. Many consultants join established firms to develop a business base, then break away to form their own firms.	Escalating competition due to oversupply
Tax accountants	Tax accountants must be registered with the Japan Federation of Certified Public Tax Accountants. Rapid growth to more than 18 000 practitioners has intensified competition. Most tax accountants have fewer than 100 clients, and the potential for corporate business development will be limited until the economy improves. Turnover from individual clients tends to be small, and tax accountants are shifting into inheritance tax and management consultancies.	Escalating competition due to oversupply
Judicial scriveners	Judicial scriveners process documents for real estate registration and court cases, and provide advice. The profession is strictly controlled by regulations on practice size and restrictions on advertising. Numbers are declining, but business is increasing.	Future potential

Source: Sakura Institute of Research, 1996.

Qualification standards and Japan's traditional nonconfrontational system have led to chronic shortages of lawyers and patent attorneys. Japan has only 17 000 lawyers, and annual additions to their ranks will not satisfy demand in the foreseeable future. Bilateral discussions are addressing regulatory barriers limiting the entry of foreign specialists. For example, foreign lawyers are not allowed to employ or enter into partnerships or other fee-sharing arrangements with Japanese lawyers and quasi-legal professionals.

HEALTH AND MEDICAL SERVICES

As more than 20 per cent of the population will be over 65 years of age by 2010 (Management and Coordination Agency, 1996b), the demand for specialised medical and nursing home care will increase markedly. The market for these services will quadruple to ¥12 trillion (US$100 billion) by 2010, and employment will nearly treble to 560 000 jobs (Ministry of International Trade and Industry, 1994).

Japan's annual expenditure on health has doubled since 1985 and is expected to double again by 2010 (Table 14.7). The share devoted to aged care is escalating even more rapidly and will account for half the total by 2025. Medical services are highly regulated, mainly provided in public institutions and quarantined from the full effect of market forces. However, with budgetary constraints forcing cost cutting and other efficiencies, pressure is mounting to ease regulations, including those barring profit-oriented corporations from hospital management.

Table 14.7

Cost of Aged Care Escalating

National Medical Costs

	1985	1990	1993	2000	2010	2025
National medical expenditure (¥ trillion)	16	21	24	38	68	141
Medical expenditure on the aged (¥ trillion)	4	6	7	13	28	71
Medical expenditure on the aged (per cent of total)	25	28	30	35	42	50

Note: The number of elderly Japanese in need of care is expected to rise from 1 million in 1996 to nearly 3 million in 2025. Average life expectancy is now 82 years for women and 76 years for men.

Source: Ministry of Health and Welfare, 1995.

The growing demand for sophisticated medical equipment and services will drive the growth of equipment and drugs, home medical support services and health management services. The welfare sector will see strong demand for nursing homes, hospices, rehabilitation facilities, general nursing services and home nursing care.

Reducing the cost of nursing services to individuals will release considerable latent demand for these services. Funding options include offering public nursing insurance. With demand for nursing care set to outpace the supply of public nurses, and the insurance system's limited ability to fund the rising expenditure, opportunities are opening up for the private sector. In recent years, several major private nursing firms have entered the market. However, many problems must still be overcome, including the high cost of private versus public care (Table 14.8).

Outside Contracting of Health-Related Services

Medical institutions, seeking efficiencies amid rising labour and equipment costs, increasingly use outside contractors for in-hospital functions. Private providers focus on new peripheral activities, such as agency services for medical institutions and support services for home-based medical care. The current market for these services is estimated at ¥3 trillion to ¥4 trillion (US$25 billion to US$33 billion).

The Medical Service Law was amended in 1992 to allow health-related services to be contracted out. Ministerial ordinances now specify provider standards for pathology laboratories, sanitation and hygiene (disinfection and sterilisation), catering, patient transport, maintenance and inspection of medical equipment and medical gas supply systems, laundry and hospital cleaning services. Providers' records and long-term connections with hospitals and physicians are key factors in awarding contracts. The most effective way to enter the market is via joint ventures, mergers or acquisitions.

Table 14.8

Regulation in the Health Sector

Item	Outline
Entry	**Residential hospitals, rest home and other such facilities:** are licensed by prefectural governments or the Ministry of Health. **Clinics:** no restrictions on establishing these, but the Japan Medical Association has power to 'adjust supply'.
Qualifications	Authorities can refuse to grant licences to for-profit entities for hospitals, clinics and health facilities for the aged. Although the home-care service segment is an exception, for-profit corporations cannot receive national health insurance payments.
Operational criteria	Eligibility for medical insurance is conditional upon supervisory indicators for facilities, staff, etc. This hinders both efficient operation and the introduction of new technology.
Official service price standards	Although quality may vary, uniform unit prices apply to services covered by medical insurance. Similarly, local authorities approve a uniform range of services, leaving little scope to expand product ranges.

Source: Sakura Institute of Research, 1996.

EDUCATION

Demographic changes, increased leisure time and business requirements are creating a relatively new services segment. Previously, the private education services industry[5] supplemented the public education system, focusing mainly on university entrance

5 Chapter 2 - *Socioeconomic Evolution* covers education and leisure trends.

exams, primary and secondary school coaching, and tutoring services. Now it is diversifying into continuing education, vocational training and specialist skills development. (Table 14.9).

Table 14.9

Active Private Sector

Overview of the Education Service Industry

Market Segment	Description
Public Sector	
Public school education	From kindergarten to university
Adult education	Public halls, libraries, gymnasiums, others
Local government organisations	Retiree clubs, youth worker clubs, others
Private Sector	
Corporate education	Employee training, career planning, others
Private sector education businesses	Culture centers, coaching schools (*juku*)

Source: Kimindo Kusaka and Softnomics Center, 1994.

Adult Education

Traditionally, Japan stressed educating young people, and only recently has begun to develop adult education. Demand is likely to expand, particularly as attitudes to employment change, especially among young people. (See Chapter 2 - *Socioeconomic Evolution*.) In addition, eroding confidence in both the Japanese and US models of management has increased demand for more broad-based business education.

In the past, large firms sent a few select employees to business schools in Europe or the USA, investing large sums in a few people. To extend the benefits of business education, companies began to advocate more business schools in Japan. This led to the establishment of various institutions affiliated with well known international business schools. The government also recognised that adult education needed to focus on developing more specialised skills. The Ministry of Labour's August 1996 announcement that it would expand further-education grants for workers indicated that the market for business and vocational training has good growth potential.

Lifelong Education

Older people are showing special interest in educational programs that strengthen links with the community, such as voluntary activities or courses imparting a better understanding of social issues (Prime Minister's Office, 1993). They prefer personal enrichment programs, such as developing hobbies, to practical knowledge programs such as learning foreign languages and business skills.

Educational services for retirees will expand and diversify to include learning activities emphasising hobbies, culture and home life, and study programs and training targeting social contribution. This will create new business opportunities, and may further develop charitable activities, which have not been very common in Japan in the postwar period.

Opportunities for Australia

Good potential exists for Australia to expand its growing educational links with Japan. Australian and Japanese primary and secondary schools and universities are establishing 'twinning' relationships, and in the case of business schools, commercial links. Japanese comprise 6 per cent of foreign students in Australia (Department of Transport and Regional Development, 1997) and increasing numbers of Australians study in Japan.

A growth segment with good potential is study tours and educational tourism, both to and from Japan. The travel industry is developing packages and individual itineraries to take advantage of this growing trend (Japan Travel Bureau, 1997).

LEISURE

Nontraditional leisure pursuits were not widespread in Japan until after the mid-1960s. In the past 15 years, the leisure industry has diversified rapidly, with a new emphasis on individual activities.

In FY1995, the market for leisure-related services was worth ¥85 trillion (US$880 billion) (Figure 14.7). Growth has been sluggish since 1991, reflecting the prolonged recession. Golf courses, for example, have yet to recover from a slump in membership and attendance. While overseas travel remains firm, rising 9 per cent in 1996, slow domestic tourism means slow business for inns and hotels. Pachinko (pinball) parlours and karaoke halls have proliferated, in the opinion of many, to an excessive extent.

The *1996 Leisure White Paper* indicates that most people's first leisure preference is to travel overseas (Table 14.10; also see Appendix Table 14.2). The next most popular choices are domestic tourism and autocamping. As annual leave uptake improves, this market should grow dramatically. The gender differences in the leisure pursuits of the 10-29 and the over-40 age groups are interesting. Generally, females have more interests, including skiing, scuba diving and swimming - areas in which Australia has much to offer. People are also more interested in hobbies and multimedia, such as the Internet, virtual reality simulation and next-generation video games.

While the leisure industry has strong potential, companies will have to innovate to remain competitive in a price-sensitive market. This will include replacing the customary high service levels at golf courses and holiday accommodation with self-service options. High-technology solutions will streamline travel planning (such as the automated outlets at major train stations) and computerise functions such as issuing ski lift tickets (Leisure Development Center Foundation, 1996).[6]

The high latent demand for overseas travel, combined with a relatively strong desire to visit Australia, should sustain Japanese tourism to Australia. In the decade to 1995, travel services trade with Japan grew at a trend rate of 25 per cent per year, earning Australia A$1.7 billion in export revenues in 1995, or nearly half of its services exports to Japan (Department of Foreign Affairs and Trade, 1997). In 1996, only 5 per cent of Japanese travellers visited Australia, so scope exists for growth.

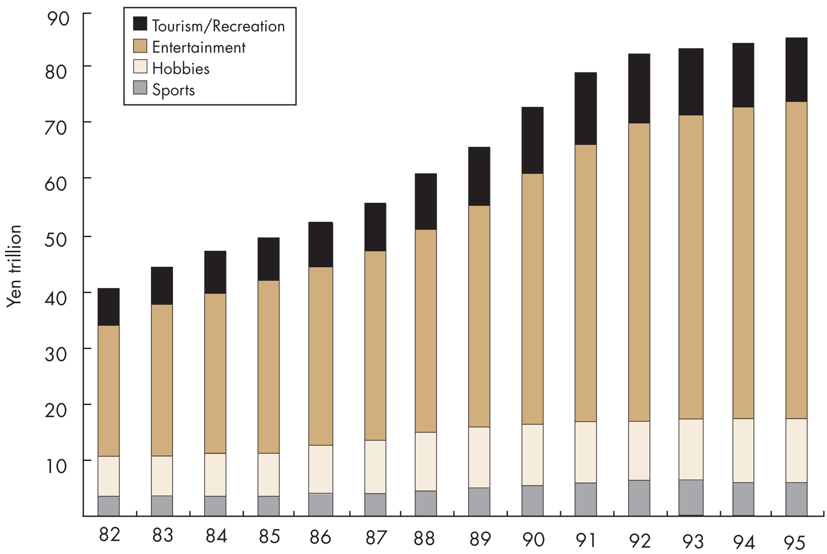
6 See Appendix 14.2 for a description of the travel industry's innovative marketing practices.

However, the Australian travel industry will have to develop innovative strategies to compete with other attractive and cheaper destinations. (See Appendix 14.2 and Chapters 3 - *Socioeconomic Evolution*, 10 - *Regions and* 13 - *Transport* for Japanese travel trends.)

Figure 14.7

Entertainment Spending Doubles

Size of the Leisure Industry Market
Industry Turnover, ¥ trillion



Note: Tourism/recreation: motoring-related activities (including petrol), domestic and overseas travel.
Entertainment: games, dining out, karaoke and gambling.
Hobbies/creative activities: hobbies, handicrafts and creative arts.
Sports: sporting goods and facilities, sports schools and spectator charges.

Source: Leisure Development Centre Foundation, 1996.

Table 14.10

Most Want to Travel

Latent Leisure Demand (Per Cent)

		1st Choice		2nd Choice		3rd Choice	
Total		Overseas travel	37.0	Domestic travel	19.6	Autocamping	14.4
All males		Overseas travel	36.1	Domestic travel	19.3	Autocamping	15.8
Males	10-19	Overseas travel	47.4	Domestic travel	17.7	Autocamping	17.6
	20-29	Overseas travel	42.6	Autocamping	27.1	Domestic travel	24.0
	30-39	Overseas travel	46.7	Autocamping	26.0	Domestic travel	25.9
	40-49	Overseas travel	36.1	Domestic travel	20.7	Autocamping	16.6
	50-59	Overseas travel	29.5	Internet	15.7	Domestic travel	14.2
	60+	Overseas travel	22.6	Domestic travel	13.1	Fishing	10.2
All females		Overseas travel	38.0	Domestic travel	20.0	Autocamping	13.1
Females	10-19	Overseas travel	54.9	Skiing	37.3	Scuba diving	32.0
	20-29	Overseas travel	52.2	Autocamping	27.3	Scuba diving	21.7
	30-39	Overseas travel	51.7	Domestic travel	27.2	Autocamping	21.3
	40-49	Overseas travel	37.0	Domestic travel	22.4	Pottery	14.5
	50-59	Overseas travel	29.2	Domestic travel	17.8	Calligraphy	16.2
	60+	Overseas travel	16.0	Domestic travel	11.1	Swimming	6.2

Note: Latent refers to the percentage of people wanting to participate in the activity minus those who have. For example, of females aged 20-29, 21.7 per cent would like to go scuba diving and have never done so.

Source: Leisure Development Center Foundation, 1996.

MULTIMEDIA

The multimedia segment is extremely diverse and difficult to define. The Ministry of Posts and Telecommunications' Telecommunications Council predicts that the multimedia segment will expand from ¥16.5 trillion (US$171 billion) in 1995 to ¥123 trillion (US$1 trillion) in 2010 (Table 14.11), creating jobs for more than 2.4 million people.

Currently the main channels for multimedia services are prepackaged multimedia terminals (including home video game machines and multimedia personal computers). The hardware market is worth approximately ¥1 trillion (US$8.3 billion), the software market ¥707 billion (US$5.9 billion) and the service market ¥131 billion (US$1.1 billion), with the last showing the fastest growth. Advances in communications infrastructure will shift the focus toward network-type information and services supplied via communications media, such as teleshopping and video on demand.

More than 40 per cent of Japanese households will have a personal computer by 2000, double the 1996 level and nearly four times the 1990 level. After a slow start, PC use among businesses also is growing rapidly, and computer networking is surging, encouraged by the Ministries of International Trade and Industry, Posts and Telecommunications, and Education. For example, Japan had only 72 409 host computers connected to the Internet in mid-1994, compared to Australia's 127 514, and 3.2 million worldwide. By mid-1996, Japan had nearly 500 000 computers connected to the Internet, compared with 400 000 in Australia and almost 13 million worldwide (Australia-Japan Economic Institute, 1997).

Table 14.11

Whole New Industries Will Develop

Multimedia Industry Growth Projections 1995 to 2010

	Item	1995 ¥ billion	2010 ¥ billion
Existing markets	Video equipment/home games	2 216.1	3 289.6
	Communications equipment/computers	5 554.9	25 009.5
	Video software	2 542.0	19 214.7
	Computer programs	29.7	10 129.1
	Network businesses etc	6 050.3	9 233.9
Subtotal		*16 393.0*	*66 876.8*
New markets	End user market	55.4	5 240.0
	Network businesses	11.9	13 706.2
	Data base services	0.9	821.1
	Video on demand	0.9	2 458.0
	Teleshopping	0.0	5 697.1
	Electronic newspapers/publishing	0.0	2 460.7
	Electronic distribution of leisure software	0.1	3 515.3
	Electronic distribution of educational software	0.1	6 116.5
	Others (parts, etc)	43.3	16 053.9
Subtotal		*112.6*	*56 068.8*
Total		**16 505.6**	**122 945.6**

Source: Telecommunications Council, 1994.

