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VIEWPOINT

The New Growth Strategy and "Minimum Unhappiness"

The year is half over already. Here in Tokyo the rainy season continues, and meanwhile the World Cup matches are keeping us awake at night. Perhaps that combination accounts for the sense of fatigue in the air. On July 7 the International Monetary Fund upgraded its outlook for global growth in 2010 to 4.6%, up 0.4 percentage points from its April forecast, but it expressed strong concern about the future prospects for the world economy. The Group of 20 summit in Toronto highlighted the difference between the European Union members, who stress the need for fiscal retrenchment, and the United States, which focuses on the need for economic stimulus. The leaders papered over their differences with a statement calling for fiscal deficits to be halved by 2013, but Japan, with its huge structural deficit, was exempted.

On June 8 Naoto Kan took office as Japan's new prime minister. At his inaugural press conference he expressed the goals of rebuilding Japan's public finances and creating a society with "a minimum level of unhappiness"—as opposed to the usual formulation: "the greatest happiness for the greatest number." This may be seen as a reflection of Kan's roots as a politician who started out as a civic activist. But it also seems to speak of the introspective posture of today's Japan.

Kan's "minimum unhappiness" reminds me of the Easterlin paradox, namely, that beyond a certain point, greater wealth no longer results in proportionately greater happiness. Though it is probably true that economic growth alone is not enough to produce increased happiness, without growth in the economy, we are unlikely to see growth in happiness either.

On June 18 the government adopted a New Economic Strategy, including targets for progress in seven strategic areas. The aim is to achieve a strong economy, strong public finances, and a strong social security system. The new strategy offers a comprehensive set of prescriptions for the many issues the country now faces. The question now is whether our political leaders are capable of turning it into reality.

Even as the developed countries of the West struggle to keep their economic upturns going, a new concept has been spreading quietly: "degrowth." The idea is that we need to recognize that the Earth's resources are limited and switch from a model that pursues economic growth to a focus on the environment and work-life balance. But the notion of holding growth below a certain ceiling does not mesh well with human nature, and the many developing countries still struggling to grow out of poverty will certainly not accept it. Emblematic of the North-South gap in attitudes toward growth is the split in ideas about creating a post-Kyoto framework to control climate change.

Japan clearly needs a new theoretical framework for managing its economic affairs—not so much a new "Wealth of Nations" as a new "Wealth of People." Among the seven fields targeted by the New Economic Strategy are "green innovation" and "life innovation." In the years to come, even as we continue to pursue growth, it will be increasingly important to incorporate key parts of the "degrowth" agenda in economic policy by switching toward greener approaches to people's wealth and well-being.

■ ***Akio Okawara, July 9, 2010***

ON OTHER PAGES

GLOBAL NETWORK

This column presents selected topics and trends viewed from the perspective of members of the Sumitomo Corporation Group working on the front lines of its global business network.

Guangdong: A view of China's future

The suicide in May of a migrant worker at a Taiwanese-owned manufacturing operation in China's Guangdong Province set off a round of strikes by laborers at plants around the province demanding better conditions and higher pay. A number of Japanese-affiliated manufacturers were among those hit by strikes, and they were forced to hike their workers' wages by large margins.

Guangdong has played a key role in modern Chinese history. The First Opium War (1840–42), which was a harbinger of the decline of the Qing dynasty, broke out following an incident that occurred in what is now the town of Humen, Dongguan City, where Imperial Commissioner Lin Zexu ordered the burning of a store of confiscated opium. Sun Yat-sen, who aimed to overthrow the corrupt Qing regime, led his first uprising in Guangzhou, the capital of Guangdong, in 1895, and this led to the Xinhai Revolution of 1911, which toppled the Qing government. More recently, Guangdong was the site of the first special economic zones established in 1980 (in Shenzhen, Zhuhai, and Shantou) as symbols of the reform and open-door policies adopted following the end of the Cultural Revolution. And the first known case of SARS (severe acute respiratory syndrome) apparently occurred in Guangdong in November 2002, though the Chinese authorities did not inform the World Health Organization about the new disease until February 2003, a delay that resulted in international criticism. Developments in Guangdong, we might say, are harbingers of future developments in China as a whole.

