mainstream work force, creation of new employment opportunities for the old, and measured increase in the employment of foreign workers.

According to a report of the Economic Planning Agency of the Japanese government, the Japanese economy will grow at an annual average rate of 3.75 percent during the 1990s, and will continue to grow at 2.75 percent during the first decade of the twenty-first century, and the Japanese rate of saving will remain around 14 percent in the 1990s, falling to 9 percent in 2010. Of course, the agency could be too optimistic. In light of the nation's demonstrated agility in transforming its land to meet challenges of the new eras, however, I am inclined to speculate that the sun will be setting more slowly than Laffer seems to believe.


DOES THE SUN HAVE TO SET?

William V. Rapp

In his paper "The Land of the Setting Sun," Professor Laffer accurately describes Japan's amazing post-war economic growth to be based on an extremely high domestic savings rate that permitted Japan to self-finance rapid but noninflationary growth with corresponding rapid asset accumulation. He also correctly surmises that this high savings was the result of intentional government policy.

Indeed, after the war the government established several tax-free savings mechanisms for individuals and excluded capital gains on stock transactions from tax while at the same time discouraging debt availability for consumer finance or home mortgages. In this manner, individ-
uals were encouraged to save for major purchases, emergencies, and old age.

At the same time, the banks, postal savings system, and insurance companies that gathered these funds were pushed to lend them to manufacturing firms for plant and equipment investment. The objective was to fund rapid non-inflationary growth without outside capital infusions in order to build a competitive Japanese manufacturing sector. How else was a country with no raw materials going to feed 120 million people? Japan had to have a competitive industrial sector to export to pay for the food and raw materials it needed to import. If savings were not high, investment rates would be inflationary and thus uncompetitive.

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Laffer is correct that a self-financing policy was being pursued for nationalistic reasons and to avoid future outflows of dividends and interest. During the 1950s and 1960s, the government applied the monetary brakes whenever the balance of payments became negative due to too rapid domestic expansion. This is why the capital account ratio remained close to zero during this period. The Japanese economy therefore was "systematically operated to maximize growth," with wealth a secondary goal.

In addition, as Laffer would expect, the slower growth of the 1970s and 1980s, an increase in pension benefits, and a phasing out of tax incentives for savings led to a decline in the savings rate. A rising capital-output ratio as Japan used up the available technology stock and approached the innovation frontier in a number of industries also had the effect of slowing growth. Slower growth resulted in less depreciation and lower gross savings. However, slower growth did decrease investment demand faster than savings, especially individual savings, so the export surplus increased. However, this could be viewed as a way of funding other people's purchase of Japanese goods in order to maintain full employment at home rather than as just a desire to build foreign assets due to high interest rates abroad. After all, the surplus continues today despite lower real interest rates in the United States than Japan.

However, it would be a mistake to assume that this all occurred in a short period of time. First, before the war, Japan was already an industrialized country. It had an educated labor force and much of the infrastructure necessary to rebuild its economy just as Germany, France, or Italy did. Second, it took almost twenty years after the war for Japan to recover
its relative prewar position. It only joined the Organization for Economic Cooperation and Development in 1964.

Similarly, given the success of its system and its actual long historical development, it is risky at best to anticipate rapid change or to project Western and especially U.S. patterns of thought and behavior onto Japan. After all, theirs is the full-employment society that has minimal crime and drugs and over 99 percent literacy that consistently outscores America in math and science tests. Why would they want to become more like us?

A SPENDTHRIFT GENERATION?

Therefore, I find Laffer's unsupported assertions concerning the emergence of a spendthrift generation questionable at best. Several young Japanese who worked for me in Tokyo lived at home and saved much of their pay toward marriage and their own home. We cannot project the behavior of the affluent few who populate Roppongi onto the younger population as a whole. Also, while it is true that the society is aging rapidly and that this is on the mind of every businessman and government policymaker, Japan also has the highest rate of over-sixty participation in the labor force of any industrialized country. Thus, as people have found they are living longer, life expectancy having risen from about fifty-five years in 1948 to over eighty today, they are working longer. This is logical since no one knows precisely when they are going, and cannot have the last yen run out the day they are wheeled out the door. An earnings and savings cushion continues to be required. Americans seem to be the ones who want to retire early.

The keiretsu system has in turn facilitated this development. Workers reaching retirement age at fifty-five or sixty are sent to related firms at somewhat lower wages. This is how they supplement their pension incomes, which continue to be paid in a lump sum or are converted into an annuity. The government's program is additional. I am not sure what Laffer means when he refers to Japan's unfunded pensions.

STOCK-VALUE UNCERTAINTY

The recent stock market crash also created enough uncertainty that most employees will not rely solely on savings and pensions for survival into the twenty-first century. At the same time, that consumption has not fallen brings into question the precise applicability of the Pigou effect in the Japanese context. A more detailed analysis reveals that most individuals do not own stock and that they did not increase their consumption on the basis of the rising value of their homes because they had no mechanism for realizing its appreciated value. If they sold it, new housing would be the same or more expensive. Thus, it is not apparent that personal consumption has risen or will rise for this reason, and Japanese society is likely to continue as heavily conservative and middle-class oriented, that is, be boringly stable.