New technology applied to a range of industries will remedy information gaps, expand information sharing, give consumers greater freedom of choice and allow services to be custom-designed to meet individual needs (Table 14.12). A survey conducted by the Prime Minister's Office identified home medical support systems as a key priority (Figure 14.8). This again indicates the growing potential for specialised medical services for the aged, an area in which Australia has expertise.

However, for the multimedia sector to achieve its potential, a number of issues must be addressed:

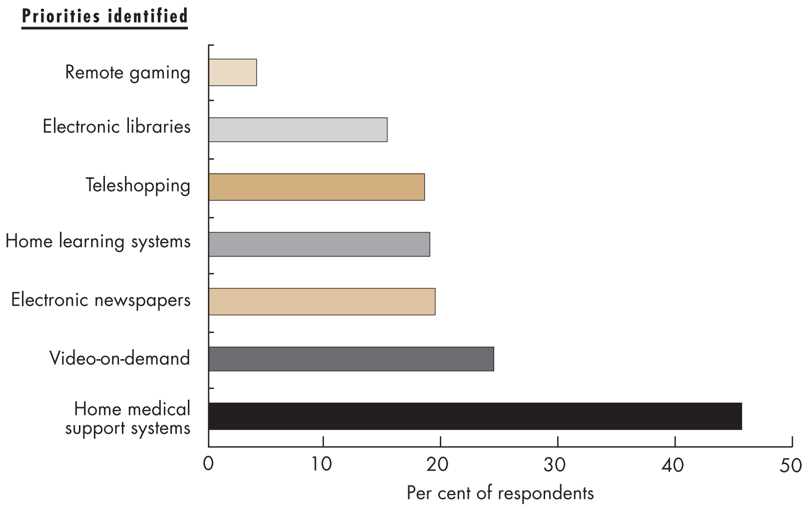
- telecommunications infrastructure requires higher capacity and lower charges
- access to information needs to be reasonably priced and user-friendly
- regulation must be reduced to encourage development
- intellectual property protection needs to be strongly enforced.

The heavy regulation is particularly serious as it hinders the introduction of modern services based on multimedia technology and will reduce Japan's international competitiveness. For example, the current Medical Practitioner Law does not allow remote medical services. In addition, high telecommunications charges impede the spread of network-type multimedia services, and inadequate bandwidth prevents the provision of image-based services.

Figure 14.8

Strong Future Demand for Home Medical Systems

Future Priorities in Information and Telecommunications Applications



Source: Prime Minister's Office, 1995.

Table 14.12

Multimedia Applications*

Category	Application
Lifestyle/consumption	Home (online) shopping Telebanking/electronic money Product and service information access systems Interactive television
Communications	Electronic notice boards/message boards Internet telephone/videophones Mobile communications
Business	Teleconferencing Telecommuting
Entertainment/culture	On-demand services (video, games, news) Virtual reality Electronic newspapers and publishing
Education	Virtual reality (experiments, observation, etc.) Remote education systems (support for home learning and study) Educational data bases Lifelong learning systems
Medicine	Remote treatment, remote medical support, remote diagnosis systems Remote care and monitoring systems for aged people living alone Hospital information retrieval systems, electronic patient records
Academia/Culture	Electronic libraries and art galleries Networks for researchers and cultural experts Academic and cultural data base services Electronic research centers (remote joint research)
Government	Administrative information services Online computerised administrative processing systems (completing formalities from home) Online municipal offices, services

Note: *Most of these applications exist in some form, but many have not yet been activated in Japan.

Source: Sakura Institute of Research, 1996.

STRONG OUTLOOK FOR SERVICES SECTOR

The services sector will expand rapidly, reflecting the diverse needs of individuals for health care, welfare, education, personal and multimedia services, and businesses for support, consultancy, professional and multimedia services. Service industries will create a new demand for information systems and new technology. In addition, growing interdependence and links between the manufacturing and services sectors, including increased service inputs into the manufacturing sector and increased investment in hardware in services enterprises, will lead to continuous new development.

As traditional industries' contribution to growth declines with the maturing economy and the shift to overseas production, new industries will emerge to satisfy new domestic and international demand. These will include: communications and multimedia applications; high-precision materials, components and production technologies; social capital development; environmental management; labour-saving applications and services; education and training; logistics; and lifestyle industries, including travel and recreation.

Given the nature and scale of these developments, foreign companies should find Japan attractive for both exporting services and investing directly in service industries. Consumers and businesses alike view foreign companies as good sources of new products, technologies and services. Australian firms are in an excellent position to participate in Japanese corporations' 'round the clock' research and development activities, and to provide technical support, including software and engineering services.

Foreign firms interested in tapping into such growth segments as legal and accounting services, logistics, personnel services, health care, environmental management and information technology should find good long-term opportunities, provided where necessary, deregulation proceeds and restrictions on foreign involvement are eased. Because such services are highly domestically oriented and competitive, companies will need an on-the-ground presence and considerable managerial autonomy in order to meet constant innovation needs and achieve a viable position in the market.

Tourism is a major growth segment in which Australia has established a firm position. Australia faces some major challenges to secure its position as one of Japan's most popular tourist destinations, including developing appropriate marketing strategies and overcoming infrastructure constraints, market rigidities and competition from cheaper destinations. (See Chapter 13 – *Transport* for an analysis of tourism-related issues, and Appendix 14.2 for a description of innovations in tourism marketing in Japan.)

Appendix 14.1

ONE SECURITY FIRM'S EXPERIENCE: A 'HOW TO' PRIMER

Persistence, innovation, flexibility and a willingness to learn from hands-on experience overseas enabled a Japanese services company to establish a strong position in the security industry and diversify into health care.

Japan's first security firm, Company X,[7] continues to lead the industry. The knowledge it has accumulated from working with security and communications systems has provided a strong base to expand into home medical and educational services and multimedia. Sales and profits have grown consistently.

The company's chairman, also its founder, attributes its success to two factors:

- a focus on automatic security systems, which are less cyclical than guards and patrols
- offering customers leasing as an option to buying security equipment and systems.

The key management moves relating to these factors trace the company's growth (Appendix Table 14.1). Its first challenge, for example, was to develop demand for security services in an environment where security was taken for granted. Progressing into automated systems presented new challenges, as did devising an innovative approach to financing. The company also had to overcome regulatory barriers in all fields it has entered, from security to health care. Its strategies included sustained efforts to develop client bases, expansion into the USA to secure know-how, and effective image building and publicity. For example, the company influenced public opinion and induced official policy changes when it decided to enter the health care field in Japan.

7 'Company X' preferred to remain anonymous.

Appendix Table 14.1

Marketing, Innovation and Client Relationships Key Success Factors

Milestones in Company X's Development

Period	Business priorities	Chronology: 1. Direct motivation 2. Obstacles and problems 3. Dealing with obstacles / approaches that led to solutions
1962	**Entry into security business**	1. Future potential. The company's founder learned about the existence of security companies in the USA and concluded that, given Japan's continuing economic growth, eventually the management and security of plant and facilities would be as important as in the West. 2. It was very difficult to attract clients because the Japanese had little appreciation of security. Neither the concept nor the custom of paying for security existed. 3. Sustained marketing and image building activities raised the company's profile, especially winning the security contract for the 1964 Tokyo Olympics. Also having a security business in the USA helped.
1965-1966	**Introduction of automated security systems**	1. Rising labor costs. 2. Clients did not understand (or trust) automated security (such as alarms). Some within the company opposed automation when the security patrol business was highly successful. 3. Media publicity helped (the success of automated systems featured in high-profile criminal cases).
1965-1966	**Selection of equipment leasing**	1. Difficulty in securing acceptance of, and in selling, automated security systems. 2. In the West, leasing was generally considered inferior to purchasing, in terms of profit and financing options. 3. Company X established successful leasing systems incorporating maintenance agreements that allowed it to consolidate client relationships. It also reduced the financial burden by introducing an advance payment system.
1991	**Entry into health care (emergency care and home medical care)**	1. Distrust of health care systems centred on hospitals and physicians (and anger over a baby dying after several hospitals refused to admit it). 2. Various regulations restricted entry into the market (for example, rules prohibiting non-physicians from providing medical care). Physicians and the Japan Medical Association traditionally protect their vested interests. 3. Company X entered health care businesses in the USA (emergency medical services in 1988, home medical services in 1989), gaining hands-on experience and technical know-how. Media publicity (for example, informing the Japanese public about advanced emergency services available in the USA) induced authorities to alter policies.

Source: Sakura Institute of Research, 1996.

Appendix 14.2

TRAVEL MARKETING IN JAPAN

Japanese travel overseas has boomed since the yen began to appreciate sharply in 1985, heightening consumer purchasing power (Appendix Table 14.2). The slower growth projected for 1997 is attributed to the weaker yen. Domestic travel, however, remains sluggish and inns and hotels have low occupancy rates. Many domestic travel enterprises are trying to improve business through creative marketing strategies and tailoring travel options to more diverse niche requirements. This appendix explores some of these strategies, as well as the evolving structure of the Japanese travel industry. It also suggests possible strategies that foreign companies may employ in entering the market.

Appendix Table 14.2

Tourism Buoyant

Japanese Outbound Travel
1986 to 1997

Year	Number	Per cent change
1986	5 516 200	11.5
1987	6 829 300	23.8
1988	8 426 900	23.4
1989	9 662 800	14.7
1990	10 997 400	13.8
1991	10 633 800	-3.3
1992	11 790 700	10.9
1993	11 933 600	1.2
1994	13 578 900	13.8
1995	15 293 000	10.5
1996	16 700 000	9.2
1997*	17 500 000	4.8

Note: * = Japan Travel Bureau projection.
Source: *Travel Journal International*, 1997 and previous years.

Travel and tourism marketing is extremely competitive, with 11 000 companies across Japan. The top 20 companies account for 70 to 80 per cent of sales, giving small travel agencies only marginal profits (Appendix Table 14.3).

Travel agencies and wholesale tour operators abound in urban areas. Large firms with massive buying power and extensive branch networks dominate the industry. Traditionally they exercised significant control over airlines' sales, block booking large numbers of seats for resale to their own travel agencies and smaller outlets. This stimulated the major airlines to launch their own travel agencies and tour businesses.

Appendix Table 14.3

Top Five Travel Agencies' Share in the Travel and Tourism Market

Per Cent of Sales

Company	1993	1994	1995
Japan Travel Bureau (JTB)	21.5	21.6	22.6
Kinki Nippon Tourist (Kintetsu)	11.4	11.4	11.6
Nippon Travel Agency	7.4	7.2	7.0
Tokyu Tourist	4.4	4.3	4.1
Nippon Express	3.0	2.8	2.5
Other	52.3	52.7	52.6

Source: Euromonitor Market Direction, 1996.

NEW TRAVEL AGENCY LAW

Travel agencies are easy to set up in Japan. Consequently, small companies often fail. To protect consumers by increasing agencies' legal liability and to facilitate business by reducing regulatory barriers to entry (such as many types of licences), a new Travel Agency Law was implemented in April 1996. The new law has already affected the structure of the industry (Appendix Table 14.4).

Appendix Table 14.4

Small Firms Proliferate

Expected Structure of the Travel Agency Industry From April 1996

Travel agent type, scope of business	Basic conditions of registration	estimated number
Class 1: Domestic and international tour product packaging, sales and booking	Net assets of ¥30 million Minimum business security deposit of ¥70 million	755
Class 2: Only domestic tour product packaging, but can sell and book both domestic and international tour products	Net assets of ¥7 million Minimum business security deposit of ¥11 million yen	2 248
Class 3: Only sales and bookings; cannot produce tour packages (many of these are dedicated to particular Class 1 agencies)	Net assets of ¥3 million Minimum business security deposit of ¥2.5 million	6 755
Total travel agencies		9 758
Subagencies (Subagencies of Class 1 and 2)		1 226
TOTAL		**10 984**

Source: *Weekly Travel Journal*, 1 January 1996, estimates based on survey of companies' intentions prior to implementation of the new law.

Class 1 agencies are licensed by the Ministry of Transport; Class 2 and 3 agencies are licensed by their respective prefecture or municipal government. Agencies producing tour products must guarantee delivery of the product and must pay compensation for itinerary changes or divergence from the advertised and contracted product.

The new law reduces the entry costs for companies wanting to operate only in sales and bookings to ¥3 million in net assets.

MARKETING AND DISTRIBUTION

The biggest agencies sell through a combination of their own wholly-owned outlets and independent retail travel agencies. The big four, JTB, Kinki Nippon Tourist, Nippon Travel Agency and Tokyu Tourist have extensive wholly-owned outlets, through which they traditionally sold 80 per cent of their business, leaving only 20 per cent of the market to independent retail agencies (Appendix Table 14.5). Airlines also have their own travel agencies and tour marketers. Japan Airline's Jalpak is the sixth largest agency selling overseas tour products.

In the last few years, the proportion of sales through independent agencies has risen, and major companies have increased their networks of affiliated independent retailers. As at the end of 1995, under the original legislation, the major agencies networks were as follows:

Appendix Table 14.5

Associate Networks of the Top Four Agencies

Company	Size of network		Per cent of sales		
	Subagents (number)	Associates (number)	Subagents	Associate agents	Own outlets
Japan Travel Bureau (JTB)	510	4 000	10	20	70
Kinki Nippon Tourist	246	3 260	11	12	77
Nippon Travel	184	1 600	9	15	76
Tokyo Travel	104	978	5	10	85

Source: Travel Journal International, 13 November 1995.

The new law will have a major impact on travel businesses' sales and distribution activities. Whereas subagents previously had exclusive arrangements with their wholesalers, any agency that registers as a Class 3 agency will be able to retail package tours from all wholesalers. This challenges the major wholesalers' control over the retail outlets. The top tour package wholesalers (JTB, Kinki Nippon Tourist and Nippon Travel) now encourage their existing subagencies to join them as quasi franchisees, aiming to secure exclusive mass marketers of travel and tourism services by paying commissions. They also are competing aggressively to establish links with the operators of retail outlets such as convenience stores.

Each major agency uses a brand name as an umbrella for its tour offerings. JTB products are known under the band name 'Look JTB'; Kinki Nippon Tourist tours are known as 'Holiday'; Nippon Travel's products are known as 'Mach'; Tokyu Tourist's products are known as 'Top Tours'; and JALPak's product is known as 'I'll'.

Sales and marketing are principally done through catalogues, brochures and pamphlets displayed in retail travel agency offices, with special seasonal campaigns supported by print, TV and rail/subway advertising.

The large travel package wholesalers operate computerised booking systems and do not directly use the major worldwide Computer Reservation Systems (CRS) such as Sabre or Apollo. Their extended networks of directly managed branches and subagents have terminals connected to the wholesalers' travel package information system. JTB's system, 'TRIPS', is designed for travel and itinerary bookings; it has more than 5 000 participating agents. However, about 50 per cent of travel agencies are connected to JAL's AXESS system, which provides airline bookings, hotel reservations and car rental booking linkages. AXESS is linked in turn to Sabre and Apollo. However it does not provide access to tour package information, which is kept in the separate data bases of the individual tour package wholesalers and larger travel agencies.

