THE JAPANESE ECONOMY IN INTERNATIONAL PERSPECTIVE

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2.

JAPAN'S INDUSTRIAL POLICY

William V. Rapp

The years 1970–1972 mark the end of an era in Japanese economic history. After a hundred years, Japan has caught up with the West and achieved foreign-exchange self-sufficiency. Two manifestations of this are a large and continuing surplus and a 17 percent yen revaluation. Japan is now rethinking her economic goals and industrial policy. The emphasis is shifting markedly from a growth, industrial-investment, export-oriented policy to a social-overhead-investment, postindustrial, free-trading policy.

In the broadest sense, industrial policy deals with economic structure: the development of particular industries and resource allocation between sectors. In Japan, this policy has used market forces and has been complementary with overall economic policy, supporting and facilitating general monetary and fiscal policies. It has provided a basis for harmonizing programs in one sector with those of another, but has been indicative rather than compelling. The various elements of the economy have been helped to move together, making efficient and consistent use of available resources and promoting rapid growth and development.

Americans have often misunderstood the nature of Japan’s industrial (structural) policy and the economic influence of the Japanese government. U.S. postwar economic policies have been chiefly macro-
economic, aimed at avoiding a repetition of the events of the 1930s. In addition, Americans often feel that an industrial policy requires centralized planning and control. Yet examination of Japan's postwar industrial policy clearly illustrates that an industrial policy can use market forces and can promote effective competition, is complementary with and supportive of macroeconomic policy, and is not dependent on centralized planning and control.

Policy Development

Historically, the Japanese government has taken an active interest in economic planning. At the end of the nineteenth century, Japan was a poor, weak country with little in the way of industry, technology, or natural resources. To maintain her independence, her leaders felt compelled to catch up with the West. For both military and economic reasons, industrialization was a necessity. This step resulted in early government involvement in promoting industry and early development of close relations between government and business. For example, the government imported and set up modern textile mills, which were later sold to private enterprise, but found that ventures were more profitable and successful when operated by entrepreneurs. As industry grew and major groupings, Zaibatsu, emerged, the government found it increasingly efficient to work with them in implementing policy. As the new business leaders had similar backgrounds to their bureaucratic counterparts, their relationships were often close and cooperative. But the Zaibatsu did not always agree with government programs. In the case of the automobile industry that MCI (predecessor of the Ministry of International Trade and Industry [MITI]) tried to develop during the 1930s, the major Zaibatsu expressed no interest. Thus Toyota and Nissan gained position by default. However, in general the two groups worked together. Yet, the government's power was weak relative to the large combines. It was the wartime controls and the postwar economic dislocations combined with the dissolution of the Zaibatsu that increased MITI's policy-making powers. Thus Japan's industrial policy was formalized and became effective during the postwar period.

At the end of World War II, Japan was confronted with the need for substantial economic development and rapid industrialization. After
much discussion and analysis, the government, in cooperation with business leaders, targeted as strategic five basic industries: steel, shipbuilding, coal, power, and fertilizer. Japan’s steel capacity was largely intact but needed repair and raw materials. Because there was a world steel shortage and steel was basic to industrial recovery, the industry’s expansion was the key to industrialization and increased export earnings. Shipbuilding was required to rebuild Japan’s shattered merchant fleet and to reduce the foreign-exchange drain of buying foreign ships and paying foreign shippers. Coal was needed for heating, power, and steel-making. Power was a prerequisite for industrial expansion. Finally, fertilizer was needed to increase agricultural output to feed people, to reduce food imports, and to release people from the agricultural labor force.