Wang Yang, who became secretary of the Guangdong Provincial Committee of the Communist Party of China in December 2007, has been pressing the case for "ideological liberation" and an end to obsession with gross domestic product, and he has come out with structural reforms aimed at shifting to high-quality industries. The Constitution of the People's Republic of China does not guarantee the right to strike, but the government's tacit acceptance of the recent round of strikes in Guangdong allowed workers there to win large pay hikes. This marks the beginning of the end for the low-wage manufacturing model of business in China. The "ideological liberation" espoused by Wang Yang does not explicitly involve political reform, but it does mean aiming for harmonious development that respects human beings. Once again, changes in Guangdong may well offer clues for future changes in China as a whole.

■ ***Hiroyuki Kojima, Guangzhou***

Philippines: New president focuses on cutting deficit and fighting corruption

The latest Philippine presidential election was held without major incident on May 10, and Benigno Aquino emerged victorious, defeating former President Joseph Estrada, who came in second, by more than 5.6 million votes. He was inaugurated on June 30 and became the fifteenth president of the Philippines.

The Philippines recorded a record-high fiscal deficit of 298.5 billion pesos in 2009. The income tax cut implemented to stimulate the economy contributed to the deficit, and the major damage caused by Typhoons Ondoy and Pepeng is seen as having placed an additional burden on government finances. Cutting the red ink is an urgent task, but the new president has come out against new taxes or hikes in the existing ones. He has called instead for stronger enforcement of the existing levies, but he has yet to propose any specific measures to improve the tax collection system.

During his campaign, Aquino expressed the view that government intervention in the business sector should be kept to a minimum. He has identified job creation as the top priority, and as a long-range objective he has called for rectification of the state of affairs in which many Filipinos head overseas just to make a living. Remittances from overseas workers are now a major prop for the Philippine economy; in 2009 they totaled a record $17.3 billion, or 10.8% of the country's gross domestic product.

In addition, Aquino made the elimination of corruption a major campaign pledge. He noted that corruption drained some 280 billion pesos from the national budget in 2009 and that the cumulative total of the losses from 2002 to 2009 came to around 1 trillion pesos. And he is seeking to secure transparency in areas like government procurement through the establishment of clear evaluation standards.

Many in the business world have expressed support for the new Aquino administration, which they hope will end the sense of stagnation that prevailed under President Gloria Arroyo. Specific expectations include lower electricity charges, continuation of infrastructure development, and balancing of the budget, along with other effective moves to reform the economy.

■ ***Katsuji Nakagawa, Manila***

Iran: A knotty domestic issue

Iran, under sanctions from the international community in connection with its nuclear development program, is now attempting to solve a major domestic problem. Ever since the Islamic Revolution 30 years ago, the government has provided subsidies to hold down the prices of energy, including gasoline, gas, and electricity, and basic foodstuffs like wheat and sugar. For example, gasoline costs only ¥9 per liter up to a certain amount, and electricity costs less than ¥1 per kilowatt hour. These prices are a mere 5%–7% of what Japanese consumers pay.

Iran is the world's fourth-largest producer of both oil and gas, but with its population of over 70 million, the country cannot afford to keep up the current subsidies on energy and foodstuffs, which cost the government some $100 billion a year. Previous efforts to scale down this burden had failed, but the current government is tackling this task once again, and after two years of debate in the national legislature, a law was passed recently providing for the gradual reduction of the subsidies starting around this autumn. Over the next five years the subsidies will be cut in stages until prices reach international levels.

It is not known how much prices for the currently subsidized items will increase, but it has been said that gasoline, for example, will probably be set at a uniform price of ¥40–¥50 per liter five years from now. With prices of other goods and services expected to rise along with those of the subsidized items, it has been estimated that consumer prices will jump 30% in the first year of the subsidy cuts. Even if cushioning measures, such as cash payments to low-income earners, are implemented as planned, there is still a danger that the sharp rise in costs of energy and basic foodstuffs will set off social unrest.