Traditionally business relied on walk-in customers, but customer requirements are changing steadily. Organised group tours used to make up most international tour business; now families and individual travellers (FIT) buy both prearranged packages and tailored itineraries. As a result, tour package types and options have proliferated to capture the imagination of an increasingly discerning and demanding consumer base.

The Ministry of Transport deregulated airline pricing in December 1994, allowing airlines to offer flexible fare discounts and telephone credit card bookings. The increased competition resulted in many new sales approaches. Marketing has shifted to retail outlets, direct mail and online information and sales.

TRENDS IN PACKAGING

The travel industry targets ever smaller niche customer segments, to provide greater flexibility and variety in package tour business. Product offerings include special seasonal event packages, packages specifically targetting mature married women, packages focused on history or culture content such as the Hemingway tour of Europe and the USA, or the Chopin Poland offerings. Packages include prepaid tickets to major sporting events or the opera. Japan's competitive domestic and outbound travel continually invents new approaches for targetting new customers, inspiring repeat travellers, encouraging new experiences and capturing consumers' growing leisure expenditure.

The trend is to provide independence, privacy and individual - as opposed to traditional Japanese semicommunal - entertainment in the new tour packages. These might include rooms in hot springs resorts (traditionally a semicommunal form of leisure) with built-in spas designed for couples or a small families to enjoy together. Outdoor entertainment is very popular, with walking and mountain-climbing packages promoted in summer and increasingly, air/hotel packages combined with tailored options.

HIGH-TECHNOLOGY MARKETING

In Tokyo Station at a row of computerised rail holiday booking terminals, customers can design a holiday itinerary and make bookings directly via a computer screen. When the National Railways was privatised in 1986, it entered the travel agency business. Nearly every railway station building has a travel agency selling domestic and international air travel and tour packages. In addition, air terminals in Tokyo and Osaka now offer ticketless travel. Travellers arrive at the terminal, consult a computer on flights and seat availability, insert a credit card and book a flight.

In 1993, a medium-sized travel company, Big Holiday, began to install Community Network (CN) Playboxes in convenience stores, so customers could buy concert tickets. The CN Playbox soon branched out into domestic airline ticket sales and tour package booking, in conjunction with All Nippon Airways (ANA). In 1996, JTB teamed up with IBM Japan to develop multimedia stations in convenience stores to directly book tour packages and air tickets.

ANA, JAL and JTB launched Internet booking services for domestic travel in 1996. Ticketless, Internet and convenience store sales are still only available for domestic travel. Many travel agencies see these developments as threatening. However, the carriers regard the role of the travel agents as crucial, and see the new approaches as tools to facilitate the process. As more travellers want specifically tailored itineraries, the travel agents' advisory role will gain importance.

Regulators fear some of these new marketing methods may put consumers at risk. In July 1996, the Ministry of Transport, in collaboration with the travel industry, established a committee to investigate travel product sales via convenience stores and multimedia terminals, to exchange information on how to protect consumers (Nikkei Ryutsu Shimbun, 1996).

Credit card companies also market travel and tourism services, either directly or via major retailers. For instance, the Saison Group, with its Saison credit card, owns Seibu Department Store, the Family Mart chain of convenience stores, a travel and tour wholesaler, Vivre, and a travel retail chain, PTS. PTS has 120 retail travel and tour agency outlets and provides point-of-sale brochures for Vivre package tours at Family Mart convenience stores. Saison cardholders receive a comprehensive catalogue every six months, from which they can directly book tour packages, paying with their Saison Card. Saison Group was the first to experiment with this form of marketing, and sales have quintupled in the four years it has been operating.

Daiei owns a travel wholesale/retail business and does direct marketing through its card company, its supermarket chain and its Lawsons convenience stores. Daiei's marketing focuses on regular full-page newspaper spreads advertising its tour packages and prices, with contact phone numbers. Daiei's offering is pitched at the budget end of the market, in line with its overall retail positioning.

These developments will change the travel agency business. The large and medium-sized agencies are seeking tie-ups with retailers and other channels to increase their spread, while also increasing their conventional networks. The carriers, the retailers and their credit card companies also operate travel agencies, competing aggressively with medium and small travel agencies. All are unlikely to survive. The big tour companies such as JTB and Kinki Nippon Tourist and the innovative credit card/ retail chain based agencies are the best positioned.

STRATEGIES FOR FOREIGN COMPANIES

The Japanese travel and tourism market is immensely competitive and dominated by a few very large players. Emerging distribution channels such as convenience stores and multimedia terminals will not directly challenge the powerful incumbents; if anything, they will make them stronger. Internet sales will pose a minor challenge. The large wholesalers control the pricing and distribution of product, and discounting among the airlines is limited to 25 to 50 per cent. Travel agents will continue to have better margins on sales of JAL or ANA tickets rather than the more heavily discounted international carriers.

To establish a strong position in the Japanese market, foreign companies can:

- offer a wide range of imaginatively packaged tour products, designed as packages but with high levels of individual flexibility. This product should ideally be theme-based, for example on cultural experiences, outdoor activities, sports, festivals, study and history. These should target microniche groups and offer considerable choice.
- base marketing and promotion on alliances with the powerful incumbents and emerging, innovative newcomers such as the Saison Group and other card companies. Continuous and intensive interaction with these key stakeholders is essential. A wholesaler which is a competitor in one line can be a powerful ally in another.
- use technology-based links to promote sales and bookings, bearing in mind that the Japanese market is less integrated technologically than Australia. Foreign travel and tour operators providing the fastest and best response to information needs in a user-friendly manner will form strong alliances.

REFERENCES

Australia-Japan Economic Institute (AJEI), 1997, *The Growth of Computer Networks and Internet Services in Japan*, Australia-Japan Economic Institute, Sydney.

Department of Foreign Affairs and Trade, 1997, *Trade in Services, Australia 1995-96*, Department of Foreign Affairs and Trade, Canberra.

Department of Transport and Regional Development, 1997, *Overview of Australia-Japan Relations*, Briefing paper for the Australia-Japan High Level Meeting on Transportation, Canberra, 19 March.

Economic Planning Agency, 1995, *Kaigai karano toushi kakudai wo mezashite* [Seeking Increased Foreign Investment in Japan], Ministry of Finance Printing Bureau, Tokyo.

Euromonitor Market Direction, 1996, 'Travel and Tourism in Japan', Japan Monitor, London, March.

Japan Travel Bureau, 1997, information from a speech by Yoshio Koteda, General Manager, International Relations, at Australia-Japan Tourism Summit, Canberra, 13 February.

Kimindo Kusaka and Softnomics Center, 1994, *Shougai kyouiku wa bijinesu chansu ni naru ka?* [Does Lifelong Education Offer Business Opportunities?], PHP Institute, Tokyo.

Leisure Development Centre Foundation, 1996, *Leisure White Paper*, Leisure Development Centre Foundation, Tokyo.

Management and Coordination Agency, 1996a, *1991 Establishment Census*, Japan Statistics Association, Tokyo.

____ 1996b, *Japan Statistical Yearbook 1996*, Statistics Bureau, Tokyo.

____ 1994, *Survey on Service Industries, Volume 1: Result for Japan*, Japan Statistics Association, Tokyo.

Ministry of Health and Welfare, 1995, *Health and Welfare White Paper*, Institute of Health and Welfare, Tokyo.

Ministry of International Trade and Industry, (MITI), 1996, *Questionnaire for Business Support Service Users*, The Subcommittee for Soft Industry, Tokyo.

____ 1996, charts and tables related to Japanese direct investment abroad, International Business Affairs Division, MITI, Tokyo.

____ 1995, *28th Survey of Trends in the Activities of Foreign Enterprise*, Ministry of Finance Printing Bureau, Tokyo.

____ 1994, *21 seiki no sangyou kouzou* [Industrial Structure of 21st Century], Research Institute of International Trade and Industry, Tokyo.

Morgan, Dr P, 1997, 'The Japanese Services Sector: The New Engine of Growth?', conference paper presented at the Australia-Japan Business Outlook Conference: Understanding the New Japanese Economy, Sydney, 17 March.

Multimedia Association of Japan, 1995, *Multimedia White Paper,* Multimedia Association of Japan, Tokyo.

Nikkei Ryutsu Shimbun, 1996

Prime Minister's Office, 1995, *Survey of Attitudes to the Role of Information and Telecommunications in Lifestyles*, Prime Minister's Office, Tokyo.

____ 1993, *Public Opinion Survey on Lifelong Learning and Voluntary Activities*, Prime Minister's Office, Tokyo.

Sakura Institute of Research, 1996, consultancy for the East Asia Analytical Unit, Tokyo.

Telecommunications Council, 1994, *21-seiki no chiteki shakai e no kaikaku ni mukete - Joho tsushin kiban seibi puroguramu* [Reforms to Create an Intellectual Society in the 21st Century - Telecommunications Infrastructure Development Program], Ministry of Posts and Telecommunications, Tokyo.

TKC National Systems Committee, 1996, *TKC Financial Indicators 1996*, TKC System Development Laboratory, Tokyo.

Travel Journal International, 1996 and previous years.

Weekly Travel Journal, 1996 (in Japanese), various issues.

Chapter 15

IMPLICATIONS FOR AUSTRALIA

Japan is at a turning point in which it is reviewing the gains of the past 50 years and setting in place the changes that will enable it to meet the challenges of the twenty-first century. In accordance with its status as the world's second largest economy, Japan will assume broader international responsibilities and become more proactive in asserting and protecting its national interests. Among the difficult and controversial issues that Japan will face in coming years are: determining the appropriate role for government in the economy; achieving an appropriate pace and depth of reform; and designing a more active foreign and security policy.

It will be important for Australia to understand Japan's perception of its national interests, as these will undoubtedly affect our own. The relationship with Japan will continue to be one of Australia's most important bilateral relationships, with trade and investment ties remaining strong and partnerships in other areas such as Asia-Pacific Economic Cooperation (APEC) and regional security cooperation developing steadily. In addition, Australia's and Japan's growing trade and investment links with the rest of Asia offer important opportunities for joint activities, in business, in development assistance and in regional fora. Both countries share a desire for, and are increasingly dependent on continued regional stability and economic development. Given the significance of the relationship, the choices that Japan makes in coming years - on economic and structural reform, market access, innovation, industry priorities, international relations and national security - will have a strong impact on Australia.

For the relationship to grow optimally, both sides must continue to work at achieving a deeper understanding of each other's systems, societies, business practices, concerns and priorities. This will require active and open communication at business and official levels, stronger people-to-people and academic exchanges, more vigorous efforts to attract Japanese students to Australia, continued support for Japan-related studies and better utilisation of the relatively high number of Japanese speakers in Australia.

IMPLICATIONS FOR BUSINESS

This report encourages Australian companies to take a new look at Japan, which can be a very rewarding place to do business for those companies prepared to make an effort to understand the market, the business environment and the factors driving change in society and the economy.

In coming years companies generally can expect to see current liberalisation moves continue. However, change is more likely to be incremental than radical, despite the need for faster, deeper reforms in some areas. Japan will continue to strengthen its institutional framework and reduce regulation, increasing transparency in many areas. This, combined with a more streamlined distribution system and a more efficient financial sector, will improve the business environment. With globalisation and exposure to international competition, Australian companies will find Japanese business practices less opaque and Japanese companies increasingly interested in forging international connections. *Keiretsu* relationships and the 'iron triangle' of government, bureaucratic and big business interests will remain to some extent, but their capacity to act as a barrier to market entry appears to be declining.

Import penetration will continue to strengthen, due to a variety of factors including:

- external multilateral and bilateral pressures to remove trade barriers
- market-driven reforms of the distribution system
- consumer demand for 'value for money' and greater acceptance of imports
- competitive pressures to reduce costs, making lower-cost imports attractive
- 'reverse imports' from Japanese firms producing offshore.

In regional Japan, improved infrastructure, greater international awareness and official support for trade and investment give foreign companies alternative gateways into the market. Small and medium-sized firms, in particular, may find a regional strategy more manageable than one based on the Tokyo market, which can be much more fiercely competitive and more volatile and require greater supply capacity.

In addition, as Japan moves up the 'value chain', producing increasingly sophisticated goods and services, niche segments are emerging in sectors in which Australia has relatively strong expertise, such as housing materials, processed foods, aged care, software and basic research.

In summary, Japan's huge market has become more accessible and attractive, and companies with high-quality, competitively priced products and services should give it higher priority. However, like virtually all markets today, Japan is very competitive, and products often get just one chance. It is therefore very important for exporters and investors to research the market carefully and investigate all the marketing and distribution options before proceeding. It is equally important for companies to adopt a reasonably long-term perspective in dealing with Japan.

Social Change Creates Opportunities

The rapidly growing proportion of elderly in the population, greater exposure to foreign ideas and products, and economic restructuring are combining to change societal and consumer values and expectations. This in turn is leading to new practices in the market, the workplace and the home which create opportunities ranging from servicing the needs of the aged and dual-income families to introducing new leisure, tourism and educational activities.

The ageing population will have a broad impact. With the population over the age of 65 expected to double to 25 per cent by 2015, whole new industry segments are developing to cater for their needs. Australian companies, with the help of Austrade, have actively explored opportunities in the healthcare field for several years; these range from management of institutional and in-home geriatric care to provision of nurse training, medical equipment and technology, and consumer goods for the elderly. Other opportunities are arising from growing interest among retirees in continuing education and leisure activities, for example, in offering tourism packages focusing on learning and recreational activities. In addition, while small, the number of Japanese buying holiday homes in Australia[1] is increasing, especially among retirees, but also among young families.

The rapid ageing of the population has other implications, as well. By 2015 the Japanese population will begin to decline, and the workforce will begin to decrease even earlier. This will give rise to potentially serious labour shortages, unless women and guest workers are employed on a much broader scale than at present. Labour shortages would also mean higher wages and increased mobility. Some progressive companies have already started to develop strategies to cope with these changes by reviewing traditional labour market practices. The trend away from lifetime employment and seniority-based pay and promotion toward merit and performance-based criteria is expected to infiltrate the economy slowly.

Australian companies in Japan should develop strategies to deal with these issues well ahead of time, including instituting programs to enhance employee loyalty and to attract more of Japan's highly educated women, both when they graduate from school and when they reenter the workforce after raising children. Companies might also consider recruiting among the many Australians who have studied Japanese and lived in Japan, as well as among the increasing numbers of Japanese studying in Australia.

The declining working age population and the rising proportion of the elderly will also have an impact on consumption. The extent of this will depend on the government's success in ensuring that health and social security systems can cope with increased demand from the aged. Taxes and mandatory contributions to retirement funds may increase considerably. This could reduce the impact of projected higher wages on consumption, and lead to a reduction in savings if people draw on them to maintain consumption.

The concept of loyalty to employees, employers and business relationships is also changing, due in part to the prolonged recession of the early 1990s and escalating labour costs which forced companies to restructure, dismiss employees, and alter longstanding supplier and distributor relationships. This, combined with the increasing acceptance of things foreign, should make it easier for non-Japanese companies to recruit quality Japanese staff and to establish supplier and distributor links.