Rather, stock is about 80 percent owned by institutions, and firms were the ones that borrowed against their appreciated stock and real estate values. But most major firms retain these appreciated values for emergencies as hidden reserves on which they do not have to pay taxes. With a smaller cushion, they are now being more cautious and are trying
to rebuild assets, that is, increasing current savings. The drop in real estate and stock prices has had the biggest impact on the banks that lent to the speculators. They are now in difficulty and are curbing lending. But consumers and large corporations seem to be doing all right, with al production, and free land for alternative use, particularly in urban areas. This will substantially dampen any inflationary pressures and may even reduce the overall cost of living, given the high proportion of food and housing in the Consumer Price Index. There will be a budget-

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unemployment nonexistent. The wealth effect seems to be a neutral to a plus for savings in the Japanese case rather than a stimulus to consumption.

An older, slower-growing labor force in turn will stimulate additional capital spending to substitute capital for labor and to make existing labor more productive. This activity is already apparent in Japan’s antiquated distribution system in terms of new automated and highly computerized warehouses. Similarly, for anyone who has taken two hours to drive across Tokyo due to horrendous traffic, an increase in government infrastructure expenditures will clearly increase economic productivity by reducing various bottle-necks. Laffer’s argument that these developments will significantly slow growth and act as a drag on savings are less than convincing.

Furthermore, the sector with the highest proportion of elderly is agriculture, where the average age exceeds fifty-five. Over the next twenty years, these people will largely exit the labor force, politically allowing the government to liberalize food imports, rationalize agricultural subsidy as well since large agricultural subsidies will decrease and land switched from agriculture will pay higher taxes and be economically more productive. Real estate prices will decrease but due to greater supply rather than rising interest rates and with on the whole beneficial consequences for individual Japanese.

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OUTLOOK: NOT SO GRIM

While there are problems, the outlook does not appear that grim. Gross savings will not decrease significantly from current levels, especially as the government has reduced debt during the last few years and, at less than 20 percent, has the lowest level of government expenditures in proportion to GNP of any industrial country. This can go up quite a bit before it hits U.S.—much less European—levels and, as noted above, is likely to be productivity enhancing. The investment in infrastructure and labor-saving technology can continue to be
made in a productive and noninflationary manner. In sum, Laffer’s prediction of fiscal drag, rising prices, and increasing interest rates seems less than sure, especially given developments in the agricultural sector.

He is right that the trade surplus will decrease due to more imports, especially food and less sophisticated consumer goods, as well as to greater overseas investment by Japanese multinationals, effectively moving export production offshore. Yet, the surplus on current accounts may actually rise as the earnings on offshore investments increase. That is, Japan will continue to save and build assets abroad via the capital, rather than the trade account, as is typical of a mature creditor.

JAPANESE MULTINATIONAL CORPORATIONS

The leaders in this process will be the Japanese multinational corporations (MNCs) whose operations to a large degree have become uncoupled from Japan. Toyota, Nippon Steel, and Toshiba can easily borrow in the international markets to fund their continued global expansion. They have the management resources and capabilities to operate in any market. Laffer’s
prediction of their competitive decline, even disappearance, seems questionable. While an individual speculator’s investment in Pebble Beach may have been ill-advised, to extend this result by implication to the competitive impact of Honda’s operation in Marysville or Toyota’s at Georgetown would be dangerous indeed.

Similar predictions of disaster for Japanese companies were floated by U.S. businessmen and economists in the early 1970s due to high debt levels, even though several knowledgeable observers of Japan warned that these debt levels were a function of high growth, lower after-tax capital costs, and a willing banking system. Once the growth slowed, cash balances would rise. However, they would be established as formidable competitors. Toyota is now the one sitting with $19 billion in cash and still making profits, while GM had to raise $2 billion in equity, the largest offering in U.S. history, due to massive losses in its North American car operations. Pushing this forward, the likelihood for the future remains that more Lexuses will be sold in Alaska than Cadillacs in Hokkaido, and that Japanese MNCs will remain strong global competitors. Indeed, given their continuing global expansion, they may well be able to claim, as the British did in the nineteenth century, that for them the sun never sets.

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JAPAN’S UNCERTAIN FUTURE:
REPLY TO ‘THE LAND OF THE SETTING SUN’

Toshiyuki Shiohara

Arthur Laffer has accurately laid out one of the reasons for Japan’s past success. Among the important factors behind its ability to maintain technological competitiveness and superior products has been an abundance of capital caused by a high level of savings. The Japanese economy has had the capital it needed to improve its technology.

The average Japanese has always considered incurring debt to be an act of imprudence and inability to repay to be a disgrace. He would rather save to spend...