These strategic industries received special government help in the form of duty-free equipment imports, accelerated depreciation benefits, loans from government banks (e.g., Industrial Bank of Japan, Long-term Credit Bank, Export-Import Bank, and Reconstruction Bank), raw-material quotas, and so on. Other industries such as automobiles, electronics, petrochemicals, and computers received no special government consideration until much later. In the case of the automobile industry, the Ministry of Finance (MOF), the Ministry of Transportation (MOT), and the Bank of Japan (BOJ) initially opposed its development as being high cost and contrary to the international division of labor. However, MITI, the chief architect of Japan’s postwar industrial policy, finally obtained government assistance in terms of depreciation allowances, technical support, loans, and so forth for the industry. But this was not done until the early 1950s and only after considerable discussion. Computers in turn were not considered strategically important until the 1960s, after more basic industries were developed. It is always after some debate and as older industries become established that new ones are encouraged. Government policy shifts as the economy changes (e.g., in regard to steel, automobiles, and computers) and is dynamic in nature, looking toward future development.

These target industries have been limited in number, however, though they are indicative of the government’s industrial policy. Policy with respect to most industries has left a great deal to competitive forces in the market. Indeed, even within the strategic industries, policy has been only indicative, and the relative success or failure of particular firms has been determined by competition.
Current Situation

Japan’s industrial policy is becoming more inward looking, concerned with the benefits of growth and the quality of life. The reasons for this major policy adjustment are clear. The postwar economy has achieved previous long-term objectives: The industrial structure is modern and sophisticated, and current exports more than pay for the massive required imports of raw materials, fuel, and technology. The chronic balance-of-payments deficit that constrained growth until 1965 is no more. A long-term, though not indefinite, surplus is the current problem.

The balance on current account surplus and trade surplus was about $5.9 billion and $7.9 billion, respectively, in 1971 and may increase in 1972. This situation has created severe external pressures, particularly from the United States. Japan has already been forced to revalue the yen about 17 percent, and another revaluation is being discussed. However, Japanese policy makers view currency revaluations and trade restrictions as temporary measures supportive of longer-term policies. More fundamental changes in economic structure are needed, they feel, to correct the long-term situation.

Even before the Nixon shock, Japan had begun to rethink her economic policies. Basic industries responsible for past growth (textiles, steel, shipbuilding, automobiles, and chemicals) were showing signs of maturity or decline. Excess capacity, sagging domestic demand, and—with the exception of automobiles—slow export growth were widely apparent. The effects of rapid industrial expansion at the expense of social-overhead facilities were also visible in pollution, congested roads, and so on. (Japan has the world’s highest gross national product per square mile, $4,245, compared to $357 for the United States. Cars per square mile are 344 compared to 41 for the United States.) Recent public surveys show that the Japanese are less concerned with income growth than with pollution, housing, living space, rising food prices, and social security. Conversely, people are satisfied with the availability of consumer durables (e.g., cars, television sets, and appliances). Successful development has created an internal atmosphere ready for change.

The response of Japanese policy makers to these dual pressures, internal and external, has been to revise the hundred-year-old policy
and to focus more on internal demands. Their plan is to reflate the economy by increasing expenditures on long-needed social-overhead investments such as roads, improved harbors, parks, and pollution control. In addition, imports will be liberalized, the rate of industrial-equipment investment will be reduced, export expansion will be de-emphasized, and overseas investment will be encouraged. The complexity of both the Japanese economy and the decision-making process has necessitated some lag between perception of the need for change, policy formulation, and implementation. The first two steps now seem fairly complete, but policy implementation is only beginning and is encountering some difficulties.

The recently published government white papers of the various ministries and agencies all address the common theme of their sector's future role within Japan's new economic context. Statements by various business leaders set forth their new goals and problems. An advisory council to the prime minister has been formed, headed by Yoshizane Iwasa, chairman of the Fuji Bank. Its mission is to study a plan for "remodeling" Japan, with recommendations due by the end of the year (1972). These are significant indications that a general policy decision is being reached via the well-known consensus process. That is, opinions are solicited from various elements of society and the economy (big business, small business, agriculture, labor, various ministries, politicians, and academics) until an overall agreement and policy emerge. At this point, although resistance and disagreements may continue, the policies will usually be pursued and implemented as each sector makes its contribution. This process facilitates consistency and accommodation in establishing Japan's structural goals and in carrying through programs. As objections are dealt with ahead of time, obstacles do not arise—as they sometimes do in the United States—once the decision to go ahead has been made. Several differences in opinion remain to be worked out with respect to short-term implementation, but the long-term orientation is now clear.