Political Realities May Affect the Pace of Reform

The political system is essentially stable and a broad consensus is emerging regarding basic policy directions. However, the political situation will remain fluid in the short to medium term, and until a clear trend emerges, policy making and implementation will reflect the underlying uncertainties. The Hashimoto Government shows signs of the necessary resolution to deliver reforms, but it may have to compromise on the pace and depth of change as it seeks to consolidate its hold on power. While the electorate and business organisations are pressing for clear reform achievements, sectoral entrenched interests and parts of the bureaucracy are reluctant to embrace more than very gradual change.

1 Queensland, primarily the Gold Coast, is especially popular, for its climate and proximity.

Conservative forces are expected to continue to dominate Japanese Governments in coming years and while the pace of reform will reflect the dominant party's or faction's particular agenda, companies should be aware that conservative governments in Japan have a good track record in implementing change.

Long-Term Pressures Drive Change

While change may be slower than many would like, it will continue, driven by underlying pressures such as demographics, fiscal shortfalls, declining savings, low potential growth rates, possible further yen appreciation and structural rigidities. Because growth rates and stability in the business environment will depend largely on macroeconomic policy management and microeconomic reforms, companies should monitor closely the government's achievements over the next five years.

Changing Trade Structure Offers New Oppotunities

As Japanese industry continues its long-term shift from labour-intensive and energy-intensive processes to higher-value-added production, raw materials imports are becoming less predominant and imports of intermediate and consumer goods, processed foods and services are expanding rapidly. Manufactures now account for about 60 per cent of Japan's imports, double the level of the early 1980s. As the relative weight of raw materials in Japan's imports falls, Australia's position as Japan's third largest import supplier will not be sustainable. Concerns over Australia's declining share of Japanese imports may be allayed somewhat if its exports to Japan and the employment they generate continue to increase.

While primary commodities will remain a significant part of Australia's trade with Japan, Australian exporters of raw materials are moving into new markets in Asia and engaging in more downstream processing, often in conjunction with Japanese investors in Australia. Exporters of higher-value-added goods and services are encouraged to explore the emerging opportunities in Japan. Fast-growing segments include elaborately transformed manufactures (ETMs), processed foods, housing and construction materials, alcoholic beverages, luxury items such as jewellery, cosmetics and fashion items.

Market Access Improving

Although Japan is widely perceived to have closed markets which are extremely difficult to penetrate, its official tariff and core nontariff barriers are generally no more prohibitive or distorting than those encountered in the European Union (EU) or the USA. What especially impedes new entrants into Japan are excessive regulation, widespread lack of transparency, the rigid use of bureaucratic discretionary power and the prevalence of informal networks that favour domestic suppliers. While progress has been made in response to domestic and external pressure, heavy regulation and weak enforcement of antimonopoly provisions still hinder access to and fair competition in many sectors. Despite all this, many foreign companies have successful businesses in Japan, and import penetration is increasing rapidly.

Food Market Valuable but Tough

Despite its highly protected agricultural and food markets, Japan is the world's largest net importer of agrifood[2] products and Australia's most valuable agrifood customer. While agrifood imports should continue to grow strongly, food self-sufficiency sensitivities remain, and influential agricultural lobbies may hinder the reforms needed to overcome inefficiency and stagnation in Japan's agrifood sector.

Tariff and nontariff barriers tightly control agrifood product access. Japan's minimum risk quarantine policy and procedures pose particular problems for agrifood exporters, including onerous research requirements and costly operational arrangements. While some of these impediments are being addressed following multilateral and bilateral negotiations, exporters can still expect to encounter frustrating delays.

Domestic pressures will probably hasten liberalisation to a certain extent, due to fast growing food demand, competitive pressures in the food processing sector, the rapid ageing of the farm workforce and the relative decline of agriculture in the economy. The forthcoming revision of Japan's Agricultural Basic Law, which for the first time will take account of consumers', as well as producers', interests, could have an important impact on Japanese agriculture and on agrifood suppliers such as Australia.

Exporters should be aware that Japanese consumers are very conscious of food safety and food quality, and that incidents such as domestic food poisoning epidemics and the UK's 'mad cow' disease can have a major, immediate impact on consumption. Moreover, this invariably reduces consumer confidence in the safety of imported food.

Japan will not become an easy agrifood market; as it opens, competition will intensify. Reliability, quality consistency, strong marketing and competitive pricing will remain important success factors in food, as well as in other sectors. Australia's advantage as an off-season supplier of fresh produce should be exploited fully.

Australian food producers and processors should be aware of the many Australian Government programs available to assist potential exporters. The Supermarket to Asia Council, for example, aims to remove barriers to export, develop a more aggressive export culture and promote Australian agrifood products in Asia. Austrade runs the Australian pavilion at Japan's premier food show, Foodex, each year and takes Japanese buyer missions to Australia. State governments also work closely with agrifood businesses seeking to enter the market. In addition, the Australian Government, through its Embassy in Tokyo and Austrade offices around Japan, is involved in ongoing negotiations to facilitate Australian agrifood exports to Japan.

Energy Exports Face More Competition, Diversification

Japan takes more than 40 per cent of Australia's energy exports, including 46 per cent of coal and virtually all liquefied natural gas (LNG). At the same time, Australia supplies more than half of Japan's coal imports and 15 per cent of its LNG imports.

2 The term 'agrifood' refers to processed and unprocessed food products, ranging from live animals and unmilled wheat to cheese and chocolate confectionary.

Japanese supply diversification policies and Australia's rapidly growing energy exports to other Asian markets will see this mutual dependency decline somewhat in coming years, although energy trade will remain important.

While the Ministry of International Trade and Industry (MITI) forecasts a slowdown in energy consumption growth over the next 15 years, changes in energy policy direction, combined with existing influences on energy demand growth, indicate that growth may be stronger than forecast. Indeed, new and anticipated changes in energy policies are likely to lead to more imports of petroleum products, replacing crude, stronger competition among LNG and coal suppliers, and increasing emphasis on price in sourcing gas and coal.

Competitive pressures on electricity suppliers may reduce their ability and willingness to buy expensive domestic coal, or pay a substantial premium for supply diversity. Similarly, gas utilities facing increasing competition will emphasise price when securing their gas supplies. While MITI may still seek to influence the fuel source mix, it is likely that except for oil, price will become the primary factor influencing sourcing of energy imports.

Reduced barriers to entry will create more energy buyers and sellers. For exporters, this could provide more flexibility in setting contract prices and conditions, and more opportunities for spot sales, especially of coal and LNG. In the longer term, the steady decline in Japan's dominance of Asian energy markets will influence the bargaining power of energy importers and exporters. The opportunity to sell to other countries as their demand for LNG grows and their supply infrastructure is developed, could place Australian exporters in a stronger bargaining position. On the other hand, other competitive gas suppliers in the region also wish to expand exports.

Niche Opportunities Developing in Domestic Services Sector

Prospects for Japan's services industry are bright as higher incomes, changing lifestyles, an evolving industrial structure and ongoing deregulation in nonmanufacturing sectors stimulate development. Demand is projected to grow particularly strongly for communications and multimedia applications; technologies for high-precision materials, components and production; environmental management; logistics; labour-saving applications and services; education and training; and lifestyle segments, including travel, recreation and services catering to the 'silver' (retirees) market.

Given the nature and scale of these developments, foreign companies should find Japan attractive for both exporting services and investing directly in service industries. Consumers and businesses alike view foreign companies as good sources of new products, technologies and services. Globalisation of corporate activities, one factor behind the growth in world services trade, also offers good opportunities for Australian companies to participate in Japanese corporations' offshore research and development activities, and to provide technical support, including software and engineering services.

Foreign firms interested in tapping into such growth segments as legal and accounting services, logistics, personnel services, health care, environmental management and information technology should find some good long-term opportunities, provided deregulation proceeds and restrictions on foreign involvement are eased. Because such services are highly domestically oriented and competitive, companies will need an on-the-ground presence and considerable managerial autonomy in order to meet constant innovation needs and achieve a viable position in the market.

Financial Markets Opening Up

Foreign firms' access to Japan's pension and insurance markets has improved with partial deregulation of these sectors. Companies with competitive cost structures, a strong capacity to price risk and solid money management skills should explore opportunities to manage pension funds and provide nonlife insurance. As liberalisation of insurance premiums continues, these opportunities should spread to life insurance. One entry option is to acquire a small to medium-sized Japanese company.

As part of insurance industry reforms, large Japanese life and nonlife insurance companies will be allowed to enter the so-called 'third sector' of Japanese insurance, covering products like personal accident, nursing and cancer insurance. This will increase pressure on foreign institutions, which currently have an important share in such segments.

Opportunities for foreign firms in Japanese banking stem from their comparative advantages and expertise in sophisticated financial products, such as derivatives. Foreign banks also tend to have more expertise in foreign exchange settlement and risk participation, and are highly price competitive. Consequently, foreign banks' operations are likely to expand from April 1998 when revisions to the Foreign Exchange and Foreign Trade Control Law take effect. Joint ventures with Japanese institutions and expanding automatic telling and computer banking networks are strategies that foreign institutions can employ to reach a broader customer base.

Transport Reform Beneficial But Slow

In an effort to overcome structural inefficiency, high costs and congestion in the transport sector, the Japanese Government is, through deregulation and infrastructure investment, encouraging the domestic distribution system to become more multimodal.[3]

Roads

Congestion on Japanese roads and constraints on cheaper methods of distribution, such as rail, can significantly increase Australian exporters' costs and delivery times. Although import/export containers may be carried on Japanese roads, quite frequently import containers are deconsolidated upon arrival and repacked into smaller vehicles for distribution, adding to exporters' delivery times and costs.

In future, relaxation of road freight restrictions and the development of more sophisticated logistics solutions should give both foreign and domestic suppliers better access to a wider range of Japanese customers. The eventual adoption of

3 That is, to better utilise the various modes of transport: road, rail, sea and air.

international standards on container weight and size, and improvements in inland container handling capacity should facilitate goods movement, reduce costs and delays, and contribute significantly to economies of scale.

As the Japanese distribution system becomes increasingly sophisticated, demand for high-technology logistics management services is growing rapidly. Some of the innovative solutions that Australian transport and logistics firms have developed may be applicable to Japan.

Rail

If proposed rail freight system improvements proceed, companies will benefit from more efficient and less costly distribution. In addition, Australian companies with experience in multimodal transport and logistics systems, and suppliers of rail equipment and services may wish to explore opportunities in Japan.

Sea and Air Freight

Government-to-government talks are focusing on a number of problems affecting shippers, including inflexible air and sea port operating hours, low labour productivity, high charges, lengthy and inconsistent customs and quarantine procedures, and low use of electronic preclearance technology. With the EU and the USA also focusing on these issues, some improvements can be expected.

To avoid congestion and high costs at major ports, a number of Australian shippers are transhipping into regional Japan through feeder services out of such hubs as Pusan, Republic of Korea, Kaiohsung, Taiwan, Singapore and Hong Kong. Air shippers are also using hubs. If the Japanese Government's plans to develop multimodal transport solutions are realised, companies will benefit from better road, rail and coastal shipping links to both major and regional ports.

While further cargo consolidation in such gateway ports as Brisbane or Melbourne (including cargo to/from New Zealand) could reduce costs and delays, its potential may be limited due to insufficient rail infrastructure. In the longer term, Australian exporters may benefit from innovations such as fast ships which could considerably reduce shipping times to East Asia. For optimum results, governments and users should continue to press for international best practice in freight handling at both Australian and Japanese ports.

Improved Distribution Can Lower Costs, Ease Access

Although Japan's fragmented, multitiered traditional distribution system is becoming more streamlined and modernised, the patterns of deregulation and change have been largely reactive to external and commercial pressures. The real challenge lies in Japan's taking a more proactive approach in setting priorities for distribution system reform. Further change in the distribution sector will be driven primarily by market pressures, assisted by pressure from foreign companies conveyed through their governments.

In coming years, a number of changes underway will benefit foreign companies: the Large-Scale Retail Store Law will either be phased out or significantly altered; restrictions on store hours will be eased; entry into the warehousing sector will be facilitated; import processing will be coordinated nationally; and standards and certification procedures will conform more to international norms.

Some tips for Australian companies with Japanese distribution arrangements include:

- review existing set-ups, possibly redesigning distribution channels to reduce unnecessary tiers
- reassess the range of local wholesale partners available and consider new forms of partnership, including joint ventures with small and medium-sized wholesalers
- secure contracts for direct supply to a retail chain, including department stores, supermarkets, convenience and discount stores, and national and regional chains
- pursue a regional (outside Tokyo) entry strategy into Japan, as regional distribution channels can be less complex than those in Tokyo and Osaka
- form a joint supply and marketing arrangement with other Australian companies for similar or complementary products and services, to increase scale and bargaining power[4]
- expand successful supply arrangements with Japanese wholesalers or retailers to other Asian markets
- discuss any proposed changes with Japanese customers at an early stage.

Regions an Attractive Alternative

Companies tackling the world's second largest economy should consider entering the market through one of the regions, rather than immediately entering Tokyo's fiercely competitive and costly business environment.

The individual economies of Japan's eight regions (Hokkaido, Tohoku, Kanto, Kansai, Chubu, Chugoku, Shikoku, Kyushu) are larger than most national economies in the rest of Asia and have the highest per capita incomes. Consumers in the regions are increasingly urbanised, display a high degree of commonality and are overwhelmingly in the middle income bracket. They are gaining an increasing international awareness and are willing to try foreign products, but getting marketing, packaging and products right the first time is important. Companies should therefore carefully research and test the market before introducing products. In the case of food products, for example, local tastes and preferences may dictate modifications in ingredients, size and presentation.

The regions are striving to revitalise and internationalise their economies in order to compete effectively. In some cases, the prefectural and local authorities are more dynamic reformers than the central Government. Companies in the regions can be

....

[4] In 1995 Austrade developed a business plan for a specialist trading enterprise to directly distribute Australian food products to Japanese retail and food service groups. However, the proposal did not attract sufficient private sector interest.

easier to deal with, being smaller (though still large by Australian standards) and often family-owned and operated. However, many have not previously done business with foreigners and can be cautious.

Infrastructure in the regions is generally quite good and is being expanded to facilitate increased commerce. Current direct air services linking several key regions (Kansai, Chubu, Kyushu and Hokkaido) to Australia are very important in facilitating business and tourism expansion. Qantas and Ansett should be encouraged as they develop strategies to maintain the profitability of the regional Japan services that they have pioneered. A key element will be to promote these services strongly to the Australian business community, and to the respective local Japanese communities and travel industries.

Companies should be proactive in utilising Austrade's regional network, strategically located in six of the largest cities (from north to south: Sapporo, Sendai, Tokyo, Nagoya, Osaka, Fukuoka) to cover all the regions. (See *Information for Companies*, following this chapter.)

Companies also should be encouraged to take advantage of Australia's extensive sister-state and sister-city relationships to establish business contacts and identify opportunities in regional Japan. While most of these relationships are not highly business oriented, state governments and local authorities are attempting to make them more so and would welcome corporate interest.

Tourism Challenges Require Innovative Responses

Australia faces some major challenges to secure its position as one of Japan's most popular tourist destinations, including developing appropriate marketing strategies, smoothing cyclical peaks and troughs, and competing with cheaper destinations.