Up to now, Iranian industry has taken low energy costs for granted and has not paid attention to energy conservation. The shift to higher energy prices can be expected to lead to demand for energy saving and recycling, particularly in energy-intensive industrial sectors.

■ ***Kazuo Miyaoka, Tehran***

United States: The oil spill and energy policy

The massive oil spill from the BP drilling site in the Gulf of Mexico, which has been going on since April, has resulted in swimming bans at many places along the Gulf coast in the United States, and even on the July 4 holiday weekend there were few beachgoers. Two and a half months after the initial accident, despite all the efforts by BP employees and others, the oil continues to spill out.

Offshore oil drilling had been seen as a trading card for securing passage of environmental legislation including a cap-and-trade system for emission rights. The BP accident was all the more shocking because it occurred just after President Barack Obama announced the lifting of the ban on offshore drilling in new locations. It has made prospects for the United States' energy policy even murkier.

The bungled response of President George W. Bush's administration to Hurricane Katrina, which struck in the Gulf of Mexico in 2005, accelerated the decline in the administration's standing and clout. Given this precedent, the Obama administration's response this time was closely watched, but it got off to a somewhat slow start, partly because the opposition Republicans, who have close ties to the oil industry, did not press very hard. In response to pressure from the left, the president announced a moratorium on deep-water drilling late in May, but critics on the right complained that this would hurt local economies that depend on the oil industry and lead to even greater dependence on imported energy.

Since then the Obama administration has moved to assuage popular anger by taking a tougher line toward BP, which "voluntarily" established a $20 billion fund to pay damage claims. Meanwhile, Congress is considering legislation to retroactively hike or eliminate the cap on such claims. The government seems to be avoiding an indiscriminate attack on the oil industry as a whole, but it remains to be seen how well the companies in the industry will bear up in the face of tighter regulation, including stricter safety requirements, and the risk of massive damage claims, which will mean higher insurance premiums. BP's survival prospects have already been called into question, and the aftermath of the accident may trigger an overall regrouping within the industry.

■ ***Ryota Yoshimura, Washington***

WORLD OPINION

India: The threat from Maoist insurgents

The Maoist (or "Naxalite") rebel movement that started in West Bengal in 1967 has since extended its influence across eastern and central India, which is now called a "red corridor." It operates in 18 of India's 28 states, and estimates of its armed adherents range from 3,500 to 10,000; the underground Communist Party of India (Maoist) is thought to have some 50,000 members.

As of July 5 Maoist terror had caused more than 600 deaths this year, a pace outstripping the 908 deaths in 2009. The Naxalites espouse the cause of communist revolution, and their support comes largely from the unemployed, poor farmers, and other low-income people in rural areas; they now seem to be working at extending their influence to urban areas as well. Their activities can be seen even in major cities like Kolkata and Hyderabad, and their presence has been casting a pall on sentiment among both Indian and foreign investors. The rebels get their money through extortion from landlords, businesses, and mining operations, and they are also thought to be involved in kidnapping and drug dealing.

The Indian government is split between those who would deal with the insurgency through development—measures to fight poverty and erode the rebels' support base—and those who advocate a hard-line military response. The "development" camp includes Prime Minister Manmohan Singh and Congress Party leader Sonia Gandhi; the hardliners include Minister of Home Affairs P. Chidambaram. According to a study by a British think tank, the level of popular concern about the Naxalites is not as great as that generated by the terrorist attacks in Mumbai in 2008, since the victims have been limited to nonmetropolitan areas; if, however, the government takes too much time in rooting out the insurgency, problems in acquiring land for industrial purposes may cause both Indian and international businesses to head overseas, a development that could affect the Indian economy as a whole.