**Revision of Past Policy**

Japan's new industrial policy represents a major change in goals but is still consistent with previous policy. Japan's old industrial policy
basically followed a Western model of economic evolution. Major industries were targeted as growth opportunities based on previous European or U.S. experience. Unlike the centrally planned economies, Japan has moved sequentially from light, technically unsophisticated industries to more capital-intensive and technically advanced industries (textiles, steel, machinery, shipbuilding, automobiles, and computers). Strategic industries received government support and assistance, but as they became competitive they were left on their own to provide their contribution to growth and development along with other industries.

The new policy turned out to be quite logical. When a country is poor in capital, income, and technology, it should produce products for which there is a large internal demand and which require little capital and few labor skills. As a country develops, incomes grow, the capital stock increases, and labor skills improve, generating demand for and making possible production of more and more sophisticated products. Similar to many less developed countries (LDCs) today, in the late nineteenth century Japan was an exporter of primary products—copper, green tea, raw silk, rice, and fish. It also was starting to produce cotton textiles and was importing steel, ships, and machinery. Today Japan imports cotton, wood, iron, copper, coal, and food and exports machinery, ships, and steel. The government has favored this change and has looked ahead to the next stage of development.

In terms of international competition, Japan's product sequencing was also appropriate. Because higher wages and lower capital costs gave the United States and Europe a comparative advantage, Japan shifted toward even more sophisticated and capital-intensive products (see Tables 1, 2, and 3). What had begun as an ad hoc patterning of Western economic development became a structural policy of dynamic comparative advantage under which industries were developed in response to local demand and in anticipation of future competitiveness.

Japan's postwar economic policies were a continuation of this pattern. Japan needed to industrialize, had a balance-of-payments constraint, and wished to emulate the United States and Europe. Therefore, although the particular policies actually pursued in individual strategic industries such as steel, shipbuilding, automobiles, computers, and petrochemicals were often responses to specific events, Japan's general industrial policy consistently stressed growth, industry sequencing, export promotion, and rapid plant and equipment investment—a policy that
TABLE 1. Real Income, Wage-Interest Ratio, and Industrial Production in Japan, 1890 to 1975

<table>
<thead>
<tr>
<th>Year</th>
<th>Real Per Capita Income (yen)</th>
<th>Wage-Interest Ratio (Index)</th>
<th>Industrial Production (percent of GNP)</th>
<th>Heavy Industrial Production (percent of all industrial production)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1890</td>
<td>57</td>
<td>37.1</td>
<td>9.8</td>
<td>12.1</td>
</tr>
<tr>
<td>1900</td>
<td>81</td>
<td>37.0</td>
<td>29.8</td>
<td>17.5</td>
</tr>
<tr>
<td>1910</td>
<td>88</td>
<td>67.3</td>
<td>23.1</td>
<td>31.9</td>
</tr>
<tr>
<td>1920</td>
<td>112</td>
<td>58.7</td>
<td>27.0</td>
<td>46.0</td>
</tr>
<tr>
<td>1930</td>
<td>192</td>
<td>110.7</td>
<td>28.6</td>
<td>50.0</td>
</tr>
<tr>
<td>1948</td>
<td>128</td>
<td>40.9</td>
<td>30.8</td>
<td>56.0</td>
</tr>
<tr>
<td>1958</td>
<td>276</td>
<td>128.8</td>
<td>33.5</td>
<td>57.7</td>
</tr>
<tr>
<td>1968</td>
<td>750</td>
<td>241.1</td>
<td>38.0</td>
<td>71.0</td>
</tr>
<tr>
<td>1975*</td>
<td>1,500</td>
<td>480.0</td>
<td>—</td>
<td>74.4</td>
</tr>
</tbody>
</table>

*Estimated
Sources: Japan, Ministry of International Trade and Industry, New Economic Plan (Tokyo); Bank of Japan, 100 Year Statistics of Japan (Tokyo); W. V. Rapp, "Theory of Changing Trade Patterns," Yale Economic Essays (Fall 1967); Japan Economic Research Center, Japan’s Economy in 1980 in the Global Context (Tokyo).

affected industrial development as a whole, that is, in both strategic and nonstrategic industries.