With competition intensifying and Japanese tour package prices being deregulated, governments and the travel industry must collaborate effectively to ensure that Japanese tourists continue to choose Australia, and that Japanese tourism to Australia remains profitable for both countries' industries. One useful mechanism is the Australia-Japan Tourism Summit, whereby Japanese and Australian travel industry and government representatives meet to discuss frankly how to tackle these challenges. This process, together with growing Japan-Australia industry collaboration, is critical in establishing the relationships necessary to develop tourism in both directions.

The Australian Tourism Commission and the tourism industry's action agenda deriving from the February 1997 Summit aims to increase the range of travel products available; to develop new services tailored for the Japanese market; to increase networking opportunities and improve dissemination of information; and to strengthen marketing and promotion in Japan, including launching a new image campaign in October. A key goal is to achieve the removal of visa requirements for Japanese tourists, to put Australia in line with other Western and most Asian countries.

Another issue of interest to the Australian Government and business is Japanese travellers' low use of Australia's electronic banking system because Japanese bank cards do not conform to international standards.

With Fukuoka, Osaka, Nagoya, Tokyo and Sapporo now connected to Australia by direct flights, effective and innovative marketing strategies and distribution links will be vital in raising awareness of Australia in regional Japan - and of regional Japan in Australia. This will be important in ensuring tourism growth as Tokyo's Narita Airport, which processes 50 per cent of travellers to Australia, faces potentially serious capacity constraints.

Some possible strategies:

- Offer a wide range of imaginatively packaged tour products, designed as packages but with high levels of individual flexibility. These products could, for example, be theme-based, focusing on cultural experiences, outdoor activities, sports, festivals, study and history. These should target niche groups and offer considerable choice, reflecting the growth of individual, as opposed to group, travel.
- Establish marketing and promotion links with powerful incumbents and emerging, innovative newcomers such as the credit card companies. Continuous and intensive interaction with these key stakeholders is essential. A wholesaler which is a competitor in one line can be a powerful ally in another.
- Use technology-based links, including the Internet, to promote sales and bookings, bearing in mind that the Japanese market is less integrated technologically than Australia. Foreign travel and tour operators providing the fastest and best response to information needs in a user-friendly manner will form strong alliances.

Education Remains a Largely Untapped Market

Good potential exists for Australia to expand its growing educational links with Japan. Australian and Japanese primary and secondary schools and universities are establishing 'twinning' relationships, and in the case of business schools, commercial links. Japanese comprise six per cent of foreign students in Australia, and increasing numbers of Australians are studying in Japan.

However, considerable scope exists for increasing the flows. Currently, most Japanese students are in Australia to learn English, although a growing number are studying at Australian universities and graduate schools. One strategy to increase tertiary student numbers might be to encourage Japanese universities to offer a year at an Australian 'sister' institution as part of the undergraduate curriculum. A similar strategy might apply to graduate schools.

One growth segment with good future potential is study tours and educational tourism, both to and from Japan. The travel industry is already developing packages and individual itineraries to take advantage of this growing trend.

Trading Companies Are Potential Allies

Japanese trading houses, which are diversifying their activities in Australia, engaging in downstream resource processing, infrastructure development and other 'nontraditional' areas, represent valuable potential allies for Australian firms. For small and medium-sized enterprises, trading houses can offer a channel for entering the Japanese and other export markets. They can assist SMEs to deal with the main difficulties encountered in exporting, including finance, market information and an overseas presence. They also represent a potential source of investment.

A number of larger Australian companies are already involved in a variety of infrastructure and industrial joint ventures with Japanese trading companies throughout Asia, with further opportunities arising in mining and agriculture. Australian consulting and engineering companies are also exploring opportunities in projects offered for international bidding under Japan's overseas development assistance (ODA) program, the world's largest bilateral aid facility. Austrade has developed a strategy to capture as much of this work as possible. Most visible is Austrade's Japanese-speaking Trade Commissioner in Jakarta who specialises in facilitating Australian-Japanese cooperation in ODA projects in Indonesia.

Invest in Japan to Create More Trade

Australian companies should consider an investment presence in Japan as a means of boosting exports. A large-scale presence is not a necessity; rather, an on-the-ground presence can be quite small and still be effective. Many foreign firms are unaware of the numerous Japanese Government programs designed to promote imports and foreign investment. These encourage domestic producers and distributors to switch to imports by temporarily subsidising their transition costs; and encourage foreigners to do business in Japan by temporarily subsidising entry costs. Measures include tax incentives, concessional loans, import promotion activities by the Japan External Trade Organisation, improvements in infrastructure and programs to teach foreigners how to do business in Japan. Specific programs are aimed at targetted sectors such as vehicles and components, housing and building materials.

Foreign Access Zones (FAZs) were introduced to revitalise local economies, facilitate imports and encourage inward investment under the temporary Import Promotion and Domestic Investment Act. Close to ports and airports, FAZs are not free-trade areas, although the government is under pressure to introduce more in-bond zones to facilitate trade. While FAZs do offer foreign companies 'incubating' facilities such as subsidised serviced offices, few firms have taken advantage of them, partly because most are in unfamiliar territory and partly because the Japanese Government has not marketed them strongly overseas.

Companies, Take the Reins

In summary, higher-value-added goods and services will become increasingly important as Japan-Australia trade and investment evolves, and important new business opportunities will emerge in Japan as market liberalisation proceeds. However, while the government can assist in facilitating market access and providing market information and contacts, it is up to companies to seek out and capitalise on specific opportunities.

IMPLICATIONS FOR GOVERNMENT

Export Efforts Can Pay Off Handsomely

Australian state and federal government agencies have programs to promote exports to and investment from Japan. Japan is not an easy market to succeed in, but Australians have made many breakthroughs after years of persistent business and government efforts. Many of these will provide lucrative benefits for producers and exporters.

Market Access Issues Remain a Challenge

The Australian Government's proactive and vigilant approach to market-access issues, closely monitoring Japan's deregulation and market-opening measures and pursuing concerns through bilateral consultations and multilateral and regional mechanisms, has paid off in many cases. For example, about 50 per cent of concerns raised by Australia in the 1997 Deregulation Action Plan review received a positive response.

However, as old barriers to foreign competition are removed in Japan, there is concern that new ones may take their places. The most recent economic revitalisation measure, the five-year Specific Measures Law to Promote Business Reform for Specific Industries, implies significant subsidies and government intervention for more than 200 mining, manufacturing, retail and wholesale sectors. Australian companies should closely monitor regulatory trends in their particular sectors.

It is important that the Government continue to give high priority to market access issues and that it publicise in both Japan and Australia the results of negotiations and the benefits of improved access.

Build on Japanese Language and Cross-Cultural Skills

Australia's strong Japanese language programs at the primary, secondary and tertiary levels are an important building block in the Australia-Japan relationship. It is important that federal and state education departments continue to support Japanese language studies and enable them to expand where possible to cover other aspects important to the relationship, such as culture, history and economics. Greater official encouragement and promotion in the business sector of this Japan-literate resource could help ensure that Australia makes effective use of this pool of talent in which it has a considerable investment.

It is also important that the Government continue to promote active and open communication at business and official levels, and support increased people-to-people and academic exchanges, including efforts to attract more Japanese students to Australia.

Attracting Japanese Investment Important for Economy

Japanese investors in Australia generate strong net exports and are major users of locally sourced inputs. However, attracting greater Japanese direct investment, particularly in manufacturing, will require an economy competitive enough to sustain plants and research and development activities that can be integrated into Japanese corporations' global activities. Governments and business alike will find this a major challenge in coming years, as other countries in the region offer lower costs, higher returns and faster growing domestic markets.

In addition to giving urgent priority to microeconomic reform at home, Australia must therefore continue to market strongly in Japan its strengths and comparative advantages, such as a highly skilled and well educated workforce, excellent research and development capabilities, reliable infrastructure, a transparent business environment and relative proximity to Japan. Austrade's investment promotion team at the Embassy in Tokyo plays an important role in promoting these factors and attracting Japanese direct investment in manufacturing and processing.

In determining foreign investment policies and attraction strategies, policy makers should take care in interpreting FDI statistics. Key issues to consider are whether investment proposals are carried through into actual projects, whether disposal of assets is recorded and how reinvestment is treated.

Support Regional Market Development

Austrade's regional network has the potential to be an increasingly valuable resource in expanding Australia's exports to Japan. Austrade should be encouraged to maintain and even expand its regional presence, and to market it more strongly to the Australian business community.

Encourage Australian Investment in Japan

Because direct investment in Japan has been shown to create exports from the home country, a stronger Australian investment presence could play a role in expanding and diversifying our exports to that market. Austrade's brief in Japan could be expanded to identifying opportunities for Australian strategic investment in Japan, including regional Japan.

INFORMATION FOR COMPANIES

1. AUSTRALIAN TRADE COMMISSION (AUSTRADE)

Austrade exporter assistance
Australian investment promotion in Japan
Austrade Internet assistance to companies

2. ASSISTANCE FOR FOREIGN INVESTORS

3. JAPAN-RELATED CONTACT DETAILS

In Japan

Australian Embassy in Japan
Australian Trade Commission (Austrade) offices in Japan
Australian state government offices in Japan
Japan External Trade Organisation (JETRO)
Peak body offices in Japan

In Australia

Australian Trade Commission (Austrade) Head Office
Supermarket to Asia
Japanese Chambers of Commerce
Japan-Related Organisations
State Government Bodies
Australian Chambers of Commerce
Japanese Government Offices
Japan External Trade Organisation (JETRO)
Japanese Prefectural Government Offices

4. KEY TRADE AND INVESTMENT BODIES IN JAPAN

Key bodies facilitating foreign participation in the Japanese market

1. AUSTRALIAN TRADE COMMISSION (AUSTRADE)

Austrade Exporter Assistance

The Australian Trade Commission (Austrade) helps Australian businesses develop export opportunities. Its services are tailored to meet the needs of both prospective and established exporters. Austrade can help businesses which are:

- seeking general information and advice on exporting
- selecting, understanding and entering export markets
- expanding existing export markets.

Austrade has an extensive network of offices in Japan. Apart from its major presence in Tokyo and Osaka, Austrade also maintains regional offices in Nagoya, Fukuoka, Sendai and Sapporo. (See Chapter 10 - *Regions*. Also see Part 3 - *Japan-Related Contact Details*.) These smaller offices identify opportunities for small and medium-sized enterprises seeking to access the Japanese market without incurring the high costs associated with business activities in Tokyo and Osaka.

In-market services, for which fees may apply, include:

- detailed market intelligence, such as competition and market prospects
- help in understanding the Japanese market from an on-the-ground perspective, such as regional customs and differences in tastes
- introductions to distributors and other market contacts
- opportunities to promote products and services through trade displays and missions
- listing on Austrade's Japanese language Internet site - *Australia Web*.

Austrade also provides a focal point for Japanese enquires on Australian products and services. Austrade passes on such enquires to relevant Australian businesses and works with them to capture export opportunities.

Australian Investment Promotion in Japan

The Federal Government's Investment Promotion and Facilitation Program, run jointly by Austrade and the Department of Industry, Science and Tourism, has an Investment Commissioner in Tokyo and an Investment Officer in Osaka.

These specialists:

- raise the profile of Australia as a location for productive investment, particularly in value-added manufacturing such as food processing, information technology, telecommunications and resource processing
- provide advice and assistance to Japanese companies seeking to invest in productive activities in Australia
- market specific investment opportunities on behalf of Australian project proponents.

Australia's benefits as a location for Regional Headquarters and call-centre operations are also promoted to multinational corporations with offices in Japan.

Austrade Internet Assistance for Companies

In March 1996, Austrade launched a Japanese language internet web site for Australian companies. The objective of the site is to assist Australian firms marketing capabilities by providing a low cost internet retail facility in Japan. With this service companies are able to promote and sell products directly to Japanese consumers over the Internet medium.

Contact Details:

Austrade Head Office - Australia

Austrade North-East Asia Office
RG Casey Building
John McEwen Crescent
Barton ACT 0221
Tel: 61-6-201-7696
Fax: 61-6-201-7409

Austrade Hotline in Australia: 13 28 78
Web Site: www.austrade.gov.au

Austrade Head Offices - Japan

Australian Embassy
2-1-14 Mita, Minato-ku
Tokyo 108 Japan
Tel: 81-3-5232-4047
Fax: 81-3-5476-7110

Australian Business Centre
7F New Otani Garden Court
4-1 Kioi-cho, Chiyoda-ku
Tokyo 102 Japan
Tel: 81-3-5214-0750
Fax: 81-3-5214-0751

2. ASSISTANCE FOR FOREIGN INVESTORS

The Japanese Government offers foreign companies an extensive array of assistance programs and incentives to encourage and facilitate investment in Japan. These include:

- preferential taxation whereby 'designated inward investors' may carry over losses incurred in the first three years of operating in Japan, for up to ten years; this scheme operates until 2006
- a loan guarantee system under which 'designated inward investors' may have up to 95 per cent of their loans guaranteed by the Industrial Structure Improvement Fund; this scheme operates until 2006
- provision of low-interest-rate loans through the Japan Development Bank, Hokkaido-Tohoku Development Corporation and Okinawa Development Finance Corporation
- subsidies for foreign affiliates in designated prefectures and local government assistance for Japanese and non-Japanese companies alike.

