Chapter 5 Japan

Japan is a very important trade, investment and aid partner for Vietnam as well as the leading nation in East Asia's dynamic manufacturing network. The mission fully recognized, even before departure, that Japan's past and current experiences could not be applied directly to Vietnam because of different development stages and socio-economic circumstances. In this sense, Thailand and Malaysia offer more directly relevant information for Vietnam than Japan. However, the mission believed that valuable lessons could still be had from Japan if proper modifications were made. The mission succeeded greatly in obtaining such important insights.

1. METI's role

The Ministry of International Trade and Industry (MITI) is considred to have contributed to Japan's rapid industrialization in the postwar period from the mid 1950s to the early 1970s, although the exact extent and scope of this contribution is still debated. Most economists agree that, while private dynamism was central, MITI also played an important assisting role. On the other hand, the view that the Japanese economy was orchestrated by a strong government dictating businesses what to do, a view sometimes expressed by foreign observers, is not supported. As time passed and the Japanese economy achieved high industrialization and maturity, the role of MITI also diversified into environment, energy saving, safety standards, trade negotiation, intellectual property rights, regional cooperation, and so forth. The overall influence of MITI on Japanese industries also declined as large private firms became competitive and globalized. In 2001, the government reorganized MITI into the Ministry of Economy, Trade and Industry (METI)[1].

Even in the high growth period from the mid 1950s to the early 1970s, MITI's main role was to coordinate and support private activities rather than dictating them. For declining industries, MITI intervened more strongly in order to downsize and restructure them. MITI also supported R&D in next-generation technology, but not always with success. In the case of Japan's highly competitive industries such as consumer electronics, cameras, watches, automobiles and motorcycles, MITI's role was small. Private firms were the driving force of these industries. MITI sometimes tried to reorganize their industrial structure but such efforts often failed to materialize or were rejected by the private sector For example, in the early 1960s, Japanese automobile firms resisted MITI's intension to merge them into a few large firms to compete with Americans. It is important to have a balanced view of the role of MITI (METI) in the history of Japanese industrialization. It should be neither overestimated nor underestimated.

In the automobile and IT industries (the two METI divisions we met), the role of the government was relatively modest. In the case of automobiles, METI has had no major

[1] We use the term MITI in discussing the past and the term METI for more recent situations. However, the basic policy orientation of this ministry did not change by the name change in 2001. For this reason, it is acceptable to use the two terms interchangeably.

role in deciding output, investment, product design or global strategy of Japanese MNCs. This has been true not only today but in the past as well. METI's concern has been various surrounding issues of the industry including air pollution, fuel efficiency, trade negotiations and improving business environment in the East Asian region (sometimes using ODA). These are the areas that cannot be handled by individual companies due to externality or the need for diplomatic leverage. Although Japan had serious air and noise pollution, traffic accidents and congestion due to heavy automotive use in the past, it never imposed any numerical restriction on automobile production or registration. The METI officials we met stated clearly that such restriction would violate the basic principle of free enterprise. It said that road safety and congestion was a traffic control problem of the government, not a problem of private companies that produce automobiles.

In the case of IT, the METI's role was somewhat greater than in the case of automobiles in creating a vision and setting and revising targets. This reflects the fact that IT is a fast evolving industry requiring huge investment and constant adjustments in law and regulation in comparison with the automobile which is a relatively mature industry. But it should also be noted that METI's policy touches only part of Japan's entire IT industry, which accounts for over 8% of GDP[2]. METI's current policy in this area is the *e-Japan Strategy* initiated in 2001. This strategy aimed to make Japan a top IT nation by 2005. However, the target for IT infrastructure (fastest and lowest-cost broadband access in the world), which was one of the four original targets[3], was already achieved in 2003. Subsequently, the main concern shifted to the active use of IT by the general population. While METI is relatively more influential in IT than in automobiles, the government still remains a follower of industrial trends and opinion rather than an enforcer of a strategy in a top-down manner. METI continually listens to the views of the industry and experts in formulating and revising e-Japan Strategy, as we will see below.

