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# Declining as a Manufacturer, Japan Weighs Reinvention

By MARTIN FACKLER

AMAGASAKI, Japan — A few years ago, the densely built-up coastal region around this port was called Panel Bay because of its concentration of factories making the sophisticated flat-panel screens that were symbols of Japan's manufacturing prowess. But now the area has become a grim symbol of its industrial decline.

In recent months, many of those plants have been closed or partially sold off, as the once seemingly invincible electronics industry has lost out to Chinese and South Korean challengers. Panasonic alone shut down two of its three factories here in March while Sharp, desperate to cover losses from its $10 billion flat-panel plant in nearby Sakai, accepted a bailout from a Taiwanese technology company — a stunning reversal in a nation that once prided itself on being Asia's economic leader.

The demise of Panel Bay is the latest sign of what many Japanese fear is the hollowing out of their heavily industrialized economy, which has been in a gradual but relentless decline since the bursting of its twin real estate and stock bubbles in the early 1990s. The decline is largely a result of growing competition from Asian rivals, an aging work force and merciless gains by the yen. But many officials and business leaders now fear that this trend has accelerated since last year's nuclear accident in Fukushima, which has raised the prospect of higher energy prices and even power failures.

"We already had a sense of crisis about the loss of manufacturing and manufacturing jobs," said Tetsuya Tanaka, a director of manufacturing promotion at the Ministry of Economy, Trade and Industry, or METI. "Now we are afraid the concerns about electricity could give manufacturers the excuse they need to move offshore."

The increased price pressures have wounded many of Japan's corporate giants. Last week, Sony — the Apple-like innovator of the 1980s — forecast a $6.4 billion loss amid reports it may cut 10,000 workers, a drastic step in a nation where layoffs are still seen as socially unacceptable. Even Japanese carmakers like Toyota, which last year handed back the title of world's largest auto company to General Motors after the supply disruptions from the tsunami, fear that they are becoming vulnerable to game-changing competition in electric cars or just lower-cost producers in South Korea and elsewhere.

The reversals have gripped Japan with a sense of national angst over its future, though economists are divided over how much the nation will actually deindustrialize — and whether a shift away from factories is really such a bad thing. Most economists agree that Japan, which rose to economic superpower status in the 1980s by building compact sedans and color televisions, has outgrown the "Asian Miracle" template and needs a new economic strategy. What that approach should be, though, is the subject of intense and growing debate.

"It is time for Japan to find a new model for its economy," said Masatomo Onishi, a professor of business at Kansai University. "We can follow the United States into a more postindustrial economy, or we can follow Germany into high-end manufacturing, but we shouldn't be trying to compete with China in mass production."

These are questions that go to the core of the identity of a nation that has long prided itself on its tradition of craftsmanship known as "monozukuri," or "making things." The debate is being watched closely by other Asian nations, which have pursued the same strategy of industrial catch-up that Japan pioneered.

One of the biggest questions, economists say, is whether Japan, and by extension Asia's newer export-oriented economies, will learn how to foster innovation, nurturing the Apples, Googles, Facebooks and other technology start-ups that sustain growth in the United States.

Yukio Noguchi, an economist at Waseda University in Tokyo, has called last year's disaster a chance for Japan to shift to a more supple, service-oriented economy like that in the United States. He says clinging to an outdated manufacturing model also hurt Japan by forcing it to cut wages and prices to compete with lower-cost Asian competitors, contributing to the crushing deflation that has burdened Japan's domestic economy for nearly two decades. "Manufacturing is destroying the Japanese economy," Mr. Noguchi said.

This deflation has hurt not just the giants but the legions of small factories bound to their "keiretsu" business groups, which ensured Japan's top corporations a steady supply of high-quality parts, and were a major source of jobs in postwar Japan.

One is Toko-Seiki, a plastic parts maker in the blue-collar city of Higashiosaka that used to make casings for Nintendo. When Nintendo started buying cheaper Chinese products about 10 years ago, Toko-Seiki cut prices by giving its 27 workers pay cuts, reducing their once comfortably middle-class wages of about $7,000 per month in the mid-1990s to less than half that. In 2009, it finally laid them off altogether and closed the factory.

Today, the company's second-generation owner, Hiroshi Ogaki, 40, works alone in a quiet, one-room apartment, designing plastic parts on a computer for other makers in Japan and China. "We see lots of bankruptcies, but no new start-ups," he said. "Japan's manufacturing just seems to keep shrinking and shrinking."

It is a similarly bleak story for many of the small factories that were the loyal foot soldiers of Japan's postwar export machine. According to METI, the number of manufacturing companies in Japan dropped by a third, to 540,000, in the 10 years up to 2006. The share of manufacturing in Japan's overall economy has also shrunk to 18 percent in 2009 from about 35 percent in the 1970s, according to the Cabinet Office.

By comparison, while the United States is still the world's largest manufacturing country, such industry accounts for just 9 percent of its overall economy.

Some economists, however, call the fears of hollowing out overblown. Takao Nakazawa, a professor of economics at Fukui Prefectural University, says that the decline in factory jobs is actually due to the introduction of new labor-saving technologies, pointing out that the value of all manufactured goods made in Japan has remained almost unchanged from the early 1990s.

"Hollowing out is a myth," Mr. Nakazawa said.

Instead, he and others say that what is happening is actually a shift away from televisions and other commodity products that can be churned out more cheaply by assembly lines elsewhere in Asia. He said the surviving Japanese companies are moving to more quality-sensitive products, like industrial robots and high-end bicycle gears, where Japan still enjoys a formidable lead.

This is the new strategy of Panasonic, which is trying to recover from its largest-ever loss last year by closing two of its three plasma display factories here in Amagasaki, a port city next to the much larger city of Osaka. Now, Panasonic says it will outsource a large chunk of its flat-panel production to lower-cost companies elsewhere in Asia, while focusing its own production lines on more profitable products like factory equipment and batteries for electric cars.

"One lesson we learned is we should not try to make every kind of product ourselves," said Atushi Hinoki, a spokesman for Panasonic. "But there are still many things we make well."

Indeed, many economists and officials say that while a continued shrinking of its industrial base is inevitable, Japan would be foolish to relinquish manufacturing to the extent that the United States already has. A focus on exports has allowed this resource-poor nation to enjoy the huge trade surpluses, at least until last year, that pay for its imports of energy and food. They say that Japan's surpluses have also given it the luxury of financing its own huge budget deficits.

“Manufacturing is the foundation on which finance and other service industries stand,” said Keiichi Konaga, who formulated Japanese industrial policy in the mid-1980s as the top bureaucrat in METI’s precursor. “Even the United States is now waking up to this. That’s why it bailed out General Motors.”