3. JAPAN-RELATED CONTACT DETAILS

CONTACTS IN JAPAN

Australian Embassy
2-1-14 Mita, Minato-ku
Tokyo 108 Japan
Tel: 81-3-5232-4111
Fax: 81-3-5232-4149

Austrade Offices in Japan

Kanto Region

Tokyo, Kanagawa, Chiba, Saitama, Ibaraki, Tochigi, Gunma and Yamanashi Prefectures

Australian Embassy
2-1-14 Mita, Minato-ku
Tokyo 108 Japan
Tel: 81-3-5232-4047
Fax: 81-3-5476-7110

Australian Business Centre
7F New Otani Garden Court
4-1 Kioi-cho, Chiyoda-ku
Tokyo 102 Japan
Tel: 81-3-5214-0750
Fax: 81-3-5214-0751

Kansai Region

Osaka, Hyogo, Kyoto, Nara, Wakayama, Shiga, Hiroshima, Okayama, Tottori, Shimane, Ehime, Kochi, Tokoshima and Kagawa Prefectures

Australian Business Office Japan
1F Osaka Chamber of Commerce & Industry Building
2-8 Honmachibashi, Chuo-ku
Osaka 540 Japan
Tel: 81-6-944-6445
Fax: 81-6-944-6444

Australian Consulate
29F Twin 21 MID Tower
2-1-16 Shiromi, Chuo-ku
Osaka 540 Japan
Tel: 81-6-941-9309
Fax: 81-3-920-4543

Chubu Region

Aichi, Mie, Gifu, Shizuoka, Fukui, Toyama, Ishikawa and Nagano Prefectures

Australian Consulate
8F Ikko Fushimi Building
1-20-10 Nishiki, Naka-ku
Nagoya 460 Japan
Tel: 81-52-211-0630
Fax: 81-52-211-0632

Kyushu Region

Fukuoka, Oita, Saga, Nagasaki, Kumamoto, Kagoshima, Miyazaki, Okinawa and Yamaguchi Prefectures

Australian Consulate
7F Tsuruta Keyaki Building
1-1-5 Akasaka, Chuo-ku
Fukuoka 810 Japan
Tel: 81-92-734-5055
Fax: 81-92-734-5058

Tohoku Region

Miyagi, Fukushima, Niigata, Yamagata, Iwate, Akita and Aomori Prefectures

Australian Consulate
8F Taiyo Twin-2 Building
1-13-22 Honcho, Aoba-ku
Sendai 980 Japan
Tel: 81-22-265-6810
Fax: 81-22-265-6816

Hokkaido

Australian Consulate
5F Daiwa Bank Sapporo Building
North 1 West 3-2, Chuo-ku
Sapporo 060 Japan
Tel: 81-11-242-4381
Fax: 81-11-242-4383

Australian State Government Offices in Japan

Government of New South Wales Office
28F Australia Business Centre
New Otani Garden Court
4-1 Kioi-cho, Chiyoda-ku
Tokyo 102 Japan
Tel: 81-3-5214-0770
Fax: 81-3-5214-0775

Queensland Trade and Investment Office, Tokyo
Suite 1303 Yurakucho Denki Building North Wing
1-7-1 Yurakucho, Chiyoda-ku
Tokyo 100 Japan
Tel: 81-3-3201-7861
Fax: 81-3-3201-7386

South Australian Government Representative Office
28F Australian Business Centre
New Otani Garden Court
4-1 Kioi-cho, Chiyoda-ku
Tokyo 102 Japan
Tel: 81-3-5214-0693
Fax: 81-3-3266-8987

Tasmania - Development and Resources Representative Office
c/o Lexis Inc
10-2 Nibancho, Chiyoda-ku
Tokyo 102 Japan
Tel: 81-3-3234-6701
Fax: 81-3-3234-6789

Victoria Government Business Office
28F Australian Business Centre
4-1 Kioi-cho, Chiyoda-ku
Tokyo 102 Japan
Tel: 81-3-5210-5041
Fax: 81-3-5210-5047

Government of Western Australia - Tokyo Office
28F Australian Business Centre
New Otani Garden Court
4-1 Kioi-cho, Chiyoda-ku
Tokyo 102 Japan
Tel: 81-3-5214-0791
Fax: 81-3-5214-0796

Government of Western Australia - Kobe Office
6F Golden Sun Building
3-6 Nakayamate-dori 4-chome, Chou-ku
Kobe 650 Japan
Tel: 81-78-5242-7705
Fax: 81-78-5214-7707

Japan External Trade Organisation

JETRO Head Office (Japan)
2-2-5 Toranomon, Minato-ku
Tokyo 105 Japan
Tel: 81-3-3582-5522
Fax: 81-3-3587-0219

Peak Body Offices in Japan

Australia-New Zealand Chamber of Commerce in Japan
28F Australian Business Centre
New Otani Garden Court
4-1 Kioi-cho, Chiyoda-ku
Tokyo 102 Japan
Tel: 81-3-5214-0710
Fax: 81-3-5214-0712

Australian Chamber of Manufactures
c/o Osaka Chamber of Commerce & Industry
Australian Business Office
2-8 Honmachibashi, Chuo-ku
Osaka 540 Japan
Tel: 81-6-944-6445
Fax: 81-6-944-6444

Chamber of Manufactures of New South Wales
28F Australian Business Centre
New Otani Garden Court
4-1 Kioi-cho, Chiyoda-ku
Tokyo 102 Japan
Tel: 81-3-5214-0767
Fax: 81-3-5214-0751

Japan-Australia Business Cooperation Committee
c/o Japan Chamber of Commerce & Industry (International Division)
3-2-2 Marunouchi, Chiyoda-ku
Tokyo 100 Japan
Tel: 81-3-3588-5311
Fax: 81-3-3216-6497

Manufactured Imports Promotion Organization
6F World Import Mart Building
3-1-3 Higashi-Ikebukuro, Toshima-ku
Tokyo 107 Japan
Tel: 81-3-3988-2791
Fax: 81-3-3988-1629

CONTACTS IN AUSTRALIA

Australian Trade Commission (Austrade) Head Office

Austrade North-East Asia Office
RG Casey Building
John McEwen Crescent
Barton ACT 0221
Tel: 61-6-201-7696
Fax: 61-6-201-7409

Austrade Hotline 13 28 78
Web Site: www.austrade.gov.au

Supermarket to Asia

Supermarket to Asia Ltd
3F, 55 Blackall Street
Barton ACT 2600
Tel: 61-6-273-1717
Fax: 61-6-273-1718

Japanese Chambers of Commerce in Australia

Federation of Japanese Chambers of Commerce and Industry
GPO Box 344
Sydney NSW 2001
Tel: 61-2-9256-9500

Japan Chamber of Commerce & Industry Sydney Inc.
29F 1 Market Street
Sydney NSW 2001
Tel: 61-2-9267-3377
Fax: 61-2-9267-4670

Japan Chamber of Commerce & Industry in Perth Inc.
c/o Hyogo Prefectural Government Cultural Centre
250 St George's Terrace
Perth WA 6001
Tel: 61-89-321-3737
Fax: 61-89-321-8586

Japan-Australia Business Council of South Australia Inc.
2F 83-85 Currie St
Adelaide SA 5000
Tel: 61-8-8212-2978
Fax: 61-8-8231-2196

Japan Chamber of Commerce & Industry Melbourne Inc.
4F Standard Chartered House
30 Collins Street
Melbourne VIC 3000
Private Bag 1111
Mulgrave VIC 3170
Tel: 61-3-9650-3666/7
Fax: 61-3-9650-1245

Queensland-Japan Chamber of Commerce and Industry Inc
375 Wickham Terrace
Brisbane QLD 4000
Tel: 61-7-3842-2222
Fax: 61-7-3832-3175

Japan-Related Organisations in Australia

Australia-Japan Business Forum
c/o Austrade
GPO Box 2386
Canberra ACT 2601
Tel: 61-6-201-7696
Fax: 61-6-201-7409

Australia-Japan Economic Institute
11F The Chifley Tower
2 Chifley Square
Sydney NSW 2000
Tel: 61-2-9233-8533
Fax: 61-2-9233-8503

Australia-Japan Business Cooperative Committee
24 Brisbane Avenue
Barton ACT 2600
PO Box E14
Kingston ACT 2604
Tel: 61-6-273-2311
Fax: 61-6-273-3196

Australia-Japan Foundation
RG Casey Building
John McEwen Crescent
Barton ACT 0221
Tel: 61-6-261-3817
Fax: 61-6-273-3971

Japan International Cooperation Agency
GPO Box 3892
Sydney NSW 2001
Tel: 61-2-9233-7652
Fax: 61-2-9233-6252

Australia-Japan Society (ACT) Inc
Price Waterhouse Centre
19-23 Moore Street
Canberra ACT 2600
PO Box 1006
Canberra ACT 2601
Tel: 61-6-279-5322
Fax: 61-6-257-5900

Australia-Japan Society of NSW (Inc)
5F 225 Clarence Street
Sydney NSW 2000
GPO Box 3802
Sydney NSW 2001
Tel: 61-2-9299-2242
Fax: 61-2-9299-2708

Australian-Japanese Association (Northern Territory)
PO Box 43041
Casurina NT 0811
Tel: 61-8-8992-7064
Fax: 61-8-8932-2057

Australia-Japan Society of Queensland
GPO Box 2036
Brisbane QLD 4001
Tel: 61-7-3831-1002
Fax: 61-7-3832-3195

Australia-Japan Society of Tasmania
PO Box 136
Sandy Bay TAS 7006
Tel: 61-362-25-4380
Fax: 61-362-25-4380

Australia-Japan Association of South Australia Inc
PO Box 3007
Unley SA 5061
Tel: 61-8-8370-8771
Fax: 61-8-8370-8771

Australia-Japan Society of Victoria Inc
Suite 3 Ground Floor
Alcaston House
2 Collins Street
PO Box 18041
Collins Street East
Melbourne VIC 3000
Tel: 61-3-654-2040
Fax: 61-3-654-2045

Australia-Japan Society (Western Australia)
GPO Box a46
Perth WA 6001
Tel: 61-89-405-2115
Fax: 61-89-481-0956

State Government Bodies (sections handling Japan-related affairs)

Australian Capital Territory

CanTrade
5F FAI House
197-207 London Circuit
Canberra ACT 2601
Tel: 61-6-205-0689
Fax: 61-6-205-0636

New South Wales

Department of State & Regional Development
International Business Group
225 George St
Sydney NSW 2000
Tel: 61-2-9242-6960
Fax: 61-2-9242-6970

Australian Business Limited

Australian Business Centre
140 Arthur St
North Sydney NSW 2060
Private Bag No 938
North Sydney NSW 2059
Tel: 61-2-9927-7500
Fax: 61-2-9923-1166

Northern Territory

Department of Asian Relations, Trade & Industry
North Asia Section
Development House
76 The Esplanade
Darwin NT 0800
Tel: 61-8-8999-5310
Fax: 61-8-8999-5106

Queensland

Department of Economic Development & Trade
Japan Secretariat - International Trade Development Division
12F Executive Building
100 George St
Brisbane Queensland 4000
Tel: 61-7-3224-6517
Fax: 61-7-3224-6154

South Australia

Economic Development Authority
International Business Division, North Asia
10F Terrace Towers
178 North Terrace
Adelaide SA 5001
Tel: 61-8-8303-2431
Fax: 61-8-8303-2411

Tasmania

Tasmania Development & Resources
Export Development Division
22 Elizabeth St
Hobart TAS 7000
Tel: 61-3623-35-829
Fax: 61-3623-35-800

Victoria

Business Victoria
55 Collins Street
Melbourne VIC 3000
Tel: 61-3-9651-9280
Fax: 61-3-9651-9531

Western Australia

Department of Commerce & Trade
International Relations Section
168-170 St George's Terrace
Perth W A 6000
Tel: 61-89-327-5546
Fax: 61-89-322-3361

Australian Chambers of Commerce

Australian Chamber of Commerce and Industry
Industry House
10 National Circuit
Barton ACT 2600
Tel: 61-6-273-2311
Fax: 61-6-273-3286

Australian Chamber of Manufactures (Canberra)
11F Canberra House
40 Marcus Clarke St.
Canberra ACT 2601
Tel: 61-6-257-2072
Fax: 61-6-248-8712

Australian Chamber of Manufactures (Melbourne)
380 St Kilda Road
Melbourne VIC 3004
Tel: 61-3-9698-4111
Fax: 61-3-9699-1729

Australian Chamber of Manufactures (Sydney)
7F 157 Liverpool St
Sydney NSW 2000
PO Box A750
Sydney South NSW 2000
Tel: 61-2-9372-0444
Fax: 61-6-9372-0400

Business Council of Australia
15/10 Queens Road
PO Box 7225
Melbourne VIC 3004
Tel: 61-3-9274-7777
Fax: 61-3-9274-7744

ACT Chamber of Commerce & Industry
2 Kembla St.
Fyshwick ACT 2609
Tel: 61-6-280-5029
Fax: 61-6-280-7458

State Chamber of Commerce (New South Wales)
12F 83 Clarence St
Sydney NSW 2000
PO Box 4280
Sydney NSW 2001
Tel: 61-2-9350-8100
Fax: 61-2-9350-8199

Chamber of Manufactures of New South Wales
The Dension 12/65 Berry St.
North Sydney NSW 2060
Tel: 61-2-9957-5792
Fax: 61-2-9923-1166

Northern Territory Chamber of Commerce and Industry Inc.
5F Confederation House
2 Shepherd St
Darwin NT 0800
GPO Box 1825
Darwin NT 0801
Tel: 61-8-8981-5755
Fax: 61-8-8981-1405

Queensland Chamber of Commerce and Industry Inc.
375 Wickham Terrace
Brisbane QLD 4000
Tel: 61-7-3842-2222
Fax: 61-7-3832-3175

South Australian Employers Chamber of Commerce & Industry
136 Greenhill Rd
Unley SA 5063
Tel: 61-8-8373-1422
Fax: 61-8-8272-9662

Tasmanian Chamber of Commerce & Industry
Industry House 30 Burnett St.
North Hobart TAS 7000
Tel: 61-362-34-5933
Fax: 61-362-31-1278

Victorian Employers Chamber of Commerce & Industry
50 Burwood Rd
Hawthorne VIC 3122
Tel: 61-3-9251-4333
Fax: 61-3-9819-0139

Chamber of Commerce & Industry of Western Australia
190 Hay St.
East Perth WA 6004
Tel: 61-89-365-7671
Fax: 61-89-481-0980

Japanese Government Offices in Australia

Embassy of Japan
112 Empire Circuit
Yarralumla
Canberra ACT 2600
Tel: 61-6-273-3244
Fax: 61-6-273-1848

Consulate-General of Japan (New South Wales)
34F State Bank Centre
52 Martin Place
Sydney NSW 2000
Tel: 61-6-231-3455
Fax: 61-6-221-6157

Consulate-General of Japan (South Australia)
29 Winham Avenue Reynella
Adelaide SA 5161
Tel: 61-8-381-6047
Fax: 61-8-381-6047

Consulate-General of Japan (Queensland)
17F Comalco Place
12 Creek Street
Brisbane QLD 4000
Tel: 61-7-3221-5188
Fax: 61-7-3229-0878

Consulate-General of Japan (Tasmania)
40 Melville Street
Hobart TAS 7000
Tel: 61-02-38-0200
Fax: 61-02-38-0209

Consulate-General of Japan (Victoria)
45F Melbourne Central Tower
360 Elizabeth Street
Melbourne VIC 3000
Tel: 61-3-9639-3244
Fax: 61-3-9639-3820

Consulate-General of Japan (Western Australia)
21F The Forrest Centre
221 St George's Terrace
Perth WA 6000
Tel: 61-89-321-7816
Fax: 61-89-321-2030

Japan Extenal Trade Organisation in Australia

JETRO Sydney Office
19F Gateway Building
1 Macquarie Place
Sydney NSW 2000
Tel: 61-2-9241-1181/7
Fax: 61-2-9251-7631

JETRO Melbourne Office
21F 101 Collins Street
Melbourne VIC 3000
Tel: 61-3-9654-4949
Fax: 61-3-9654-2962

JETRO Perth Office
21F The Exchange Plaza
2 The Esplanade
Perth WA 6000
Tel: 61-89-325-2809
Fax: 61-89-325-2472

Japanese Prefectural Government Offices in Australia

Osaka Prefecture Government Office
19F Gateway Building
1 Macquarie Place
Sydney NSW 2000
Tel: 61-2-9247-7433
Fax: 61-2-9247-8759

Aichi Prefecture Government Office
c/o Japan External Trade Organisation (JETRO)
19F Gateway Building
1 Macquarie Place
Sydney NSW 2000
Tel: 61-2-241-1181/7
Fax: 61-2-251-7631

Hyogo Prefecture Government Office
Hyogo Prefectural Government Cultural Centre
250 St George's Terrace
Perth WA 6000
Tel: 61-89-321-8536
Fax: 61-89-321-8586

Saitama Prefecture Government Office
185 Brisbane Albert Street
Brisbane QLD 4002
Tel: 61-7-3224-6516
Fax: 61-7-3225-8386

4. KEY JAPANESE ENTITIES FACILITATING FOREIGN PARTICIPATION IN THE JAPANESE MARKET

Japan External Trade Organisation (JETRO)

Established:	Established in 1958, initially to promote Japanese exports, but more recently its focus has been on promoting imports.
Legal Status:	Law concerning Japan External Trade Organisation enacted in 1958.
Activities:	Vast range of activities, mainly in information dissemination (understanding the Japanese market, new market opportunities, trade statistics, etc.), targeting foreign companies interested in the Japanese market. Offices throughout Japan and overseas.
Australian Involvement:	JETRO has offices in Sydney, Melbourne, and Perth
Contact Details:	See *Japan-Related Contact Details* in the previous section.