Clearly, the government's supplementary role in industrialization reflects the very strong dynamism and competitiveness of Japanese manufacturing enterprises. MITI had to carefully listen to and work with the private sector and implemented policies that were really desired by the industry. In rare cases where MITI tried to intervene in the strategy and organization of private enterprises against their will, policy was not effective.

2. Channels with the private sector

To play a role appreciated by businesses, MITI needed effective communication channels with them. In fact, MITI's strong and multi-faceted linkages with the private sector in the past were a favorite research topic of foreign scholars such as Chalmers Johnson, Daniel

[2] Japan's IT industry is divided into (i) contents and platform (cable TV, mobile phone service, broadcasting, etc); (ii) hardware (computers, mobile phones, audio-visual equipment, consumer electronics, etc); and (iii) information service (system maintenance, software production and sales, information processing, etc). The value of these segments amounted to 19 trillion yen, 9 trillion yen and 14 trillion yen respectively in 2003 with the total of 42 trillion yen (this may contain some double-counting if purchasers are not final consumers). Japan's GDP in 2003 was 502 trillion yen.

[3] The other three original targets were e-business, e-government and human resource development (IT training)—see Table 1 below.

Okimoto, the World Bank, and Campos and Root[4]. At present, METI still maintains many communication channels inherited from the MITI days although the private sector is now relatively more independent from METI compared with the past.

Deliberation councils still play an important role in linking government, industry and experts and in generating consensus and solving problems among them. Special committees and study groups also play a similar role. Whatever the name may be, the mechanism for listening to the industry's needs and opinions before making a policy is well established in Japan. These councils, committees, and study groups meet as frequently as necessary and produce reports to identify new issues and map out future directions.

In addition to councils, committees, and study groups set up by the government, industrial associations such as the Japan Automobile Manufacturers Association (JAMA) and the Japan Electronics and Information Technology Industries Association (JEITA) provide permanent bridges between the government and businesses. METI usually works with industrial associations to gather information and formulate policies. METI also contacts individual companies by telephone, email and informal meetings as needed. Before going to an FTA negotiation, for example, METI approaches businesses through an industrial association and individual contacts to determine Japan's negotiating position. In the case of introducing a new law, the draft is routinely discussed in an official open committee attended by concerned businesses and experts. The draft law also receives public comments for at least one month.

Japanese enterprises are required by law to report basic data such as production, sales and exports to the government every month. However, data collected by industrial associations are usually faster than official data. When METI needs special or sensitive data from enterprises, it must explain the reason. Enterprises cooperate only when they agree with the purpose of such data collection.

3. Quick implementation and flexible revision

METI's industrial strategy is frequently reviewed and adjusted. In the case of the IT industry, strategies are revised every one to three years depending on the targeted product or service. Let us take *e-Japan Strategy* mentioned above as an example.

Table 5-1 shows the evolution of this strategy from January 2001 (establishment) to September 2004. Within this 45-month period, key targets were revised annually and new goals were introduced constantly. Two new bodies were created to revise the strategy. In light of early achievement of the initial targets, the completely revised *e-Japan Strategy II* was formulated in July 2003. Although IT is an area in which speed is essential, it must

[4] See Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975*, Stanford University Press, 1982; Daniel I. Okimoto, *Between MITI and the Market*, Stanford University Press, 1989; World Bank, *The East Asian Miracle: Economic Growth and Public Policy*, Oxford University Press, 1993; and Ed Campos and Hilton L. Root, *The Key to the Asian Miracle: Making Shared Growth Credible*, Brookings, 1996.

be admitted that METI's policy formulation and execution is extremely fast and flexible. Moreover, agreed actions are immediately put into practice without delay. This is in sharp contrast to Vietnam where the process of drafting and approving industrial strategies and master plans normally takes years, and implementation is often delayed while operational rules and regulations are being prepared. In the fast-changing IT industry, five-year or ten-year targets are not meaningful since it is hard to predict the industry's direction beyond immediate future.