A US-based research body offers the judgment that the Naxalite insurgents are likely to continue activities in their rural strongholds and may continue to clash with security forces, but that they are unlikely to extend their clout to urban areas, where government forces are strong and their supporters few. Though ending the insurgency will take time, the impact on the Indian economy will probably be limited.

■ ***Kanji Ishitsuka, July 6, 2010***

Colombia: Mixed picture for President Uribe's successor

Colombia has recently completed a two-round election for a new president to succeed the incumbent, Álvaro Uribe, who enjoys support ratings of over 70% but whose second term expires this August. The first round of voting was held on May 30, and since no candidate emerged with a majority, the two top vote getters held a run-off on June 20. Former Minister of Defense Juan Manuel Santos, who was widely regarded as Uribe's heir, won with 69% of the votes, defeating former Bogotá Mayor Antanas Mockus.

For almost half a century the government of Colombia has been engaged in a struggle with insurgents calling themselves the Revolutionary Armed Forces of Colombia (FARC). The intensive anti-insurgency operations conducted by the Uribe administration have weakened FARC, but it still has some 8,000–10,000 armed fighters, and it commands ample revenue sources involving drug dealing not just within Colombia but extending to other Latin American countries. In the view of the International Crisis Group, an influential think tank, FARC thus still presents a threat.

Colombia also has a major poverty problem and serious problems in its labor market: The unemployment rate is 12%, and over half of the country's jobs are in the informal sector. In foreign relations, meanwhile, commercial relations with Venezuela have been temporarily frozen, and according to the Venezuelan daily *El Universal*, the value of bilateral trade in January–March 2010 was down 70% from the same period last year.

Meanwhile, however, Colombia's exports to China have been surging, and this growth is said to be making up for 40% of the decline in exports to Venezuela. Colombia has been maintaining a pro-US line and working to put its democracy on a solid footing, and according to the World Bank it now offers the best business environment in Latin America for investors. President-elect Santos has shown his eagerness to improve relations with neighboring countries and work to further improve the security situation. His abilities will be put to the test as he deals with the country's domestic and external problems.

■ ***Yoichi Oizumi, July 6, 2010***

ECONOMIC TRENDS

Major economies

The Japanese economy is continuing to expand gradually. The recovery in consumer spending has been gaining strength, with the bottoming out of the slide in incomes leading to the brightening of consumer sentiment. And residential investment, which slumped last year, has been registering a pickup in demand as uncertainty about future prospects recedes. Also, business sentiment and the appetite for capital investment have been improving in the corporate sector. Exports continue to grow, though the pace of expansion is expected to slow gradually because of the yen's rise and the tightening of macroeconomic policy in China.

In the United States, the effects of inventory restocking and stimulus measures have helped the economy improve. Consumer spending, which accounts for about 70% of gross domestic product, has been advancing smoothly, with retail sales increasing for seven straight months. However, recent indicators for housing and employment seem to reflect the impact of temporary factors, such as policy measures, and it remains to be seen how well demand will hold up after this impact wears off.

The recovery in the euro area has lagged behind that of other regions, partly because of the heightened pressure for fiscal belt-tightening in the wake of the sovereign debt problems that struck Greece and other Southern European countries. But the weakening of the euro is expected to contribute to the competitive strength of European exports, leading to a gradual upturn in Germany and elsewhere in months to come.

The Chinese economy is continuing to register domestic-demand-led growth, with policy measures supporting strong performance in infrastructure investment and consumer spending. But concerns about overheating and asset bubbles have grown, and the government has responded by hiking the reserve requirement ratio and imposing restraints on investment in industries with excess production.

Russia recorded positive growth in its real GDP in January–March for the first time in five quarters, and the upturn has continued since then. Consumer spending has been strong thanks to economic stimulus measures, and higher prices for resources have contributed to export growth; production levels, particularly in manufacturing, have also been recovering.