Office of the Trade and Investment Ombudsman (OTO)

Established:	Established in 1982; adjudicates standards and certification disputes between foreign companies and the government. In 1994 the Chairmanship was upgraded to Prime Ministerial level.
Legal Status:	In 1994 authorised to recommend actions to appropriate ministries; but holds no power in law and no enforcement authority.
Activities:	In 1996, 59 issues examined and 19 (including 1 issue from Australia) given priority in recommendations. Wide range of issues deliberated for improvement of market access including simplification of import procedures, such as, animal and plant quarantine, and customs clearance on holidays, and deregulation on cosmetics, medical devices, cool storage, harbours, and medical devices.
Australia:	In 1996 the following cases were raised: Requirements of Japanese Marine Construction Corporation (MCC) for financing purchase of foreign ships and restrictions on access for foreign race horses.
Other:	Since establishment has received total of 549 complaints, most from US and EU. 34 per cent of complaints resulted in improved market access; 38 per cent arose from ‘misunderstandings’ and a ‘lack of information’.
Contact:	OTO Secretariat 3-1-1, Kasumigaseki, Chiyoda-ku Tokyo 100 Japan Tel: 81-3-3581-5469 Fax: 81-3-3581-9897

Import Board

Established:	Established as a sub-committee of the Trade Conference chaired by Prime Minister of Japan in 1990 as result of US-Japan Structural Impediments Initiative (SII)Talks with the objective of hearing general views on and requests for the expansion and facilitation of Japan's imports, and to report to the Trade Conference.
Activities:	Meets twice a year for direct exchange of views. The results of some discussion have been transformed into actual policy measures.
Other:	Has members from the private sector. It consists of 10 foreign members, 9 Japanese members from the private sector. Government representatives also attend to respond to requests and opinions from the members.
Contact:	Secretariat of the Import Board: Import Division, Ministry of International Trade and Industry (MITI) 1-3-1, Kasumigaseki, Chiyoda-ku Tokyo 100 Japan Tel: 81-3-3501-1659 Fax: 81-3-3503-8436

Fair Trade Commission (FTC)

Established:	Body established postwar to enforce antimonopoly provisions.
Legal Status:	Provided by Antimonopoly Act enacted in 1947, which contains a variety of administrative and private remedies as well as criminal penalties.
Activities:	Japans only fair competition body. Investigates complaints and monitors business activity. Major concerns are: private monopolisation, unreasonable trade restraints, and unfair trade practices. Criminal penalties were reinforced in November 1993 through the revision of the Antimonopoly Act.
Contact:	Fair Trade Commission 2-2-1, Kasumigaseki, Chiyoda-ku Tokyo 100 Japan Tel: 81-3-3581-5471 Fax: 81-3 3581-1944

Japan Investment Council

Established:	Established in July 1994 to improve the programs and measures for promoting direct investment in Japan. Key function is to identify those regulations which hinder FDI and to receive requests and complaints from foreign firms regarding those regulations.
Activities:	Support of legislation to promote imports and facilitate FDI; provision of low-interest loans for FDI; improve business climate for foreign companies (eg. review residency period); efforts to ameliorate high costs; information dissemination; employment support; intellectual property and patent rights work; direct complaint mechanism in conjunction with OTO; steps to improve climate for mergers and acquisitions.
Australia:	Scope exists for Australian companies to make much greater use of the resources at the disposal of the JIC.
Contact:	Office for Market Access Improvement, Economic Planning Agency 3-1-1, Kasumigaseki, Chiyoda-ku Tokyo 100 Japan Tel: 81-3-3581-9576 Fax: 81-3-3581-9897

Foreign-Affiliated Companies Management Association

Established:	FAMA was established in June 1993 and now has 45 member companies from the US, Europe and Korea. Its aim is to provide a forum for foreign companies to discuss issues of mutual interest and to serve as a pressure group. Its report on regulation was widely publicised by the Japanese press.
Contact:	Mr Nagami Kishi Secretary General, FAMA Grande Maison 203 1-8-8 Kojimachi, Chiyoda-ku Tokyo 102 Japan

Office for Government Procurement Challenge System

Established:	Established January 1996 following the international agreement on government procurement negotiated concurrently with the Uruguay Round. Its purpose is to ensure greater transparency, fairness and competitiveness of the government procurement system, under the principle of nondiscrimination between foreign and domestic suppliers.
Legal Status:	Makes recommendations only, with expectation that they are implemented. Findings of contravention of the law are referred to appropriate legal body.

INDEX

D

E

F

ALSO BY THE EAST ASIA ANALYTICAL UNIT

Australia and North-East Asia in the 1990s: Accelerating Change
Published February 1992 (ISBN No. 0 644 24376 7), 318 pages, A$29.95

Korea to the Year 2000: Implications for Australia
Published November 1992 (ISBN No. 0 644 27819 5), 150 pages, A$19.95

Grain in China
Published December 1992 (ISBN No. 0 644 25813 6), 150 pages, A$19.95

Southern China in Transition
Published December 1992 (ISBN No. 0 644 25814 4), 150 pages, A$19.95

Australia's Business Challenge: South-East Asia in the 1990s
Published December 1992 (ISBN No. 0 644 25852 7), 380 pages, A$34.95

Changing Tack: Australian Investment in South-East Asia
Published March 1994 (ISBN No. 0 644 33075 9), 110 pages, A$19.95

ASEAN Free Trade Area: Trading Bloc or Building Block?
Published April 1994 (ISBN No. 0 644 33325 1), 180 pages, A$26.95

India's Economy at the Midnight Hour: Australia's India Strategy
Published April 1994 (ISBN No. 0 644 33328 6), 260 pages, A$34.95

Expanding Horizons: Australia and Indonesia into the 21st Century
Published June 1994 (ISBN No. 0 644 33514 9), 350 pages, A$34.95

Subsistence To Supermarket:
Food and Agricultural Transformation in South-East Asia
Published August 1994 (ISBN No. 0 644 35093 8), 376 pages, A$37.95

Overseas Chinese Business Networks in Asia
Published August 1995 (ISBN No. 0 642 22960 0), 362 pages, A$39.95

Growth Triangles of South East Asia
Published November 1995 (ISBN No. 0 642 23571 6), 136 pages, A$26.95

Iron and Steel in China and Australia
Published November 1995 (ISBN No. 0 642 24404 9), 110 pages, A$26.95

Pacific Russia: Risks and Rewards
Published April 1996 (ISBN No. 0 642 24521 5), 119 pages, A$26.95

Asia's Global Powers: China-Japan Relations in the 21st Century
Published April 1996 (ISBN No. 0 642 24525 8), 158 pages, A$26.95

China Embraces the Market Achievements, Constraints and Opportunities
Published April 1997 (ISBN No. 0 642 26952 1), 448 pages, A$39.95

The New ASEANS: Vietnam, Burma,Cambodia & Laos
Published June 1997 (ISBN No. 0 642 27148 8), 380 pages, A$39.95

Reports can be obtained from major bookstores and
Commonwealth Government Bookshops Australia-wide.

Trade enquiries, contact Gary Allen Pty. Ltd.
Telephone 02 9725 2933, Facsimile 02 9609 6106

Telephone Order Enquiries: 06 261 3114 Facsimile 06 261 3321

Internet: http:/www.dfat.gov.au/bookshelf/
(provides access to Executive Summaries and Order Form)

The Unit also produces a range of Working Papers,
available from above contact numbers, A$15 each.

A NEW JAPAN?

CHANGE IN ASIA'S MEGAMARKET

日本は再起できるか

アジアのメガマーケット日本における変化

EAAU
East Asia Analytical Unit

DEPARTMENT OF FOREIGN AFFAIRS AND TRADE

BHP

The National Library of Australia Cataloguing-in-Publication data: 11 June 1997

A New Japan? Change in Asia's Megamarket

Bibliography. ISBN 0 642 27131 3.

1. Japan - Economic conditions - 1989-.
2. Japan - Economic policy - 1989-.
3. Japan - Foreign economic relations.
I. Australia. East Asia Analytical Unit

330.951059

Design, typesetting and printing by Green Advertising #8051

EAST ASIA ANALYTICAL UNIT

The East Asia Analytical Unit was established in 1990 as the main agency within the Australian Government responsible for publishing analyses of major economic and political issues in Asia.

Located within the Department of Foreign Affairs and Trade, the Unit has to date undertaken and commissioned 16 studies on a range of topics related to Australia's trade policy interests in the region.

Staffed with 10 professionals, the EAAU also contracts consultants with specific expertise. It draws on a wide range of data and information sources, including Australia's diplomatic and trade missions in Asia.

Reports and working papers produced by the Unit are intended to assist analysts and decision-makers in business, the Australian Government and the academic community.

Executive summaries of the Unit's reports can now be downloaded from the Internet. See access details below.

Contact details:

East Asia Analytical Unit
Department of Foreign Affairs and Trade
R. G. Casey Building
Barton
Australia 2600

Head of the Unit:
Dr Frances Perkins

Directors:
Phillip Stonehouse
Andrea Spear

Telephone: 61 6 261 3057

Facsimile: 61 6 261 3493

Internet access code: .http://www.dfat.gov.au/dfat/dept/eaau/eaauhome.html.

ACKNOWLEDGEMENTS

This report was researched and written by an EAAU team comprising William Brummitt, Leith Felton-Taylor, Judith Laffan and Andrea Spear, who also directed the project. EAAU Head, Dr Frances Perkins, provided conceptual and editorial assistance.

The EAAU wishes to acknowledge the extensive assistance provided by officers of the Department of Foreign Affairs and Trade and of other Commonwealth Government Departments, in Canberra and in Japan.

The Australian Embassy in Tokyo provided invaluable assistance in producing this report, as did the Australian Consulate-General in Osaka and Australian Consulates in Nagoya, Fukuoka, Sendai and Sapporo. In the Embassy, particular thanks go to: H.E. Dr Ashton Calvert, Australian Ambassador to Japan; Minister Trevor Wilson; Minister- Counsellor William Patterson; former Minister-Economic Dr James Horne; current Minister-Economic Murray Edwards; Minister-Counsellor-Agriculture John Sainsbury; Counsellor-Economic Stuart Jones; Counsellor-Minerals and Energy Allan McKinnon; Janet Tomi, Jane Madden, Glenda Gauci, Don Dobinson, Naotoka Akatsuka, Richard Andrews, Simon Farbenbloom, Sam Niiyama, Peter Knight, Sachiko Yamaya and Yuka Uchiyama.

The EAAU is also grateful to staff at all six Austrade offices in Japan. In Tokyo: Executive General Manager for Japan/Korea Greg Dodds and Minister-Counsellor Marketing Leonie Muldoon. In Osaka: former Consul General/Senior Trade Commissioner Graham Wilson and current Consul-General Dr Greg Story (formerly Consul, Nagoya), Derek Brown, Brent Juratovich, Jacqueline Davison and Shigeru Ohmori. In Sendai: Glenys Shuntner and Ayako Gumizawa. In Fukuoka: Chris Rees. At Austrade Canberra, thanks go to Fiona Buffington, Christine Elsley and Mark Wood. Former Trade Commissioners to Japan, Peter Downie and Jim Short, also gave generously of their time and expertise.

Within the Department of Foreign Affairs and Trade in Canberra, Dr Mark Higgie, Stephen Kentwell, Savitri Chandrasena, Danielle Morris, Michaela Browning and Alex Fraser of the Japan Section were particularly helpful. Others who provided insights and assistance were: Deputy Secretaries Kim Jones and Joanna Hewitt; North Asia Division First Assistant Secretary Penny Wensley; North East Asia Branch Assistant Secretary John Richardson; and Peter Hussin, Pamela Fayle, Bill Wise, Tony Urbanski, Michael Court and Evelyn Killick. Steve Moran of the Australian Delegation to the OECD in Paris was also very helpful. Special thanks go to the Statistical Services Section, especially Susan Begley.

Much appreciated comments and assistance were also received from: Betty Grueber, Australian Bureau of Statistics; Rick Deverall, Department of the Treasury; Craig Thorburn, Foreign Investment Review Board; Ivan Roberts, Australian Bureau of Agricultural and Resource Economics; Rod Shaw, Department of Primary Industries and Energy; Ken Miley at the Office of National Assessment; Victoria Callioni and Susan Kruska, who coordinated comments from the Department of Transport and Regional Development; and Helen Jolly of the Queensland Department of Economic Development and Trade's Japan Secretariat who coordinated Queensland Government comments.

The EAAU wishes to acknowledge the information and material provided by consultants including: Masahiro Kogawa, Australian National University MBA program; Dr Luke Gower and Professor Naoyuki Yoshino, Australia-Japan Research

Centre, ANU, and Keio University, respectively; Yoshitaka Matsuda and Hiroko Yamamoto, Sakura Institute of Research; Chris Nailer, IMA/EIU Australia; Professor Warwick McKibbin, ANU; Professor Stephen Nicholas, Dr David Merrett and Dr Greg Whitwell, Melbourne University; Dr William Purcell, University of NSW; Tom Waring and others, Australian Bureau of Agricultural and Resource Economics; David Lawson, NAsPacT Consulting; Denis Gastin, Instate Pty Ltd; and Dr Paul Riethmuller, University of Queensland.

Case studies were provided by EIU Australia; GIO Reinsurance Japan; ANZ Japan; Australian Rice Growers Cooperative; Australian Dairy Corporation; Tasmania Development and Resources; Queensland Department of Primary Industries; Premium Chestnuts Australia; and Ehime Prefecture Foreign Access Zone.

Particularly valuable insights and comments were also received from: Dr Mark Michelson of Warren Williams International Ltd, Hong Kong; Tomohiro Ishiguro of Hattori-Marshall, Tokyo; Dennis Tachiki of Sakura Institute of Research, Tokyo; John McKindley, Mitsui and Co, Sydney; Professor Peter Drysdale, Executive Director of the Australia-Japan Research Centre, ANU; Professor Arthur Stockwin, Nissan Institute of Japanese Studies, University of Oxford; Manuel Panagiotopoulos, Director, and other staff at the Australia-Japan Economic Institute, Sydney; Dr Guy Meredith, International Monetary Fund, Washington; Holly Lindsay and Anne Leahy, Senior Economists at BHP; Norio Fujii, International Business Affairs Division, Ministry of International Trade and Industry, Tokyo; Kenji Shigyo, Research and Statistics Department, Bank of Japan; Joanne Hickey and others at the JETRO Sydney office; Dr Aurelia George-Mulgan, University of New South Wales (ADFA); Dale Honeck, WTO, Geneva; Michael Daley, OECD, Paris; Reiko Gibbons, Japan Centre, ANU; Professor Leith Morton, Japanese Department, University of Newcastle; Dr John Caiger, ANU; Mariko Fujiwara, Hakuhodo Institute of Life and Learning, Tokyo.