Table 5-1. Evolution of Japan's IT Policy in Recent Years

	Activity	Outcome
e-Japan Strategy (Jan.2001-)		
Jan.2001	IT Basic Law & IT Strategy Headquaters established	
Mar.2001	"e-Japan Key Targets" decided: (1) infrastructure, (2) e-business, (3)e-government, (4) HRD; to become top IT nation by 2005	Infrastructure target achieved by 2003
Jun.2002	"e-Japan Key Targets 2002": (1) fast internet 30 million households, (2) very fast internet 10 million households, (3) 98% electronic application & reporting to government by end FY2003	Achieved by 2003
Sep.2002	Special Study Council established to map out new strategy	
e-Japan Strategy II (Jul.2003-)		
Aug.2003	"e-Japan Key Targets 2003": Increasing IT use in (i) seven leading areas: health care, food, life, SME, finance, learning, job, public service; (ii) five cross-cutting areas: next-generation infrastructure, security, R&D, HRD, international strategy	
Dec.2003	Evaluation Special Study Council established	
Feb.2004	e-Japan Strategy II Acceleration Package decided: Asia & global strategy, security contents, deregulation evaluation, e-government	
Mar.2004	ESSC's first report	
Jun.2004	"e-Japan Key Targets 2004": reflecting Acceleration Package above; numerical targets introduced for improving life quality and enhancing firms' competitiveness; to remain top IT nation after 2006	
Sep.2004	ESSC's second report	

Source: METI Commerce and Information Policy Bureau.

The VDF-MOI mission has found in all of the countries it visited, namely Thailand, Malaysia and Japan, that effective industrial policy formulation requires constructive and continuous contacts with businesses and a mechanism to frequently review and flexibly adjust the policy in implementation. Without these, policy becomes too slow and out of synch with the requirements of the industry.

4. Numerical targets

One of the questions raised by the VDF-MOI joint research is how Vietnam should use numerical targets in industrial strategy formulation in the future. It is clear that setting rigid numerical targets for all industries and products and requiring them to be met by any means is no longer appropriate in an economy under market-orientation and global integration. But this does not mean that all numerical targets must be abolished. Thailand uses numerical targets for the total output and exports of automobiles and motorcycles, and Japan currently uses numerical targets for the household use of broadband internet and the promotion of e-government. Which numerical targets are appropriate and which ones are irrelevant and even harmful?

In reality, Vietnam's policy making is shifting gradually away from rigid targets to softer guidelines and recommendations. However, quantitative mentality is deeply entrenched from the days of economic planning and difficult to overcome immediately.

For the rethinking of numerical targets, it is useful to classify them into different groups. Table 5-2 shows the hardness of targets, the level of aggregation and the periodicity of revision as three key characteristics of real-sector numerical targets. This framework allows us to selectively adopt numerical targets rather than accepting or denying them in totality.

Table 5-2. Three Characteristics of Numerical Real-sector Targets

Hardness	Aggregation	Periodicity
Legal order	**Macro level** (GDP, total export)	**5 to 10 years ahead or longer**
⇕	⇕	⇕
Indicative targets	**Sectoral** (manuf./agri./service, SOE/FDI/Priv, etc)	**2 to 3 years**
⇕	⇕	⇕
Business plans by firms or industries	**Industry level** (automobile, steel, garment, electro. etc)	**Annual**
⇕	⇕	⇕
Forecasts	**Product level** (cold rolled steel, camera, engine, etc)	**Monthly & quarterly**

Under economic planning, hard numerical targets commanded all levels of aggregation from macro to product level, with five-year plans and annual budgets as key planning cycles. Under market-orientation and international integration, however, legally binding targets are no longer feasible or desirable. Numerical targets should be much less in

number and remaining ones should be of the other three types (indicative targets, business plans, or forecasts).