The success and the soundness of this policy are apparent in Japan’s current economic position and in the growth, composition, competitiveness, and size of her exports. At the same time, the greater sophistication of her industries has raised the value added per unit of exports so that net foreign-exchange earnings per yen of exports have been increasing. These two effects, combined with a relatively constant composition of imports (food and raw materials), have changed Japan’s traditional balance-of-payments deficit to a large surplus.

Government policy makers feel that the logical continuation of past development can ease the current situation but that a shift toward a
postindustrial, knowledge-intensive economy is required to emphasize infrastructure investment, housing, pollution control, and social welfare facilities. In effect, Japan’s new policy will continue to follow the U.S. and European economic models, while it simultaneously addresses mounting internal and external pressures. More sophisticated employment opportunities will be needed to justify higher incomes. Industries such as steel, chemicals, and automobiles, while continuing to provide employment and foreign-exchange earnings, are not fast growing. Areas such as computers, fashion, oceanography, research institutes, consulting, city planning, pollution, prefabricated housing, and social welfare facilities offer more logical investment and growth alternatives and are primarily domestic-demand oriented. As resources are redirected to these sectors, productivity in the major export industries will begin to decline, and their international competitiveness will decrease. The export surplus will decline, and the people’s quality of life will rise. At the same time, Japan plans to import many more agricultural products, textiles, handicrafts, and other less sophisticated manufactured goods. This will also help to correct Japan’s balance-of-payments surplus while upgrading her economic structure and lowering the cost of living.

Many economic and political problems must be solved in implementing this policy, but the economic and political logic is apparent. It is in fact a major conclusion of this paper (and also the opinion of many Japanese policy makers) that Japan’s industrial policy has been successful because of its logic and consistency, which are the result of interaction and acceptance by various social elements. That is, it makes use of, rather than opposes, social and economic forces.

Japan’s Postwar Policy and Changing Economic Structure: Product Cycles and Economic Growth

Japan’s new industrial policy is important in assessing her future economic role and relations with the United States. But some appreciation of the Japanese economic system is required to place this new policy in perspective.

Japan’s competitive environment is growth oriented, and this has been encouraged by government policy. Japan’s per capita income in 1948 (Table 1) was equivalent to that of the 1920s, and not until 1957
TABLE 2. Japanese Industrial Production and Manufactured Exports, Selected Years and Projection for 1975 (percent)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>Heavy</th>
<th>Light</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1928</td>
<td>100</td>
<td>35</td>
<td>65</td>
</tr>
<tr>
<td>1935</td>
<td>100</td>
<td>53</td>
<td>47</td>
</tr>
<tr>
<td>1950</td>
<td>100</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>1960</td>
<td>100</td>
<td>68</td>
<td>32</td>
</tr>
<tr>
<td>1969</td>
<td>100</td>
<td>71</td>
<td>29</td>
</tr>
<tr>
<td>1975 (projected)</td>
<td>100</td>
<td>74</td>
<td>26</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1928</td>
<td>100</td>
<td>7</td>
<td>83</td>
</tr>
<tr>
<td>1935</td>
<td>100</td>
<td>18</td>
<td>72</td>
</tr>
<tr>
<td>1950</td>
<td>100</td>
<td>33</td>
<td>67</td>
</tr>
<tr>
<td>1960</td>
<td>100</td>
<td>51</td>
<td>49</td>
</tr>
<tr>
<td>1969</td>
<td>100</td>
<td>70</td>
<td>30</td>
</tr>
<tr>
<td>1975 (projected)</td>
<td>100</td>
<td>78</td>
<td>22</td>
</tr>
</tbody>
</table>