In Japan, special thanks go to the many people in central and local government organisations, business peak bodies, the private sector and academic institutions who gave their time and shared their knowledge, experience and perspectives with the EAAU and responded to our requests for information. The EAAU would particularly like to acknowledge: Takeshi Kondo, General Manager, Itochu Corporation; Takuya Okada, Chairman, Jusco Co Ltd; Shinsuke Kataoka and Masayoshi Nozawa, Daiei; Dr Paul Sheard, Baring Asset Management; Masayuki Yasuoka, Managing Director, Bankers Trust Japan; Isoroku Sawada, Director-General, Economic Research Institute, Economic Planning Agency; Shigeki Tejima, Deputy Director-General, Research Institute, Export-Import Bank of Japan; Hidehiro Konno, Director-General, Economic Cooperation Department, MITI; Akinori Yamada, Fair Trade Commission; Omi Koji, LDP; Dr Takeshi Kiuchi, Director/Chief Economist, Long-Term Credit Bank of Japan; Kuniyoshi Sasaki, Japan Productivity Centre for Socioeconomic Development; Yoshitsuga Minagawa, Food Agency, and other Ministry of Agriculture, Forestry and Fisheries staff; and Tadaoki Ishikawa, General Manager, International Affairs Division, Toyota Motor Corporation. The EAAU also wishes to acknowledge the kind assistance provided by the Embassy of Japan in Canberra in response to our numerous requests.

The EAAU is grateful to Keith Mitchell of the Cartography Unit, Research School of Pacific and Asian Studies, Australian National University, for his expertise and patience in producing the maps for the report.

The EAAU would also like to thank Ann Duffy, Justin Hynes and Monica Short for writing, editorial and proofing assistance.

Finally, the EAAU is grateful to BHP for providing corporate sponsorship.

This report was commissioned by the Australian Government's Standing Committee of Deputy Secretaries on East Asia.

CONTENTS

GLOSSARY OF TERMS AND ABBREVIATIONS

ABARE: Australian Bureau of Agricultural and Resource Economics

ACCJ: The American Chamber of Commerce in Japan

Ad valorem tariff: a tariff rate expressed as a percentage of the value of the goods to be imported

Administrative prices: prices set by the government in order to determine domestic market or producer prices

Administrative reform: longstanding goal of reform of government structure to increase efficiency and reduce costs, and reassessment of the role of government

Ageing population: this term is used to refer to the phenomenon of the rapid increase of the proportion of elderly people relative to the rest of the population in Japan

Agrifood: processed and unprocessed food products

AIDS: Acquired Immune Deficiency Syndrome

AJEI: Australia-Japan Economic Institute, Sydney

AJRC: Australia-Japan Research Centre, Australian National University, Canberra

Amakudari: 'descent from heaven', the practice whereby senior bureaucrats 'retire' into top positions in business and organisations regulated by their former Ministry

ANA: All Nippon Airways

ANL: Australian National Line

ANZCC: Australia-New Zealand Chamber of Commerce in Japan

APEC: Asia-Pacific Economic Cooperation group. Founded in 1989, now has 18 members from around the Pacific rim. APEC aims to remove impediments to trade and investment and build on the natural economic synergies of the region. Cooperation takes place in the ares of trade and investment liberalisation, trade and investment facilitation, and economic and technical cooperation

Applied tariff: the tariff rate actually used, as distinct from the maximum permissible 'bound' tariff

AQIS: Australian Quarantine and Inspection Service

ARGC: Australian Rice Growers' Cooperative

ASEAN: Association of South East Asian Nations (Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam)

BOJ: Bank of Japan, the central reserve bank

Bound tariff: The conversion of nontariff barriers to an equivalent tariff, which is then 'bound'. There is a legal obligation not to raise tariffs above the bound level

BSE: Bovine Spongy Encephalitis, otherwise known as 'mad cow' disease; caused devastation to the UK beef industry

Bubble economy: the period from the beginning of 1987 to the end of 1990 when land and stock prices grew rapidly under the influence of an accommodating monetary policy

Chukeiren: Chubu Economic Federation

CIF: term for pricing goods for export including cost, insurance and freight

Compound tariff: a rate of duty on a product consisting of two parts: the first is an ad valorem rate, then there is a specific rate

CPI: Consumer Price Index

CSE: Consumer Subsidy Equivalent measures the value of transfers, above the free market price, to consumers of agricultural products; this is usually negative, representing a tax on consumers

Daisan secta kaisha: So-called 'third sector' company, comprising investment from all levels of government and the private sector

DAP: Deregulation Action Plan. Initiated in 1995, including 1091 measures in ten major sectors with provisions for annual reviews the last of which occurred in 1997

Development imports: products developed overseas by the Japanese for the Japanese

DFAT: Australian Department of Foreign Affairs and Trade

DPIE: Australian Department of Primary Industries and Energy

DPJ: Democratic Party of Japan - Minshuto - formed in late 1996 by Yukio Hatoyama and Naoto Kan, to be distinguished from the early postwar Minshuto which helped form LDP in 1955

EAF: Electric Arc Furnace

EEO: Equal Employment Opportunity

ETM: Elaborately Transformed Manufactures. Term used in Trade Exports Classification (TREC) by the Australian Department of Foreign Affairs and Trade denoting products that have undergone significant value-adding

EPA: Economic Planning Agency (Japan)

EU: European Union

FAZ: Foreign Access Zone

FDI: Foreign Direct Investment. Investment in overseas branches, subsidiaries or associated companies in which the investor owns 10% or more of the equity

Final energy consumption: The total amount of energy consumed outside the energy conversion sector. It is equal to total energy consumption less energy consumed or lost in conversion, transmission and distribution

FIND: Foreign Investment in Japan Development Corporation

FOB: Free on Board. The cost of a product for export less freight and insurance costs

Foodex: Japan's premier annual food trade exhibition

FTC: Fair Trade Commission (Japan)

FY: Australian Financial Year (1 July to 30 June)

G7: Group of seven leading industrialised countries (US, Canada, France, Italy, Germany, UK, Japan)

Gaiatsu: 'external pressure' from foreign governments and organisations (especially the US government) for deregulation and liberalised market access

GATS: General Agreement on Trade in Services

GATT: General Agreement on Tariffs and Trade (predecessor to the WTO)

Great Hanshin Earthquake: major earthquake of 17 January 1995 centring on Kobe and Awaji Island, with loss of over 6 500 lives and huge infrastructure damage

Gross Domestic Product (GDP): measures the value of economic production undertaken within the domestic territory

Gross National Product (GNP): GDP plus residents' income from overseas property or productive activity less income paid to overseas residents

GW: gigawatt (1000 million watts)

Han: feudal fief

Heisei period: 1989-present. Reign of Emperor Akihito.

Henpin: practice of return of unsold merchandise, a feature of the traditional distribution system

Holding company: a company the main purpose of which is to manage shareholdings in other firms

Hollowing out: variously described as the transfer of production bases to overseas sites, a fall in domestic employment levels, a decline in technological standards, the replacement of domestic production by imports and the replacement of manufacturing by nonmanufacturing industry. The most appropriate definition is the forcing offshore of industries that, given the proper environment, could be competitive in Japan

IAP: Individual Action Plan. Prepared by individual members setting out how they will reach the free trade goals of APEC

IATA: International Air Transport Association

IEEJ: Institute of Energy Economics, Japan

IMF: International Monetary Fund

Internationalisation of the yen: the increased role for the yen both as an international currency for trade and finance and as an anchor currency against which other countries may peg their own currencies

IPP: Independent Power Producer

Iron triangle: a common way of describing the perceived close cooperation in Japan between government, bureaucracy and business for policy-making

JAL: Japan Airlines

Japan Inc: Term commonly used to describe the close consultation and cooperation among government, bureaucracy and business in economic policy-making, particularly in the 1950s to 1980s period

JAS: Japan Air System, Japan's third largest airline operator, formerly Toa Domestic Airlines

JCP: Japan Communist Party - Kyosanto - established in 1945

JETRO: Japan External Trade Organisation

JFY: Japan Financial Year (1 April to 31 March)

JIT: Just In Time. Manufacturers and retailers order stock in small amounts to meet short-term requirements, reducing inventory costs

JNOC: Japan National Oil Corporation

JNP: Japan New Party - Nihon Shinto - formed in 1992 by Morihiro Hosokawa

JNR: Japan National Railway

JR: Japan Rail, formerly JNR, now a group of six passenger companies and one freight company

JSP: Japan Socialist Party - Nihon Shakaito - established in 1945; changed its name to Social Democratic Party of Japan (SDPJ) in 1996 - Shakaiminshuto

Juku: coaching or 'cram' schools at mainly secondary level

Jusen: housing loan companies which went bankrupt upon the collapse of the bubble economy

Kakaku hakai: 'price destruction' - term used to describe the fall in prices during the early 1990s recession from greater competition

Kankeiren: Kansai Economic Federation

Kasumigaseki Reform Initiative: the Hashimoto Government's proposal for major administrative reform over the next decade

Kasumigaseki: central Tokyo area where the main central government ministries and agencies are located; commonly used to refer to the government and bureaucracy

Keidanren: Federation of Economic Organisations

Keiretsu: Various forms of interfirm relations or sets of closely affiliated firms

Keizai Doyukai: Japan Association of Corporate Executives

Kokusaika: 'Internationalisation'

Komeito: Clean Government Party, formed in 1964 by Buddhist Organisation Soka Gakkai; became part of Shinshinto in 1994

kWh: Kilowatt hour (1000 watts per hour)

LDP: Liberal Democratic Party - Jiyuminshuto - formed in 1955 by merger of two long-existing conservative parties (Liberal Party - Jiyuto; Democratic Party - Minshuto)

Lifetime employment: Many large Japanese companies have traditionally guaranteed lifetime employment to new recruits. However, this practice is expected to become less common in coming years

LNG: Liquefied Natural Gas

LPG: Liquefied Petroleum Gas

LSRS Law: Large-Scale Retail Store Law, enacted in 1974 to contain the fast growth of department stores and supermarkets and protect small and medium-sized retailers

Maekawa Report: landmark report in 1985 recommending major restructuring of the Japanese economy

MAFF: Ministry of Agriculture, Forestry and Fisheries

Main bank: A bank through which a particular firm does the majority of its business, which in turn has substantial shareholdings in the particular firm (up to a legal limit of 5% of outstanding equity)

Meiji period: 1868-1912. Reign of the Meiji Emperor

MFN: Most Favoured Nation (meaning that the most favourable treatment extended to one trading partner must be extended to all other WTO members)

MHW: Ministry of Health and Welfare

Minimum access tenders: the majority of rice imports occur under this system and are bought and managed by the Food Agency of MAFF

MITI: Ministry of International Trade and Industry

MMBtu: Millions of British thermal units

MOC: Ministry of Construction

MOF: Ministry of Finance

MOHA: Ministry of Home Affairs

MOJ: Ministry of Justice

MOT: Ministry of Transport

mtoe: Million tonnes of oil equivalent

MW: Megawatts (1 million watts)

NAC: Nominal Assistance Coefficient. The ratio of the domestic price to the world price

nes: Not elsewhere specified

Nihon Keizai Shimbun: 'Japan Economic Newspaper'- Japan's main financial and business daily, often called by its abbreviated name the 'Nikkei'; weekly edition is the Nikkei Weekly

Nikkeiren: Federation of Employers' Associations

Nokyo: Agricultural Cooperatives

Nokyogiin: Diet members with direct links to agricultural cooperative organisations

NTB: Nontariff Barrier

NTT: Nippon Telegraph and Telephone Corporation

OECD: Organisation for Economic Cooperation and Development

OTO: Office of the Trade Ombudsman

Pachinko: Japanese pinball

PCI: Pulverised Coal Injection

PCM: Price Control Measure

POS: Point of Sale. Corporate advertising at retail level - for example, at the check-out area in supermarkets

PRA: Pest Risk Analysis

Primary energy: Energy obtained directly from nature; includes energy from non-renewable fuels such as coal, uranium, crude oil, naturally occurring LPG, natural gas, and renewable fuels such as wood, hydroelectricity and solar energy

PSE: Producer Subsidy Equivalent. Represents a subsidy that would be equivalent to the value of transfers from taxpayers and consumers to agricultural producers

QR: Quantitative Restriction

Quad countries: US, Japan, EU, Canada

Real effective exchange rate (of the yen). Measures the strength of the yen against all currencies after removing the influence of inflation

Reverse imports: imports by a company from its offshore subsidiaries

Sakigake: Harbinger Party, formed in 1993 by breakaway LDP members

SBS tenders: Simultaneous Buy and Sell tenders. Rice imports under SBS, which are relatively small amounts, go directly onto the market

SCAP: Supreme Commander for the Allied Powers during the US Occupation - used to refer to both the office holder and the office

SDPJ: Social Democratic Party of Japan - Shakaiminshuto - new name of JSP from 1996

Shinkansen: Bullet Train

Shinseito: Japan Renewal Party - established in 1993 by breakaway LDP members

Shinshinto: New Frontier Party (NFP) - formed in 1994 by a merger of nine non-communist opposition parties (Shinseito, Komeito, Japan New Party, and others)

Showa period: 1926-89. Reign of Emperor Hirohito

SII Talks: Structural Impediment Initiative Talks. Launched in mid-1989 as part of the Bush Administration's bilateral trade strategy towards Japan

Silver industries/market: industries serving the retired population

Simply transformed manufactures: manufactured products which have undergone basic processing

SME: Small to medium-sized enterprise

SML: Specific Measures Law to promote business reform for specific industries

Sogo shosha: Japanese general trading houses. These large and diverse businesses include such companies as Mitsui and Co. Ltd, Sumitomo Corporation and Mitsubishi Corporation

Specific tariff: a tariff expressed as a specific charge on the particular import, regardless of its value

SPS: WTO Sanitary and Phytosanitary Agreement, negotiated under the Uruguay Round

Super Ice Age: colloquial term used to describe the current difficult employment situation for female university graduates

Taisho period: 1912-1926. Reign of the Taisho Emperor

Taiyoto: Sun Party, formed in late 1996 by breakaway members of Shinshinto led by former PM Hata

Tariff escalation: the setting of tariffs in such a way that they rise with the transformation of a product

Tariff spike: when a tariff for a product exceeds the national average MFN tariff rate for all products by three times

Tariffication: the conversion of nontariff barriers into an equivalent tariff

Tatene: traditional list price system, feature of the traditional distribution system

toe: tonnes of oil equivalent

TWh: Terawatt Hour (10^{12} watts per hour)

UK: United Kingdom

USA: United States of America

VER: Voluntary Export Restraint. An agreement whereby a country agrees to limit its exports to another country of a defined product to an agreed maximum within a certain period. Commonly used in trade disputes between the US and Japan

WTO: World Trade Organisation

Zaibatsu: financial and industrial conglomerates which developed from the Meiji period but were partly dismantled by the US Occupation reforms

Zoku: crossfactional 'tribe' or 'group' of Diet members with a common policy interest


Sapporo
Sea
of
Japan
Sendai
JAPAN
Osaka
Tokyo
Hiroshima
Yokohama
Fukuoka
Nagoya
PACIFIC
OCEAN
South
China
Sea
EQUATOR
Darwin
INDIAN
OCEAN
AUSTRALIA
Brisbane
Perth
Sydney
Canberra
Adelaide
Melbourne
Hobart