Long- and medium-term targets on GDP growth, overall export performance or industrial structure may still be adopted, but they should be indicative without legal obligation. At the sectoral and industry levels, the appropriate choice of targets depends on the nature of each sector or industry. For material industries supplying mainly domestic markets such as steel, cement and power, numerical targets based on realistic demand forecast scenarios are still useful. But private enterprises, not the public sector, should gradually become the major supplier, and policy should shift from direct intervention like price and investment control to indirect coordination of the industry's interest such as drafting reports and master plans, and strengthening human resources, supporting industries, marketing, procurement, and so on.

For processing- or assembly-type export-oriented industries such as electronics, motorcycles, automobiles, garment, footwear and food processing, collective numerical targets are less meaningful and should be indicative at best. The effort of individual producers and global market competition should determine quantitative performance, and the main goal of enterprise managers should be innovation, competitiveness and strategic positioning rather than achieving predetermined numerical targets regardless of demand. Furthermore, for dynamically evolving industries like IT, software and consumer electronics where new products and markets emerge constantly, quantitative forecasts beyond a few years are largely meaningless.

5. Vietnam in global and regional competition

Japanese MNCs are striving to expand their business operation in highly dynamic and competitive global markets. Whether they invest in Vietnam is not a bilateral consideration between Vietnam and Japan but one move among many to take a strategic position in the context of global innovation, production and marketing. While improving Vietnam's business conditions is important, this effort must always be made in full understanding of Vietnam's position in the global and regional business environment. Even if Vietnam improves its investment climate, that will not necessarily accelerate FDI inflows if the speed of improvement is slower than in other host countries or if improvements are made in the areas that do not interest foreign businesses.

The importance of evaluating Vietnam in the context of global and regional business strategy was clearly shown in the following three meetings.

First, the Japan Bank for International Cooperation (JBIC) explained the results of the annual survey of Japanese manufacturing MNCs to the mission. According the latest surveys in 2003 and 2004, Vietnam was the fourth most popular FDI destination for Japanese MNCs after China, Thailand, and the US. But unlike China, Thailand, and the US, Japanese MNCs had few concrete plans to invest in Vietnam although general interest was high. This was partly because Vietnam was a relatively new FDI host country and it would take some time for Japanese companies to gather information and

draft business plans. Japanese MNCs lauded low-cost labor, market potential, and human resources as three attractive points of Vietnam, while the weaknesses in the legal and policy system and insufficient infrastructure were the main drawbacks in comparison with other FDI destinations.

Second, Mr. Susumu Sanbonmatsu of the Research Institute of Economy, Trade and Industry (RIETI) under METI discussed the strategic dynamics of Japanese MNCs. In his research, key strategic ingredients are markets, product line, and value chain positioning. To introduce new products for each major market continuously, MNCs must always plan and invest ahead (*global innovation chain*). Moreover, for high-quality, low-cost, and speedy production, MNCs must allocate different functions and processes to various countries correctly (*global supply chain*). In all this, management leadership and corporate culture play very important roles. The essential point here is that MNCs come to Vietnam if that improves their performance in global innovation chain or global supply chain. The government must know what Vietnam can offer to attract them when it launches an FDI marketing campaign.

Third, Honda Motor Company explained its business situations and strategy to expand Asian production[5]. Recently Honda received a license to produce cars in Vietnam, for which the company was grateful. Honda hopes to build good relations with MOI in particular, and with the Vietnamese government in general, to realize Vietnam's potential with rising income and highly skilled labor. For motorbikes, India, China, Thailand, Indonesia, Philippines, and Vietnam are the key production sites of Honda. For cars, China and Thailand are particularly important in East Asia. When car production starts in Vietnam, Honda plans to assign Vietnam to produce certain parts for global export. Honda already exports automatic transmission from Indonesia to Asia, EU and US, and its plant in the Philippines also exports manual transmission to global markets.