■ ***Economic Research Team, July 6, 2010***

Markets

Over the past month, fears of an economic downturn across the world have begun to stalk markets again. As the market continues to worry about a possible slowing in China's growth and the protracted euro zone debt crisis, the disappointing US job numbers and weaker housing data that came out in June deteriorated market sentiment further. A fresh round of risk aversion in global markets supported demand for debt, sending US 10-year yields below 3%, while the commodities market lost enthusiasm for the upside amid US demand concerns. In contrast, however, macroeconomic data suggested the world's growth was still relatively robust.

What does this gap suggest? The scenario that is now gradually emerging as the consensus goes like this: Markets have overreacted with pessimism at the loss of momentum accompanying the shift from speedy recovery powered by stimulus measures adopted in the wake of the financial crisis to cruising-speed growth powered by private-sector demand; over the next few months they should adjust to this change of speed and start rising again. With the prolongation of the low interest rates in developed countries resulting in a pool of excess liquidity, demand for commodities continues to be strong, and it is hoped that their prices will remain high enough to cover the production costs involved in keeping up supplies to meet this demand. This means an ongoing return toward the long-term trend lines from before the crisis, conditioned on the confirmation of continued recovery in the real economy.

However, a different sort of scenario has also emerged: We may be on an inflection point from the leverage-swollen world to a new, slimmer equilibrium. Implementation of the new US financial reform bill looks set to constrain Wall Street banks' risk-taking and profits. If we are to see similarly constrained economic growth induced by deleveraging, we will have to expect turbulent markets until the new equilibrium is found.

■ ***Market Research Team, July 5, 2010***

INDUSTRY TOPICS

The promising new field of "biosimilars"

As population aging progresses, particularly in developed countries, reining in the growth of medical care expenses has become an important issue for national governments around the world. One way of controlling costs is through increased use of generic drugs—inexpensive "follow-on" drugs with the same ingredients and efficacy as innovator drugs on which the patent has expired. And recently "biosimilars" have been attracting attention as an effective means of holding costs down.

Pharmaceuticals may be divided into two broad categories: small-molecule drugs, which are produced by chemical synthesis, and biopharmaceuticals, commonly called "biologics," which are made using substances (such as antibodies and cells) from living organisms. Biologics can be further divided into innovator and follow-on types; the latter are called "biosimilars" (or "biogenerics"). Biologics of both types are considered effective in treating some diseases that are hard to handle with traditional pharmaceutical technology. Innovator biologics are difficult and expensive to develop, and the success ratio is low. Biosimilars are based on biologics that have already been placed on the market, and so it is possible to develop them much more inexpensively. So shifting to biosimilars offers even greater potential savings than shifting to generics in the case of small-molecule drugs. They have thus come into the limelight as a key tool in the drive to reduce the burden of medical care expenses.

There are, however, a number of hurdles that must be cleared before biosimilars can be widely used. These include problems relating to production. It is relatively simple to manufacture a generic small-molecule drug based on patent information about the composition and production of the original drug. But producing biosimilars involves complex processes like culturing. Developing these follow-on pharmaceuticals can become an expensive undertaking without know-how concerning the regularization of the processes and ways to hold down costs.

There are also problems relating to regulatory approval. Biosimilars involve processes different from those used for existing generics, and guidelines for their approval by the national authorities have yet to be fully formulated. Drug makers need to prove the effectiveness and safety of such follow-on biologics through clinical tests, but in the absence of standards for proving they are identical to innovator biologics, it is hard for makers to undertake their development.

Though there are various issues to be dealt with in connection with the commercialization of biosimilars, Japan's Ministry of Health, Labor, and Welfare published a set of development guidelines for them in March 2009, and in June last year it granted the first domestic approval of a biosimilar. In the United States, which is said to account for 80% of the global market for biologics, the Patient Protection and Affordable Care Act that was signed into law in March this year contains explicit provisions encouraging the speedy adoption of biosimilars. As governments move to provide support for these drugs, pharmaceutical companies and manufacturers of generics are moving into this field, and so are companies from other industries, such as Samsung Electronics. It is a promising market that bears watching.

■ ***Yasukatsu Takei, July 6, 2010***

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