6. Partnership based on business architecture

The mission also exchanged views with Prof. Takahiro Fujimoto of Tokyo University at his project office. He is the leading Japanese authority in business architecture theory and his current research documents the *integration*-based manufacturing system which is at the heart of Japan's competitiveness[6]. For this purpose, sixteen Japanese MNCs such as Toyota, Canon, Honda, Matsushita, and Sony cooperate with this project.

According to Prof. Fujimoto's theory, comparative advantage is created when the organizational capability of an enterprise or a country is matched properly with the architectural property of its product (*integral* or *modular*). Production partners should also be selected appropriately from the viewpoint of business architecture. Japan is an

[5] Our discussion contained many concrete actions that Honda planned to undertake in the near future whose details cannot be reported here.

[6] Business architecture is divided into two main types: *integral* (creating original parts for each product) and *modular* (combining common parts available in the market). Japan's competitive firms often exhibit integral architecture while Chinese firms usually have modular architecture. However, not all Japanese firms are competitive or integration-based. According to Prof. Fujimoto, about half of Japanese firms are globally oriented and only 10-20% have integration-based manufacturing.

industrial country with integral capability while the US is an industrial country with modular capability. The US and China are appropriate production partners since they are both modular. Japan and ASEAN countries would also become good partners *if ASEAN improves integration-based manufacturing capability*. On the contrary, if ASEAN pursues modularity-based production (copy production with low quality and low price under excess competition), it will lose out to China since China is much bigger and better at modular manufacturing than ASEAN (see Figure 1-3 in chapter 1 of this book).

Vietnam must shift from modularity-based businesses to integration-based business in order to avoid direct confrontation with China and to build a more productive relationship with Japan. Prof. Fujimoto emphasized that Vietnam should learn the skills suitable for integration-based manufacturing. The government and donors (including Japan) should also support this effort in the private sector. More specifically, local capability in product design and engineering must be raised in a way directly linked to production processes. Human resource development for the purpose of high-quality manufacturing is particularly important. In fact, these are exactly the targets that Japanese firms are trying to achieve and what the Japanese government has been helping with its technical assistance programs in ASEAN. However, Prof. Fujimoto's theory puts these ongoing efforts in a new theoretical perspective[7].

The mission raised three questions related to this view. First, can modularity-based local firms (such as Vietnam's local motorcycle assemblers) survive WTO and FTAs and become the basis of further development or will they be eliminated? Second, in light of the finding that industries in developing countries go through three stages: (i) the rise of a pioneer to start a new business; (ii) expansion of copy production with low quality and low price; and (iii) emergence of an innovator to raise quality and competitiveness[8], does the transition from quantity to quality (from (ii) to (iii)) require FDI or can it be done by domestic effort only? Third, architectural evolution is private sector-driven in Japan, but does it perhaps require policy intervention in developing countries?

Whether the government and ODA can play useful roles in speeding up the upgrading process of industries was also discussed. While policy support is theoretically desirable, actual policies based on insufficient information tend to assist wrong producers (weak or politically connected producers), leading to a waste of public money. Unproductive copycats who will disappear soon and innovative imitators who will contribute to industrialization must be distinguished before assisting local producers. But such a distinction may not always be possible.

[7] Ohno previously argued that Vietnam should break through the "glass ceiling" of industrialization by not only agglomerating assembly and parts industries (quantitative expansion) but also enhancing technical absorption (qualitative improvement) in the future. Prof. Fujimoto's advice is basically the same as this but phrased in a more analytical language. See chapter 1 of this book, and also chapter 1 of VDF's *Improving Industrial Policy Formulation*, edited by Kenichi Ohno and Nguyen Van Thuong, and published by the Publishing House of Political Theory, 2005.

[8] Tetsushi Sonobe and Keijiro Otsuka, *Roots and Strategies of Industrial Development: Lessons from the East Asian Experience*, Chisen Shokan, 2004 (in Japanese).

Application of business architecture theory to industrial dynamics in developing countries is a new and evolving field in the Japanese academic circle, and answers to the questions raised above cannot be given immediately. But they may provide useful insights to Vietnam's industrialization in the near future when these ideas are better organized and expressed.