did it again achieve its prewar highs. Thus, economic growth was a logical postwar priority. This growth required high rates of investment and export promotion if capacity was to be expanded rapidly and imports were to be financed. But Japan’s capital stock was extremely small, and only the banks had the necessary funds. Therefore the government, through the Bank of Japan, encouraged the debt financing required for high investment rates. In addition, tax reforms continually altered the progressive nature of Japan’s income tax to favor capital accumulation and high savings rates. Interest income was taxed at lower rates than was salary income, and capital gains were often not taxed at all (e.g., in the case of stock sales). Extensively used commodity taxes encouraged savings. Corporations were allowed to revalue their assets to compensate for the high immediate postwar inflation, and accelerated depreciation was given on purchases of new equipment. Companies also received favorable tax and interest-rate benefits for exports (e.g., even more favorable allowances on equipment depreciation and lower interest rates on export bills and on imports-for-exports). These and other measures encouraged industrial recovery, rapid investment, and export growth.

The program was particularly successful because it favored those firms that grew fastest and were effective exporters. The measures were growth incentives, not subsidies. The fastest-growing firms used the most debt and received the most tax benefits, and they could thus price lower relative to competitors and achieve the same return on equity even if costs were the same. They could then undersell competitors both domestically and overseas. As their volume increased, their unit costs became lower and they could further lower prices, grow faster, and benefit from government tax policies. Conversely, slow-growing firms had to repay loans and deferred taxes (i.e., had declining depreciation allowances).

The government itself favored private investment over public investment, which had a lower income payout. The government consistently underestimated growth rates and thus fiscal revenues. Budget surpluses were then returned to the private sector via tax cuts. These economic forces reallocated financial resources to the faster-growing firms and industries via the banking system and the government budget. As high-growth industries and firms gained comparative advantage relative to slow-growing industries and firms, there was an upgrading of the industrial structure and a consolidation of industries, particularly in
TABLE 3. Ratio of Japanese Industrial Production to Manufactured Exports, Selected Years and Projection for 1975

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>Heavy</th>
<th>Light</th>
</tr>
</thead>
<tbody>
<tr>
<td>1928</td>
<td>1.00</td>
<td>0.2</td>
<td>1.3</td>
</tr>
<tr>
<td>1935</td>
<td>1.00</td>
<td>0.3</td>
<td>1.5</td>
</tr>
<tr>
<td>1950</td>
<td>1.00</td>
<td>0.7</td>
<td>1.3</td>
</tr>
<tr>
<td>1960</td>
<td>1.00</td>
<td>0.8</td>
<td>1.5</td>
</tr>
<tr>
<td>1969</td>
<td>1.00</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>1975</td>
<td>1.00</td>
<td>0.8</td>
<td></td>
</tr>
</tbody>
</table>


the capital-intensive sectors. The cost of this growth was underinvestment in public facilities and high rates of industrial investment instead of personal consumption.

The government’s policies in effect accelerated the impact of internal competition and market forces on Japan’s development. As already noted, economic growth increases incomes, labor skills, capital stock, and technical sophistication, thus raising consumer expectations while facilitating production of more advanced products. Japan’s high-growth policies accelerated these demand and supply shifts. But, while Japan upgraded her industrial structure, more advanced countries such as the United States were also upgrading theirs and becoming less competitive in Japan’s new high-growth industries. Because Japan was following the United States and Europe, its high-growth industries were the maturing U.S. and European industries. Therefore, by redirecting
substantial resources toward high-growth firms in high-growth industries (Japan's investment and savings rate averaged 24 percent between 1955 and 1968 and is currently over 30 percent of GNP), the government's policies and the economic system accelerated Japan's evolving comparative advantage. The long-term international and domestic effects of this dynamic policy were profound.

Other elements of the Japanese economic system also foster the rapid reallocation of resources for growth, efficiency, and competitiveness. Japanese labor practices are a particularly interesting example. Workers in major Japanese companies are hired directly from school for life. They are promoted and paid according to seniority. Thus, fast-growing firms have a younger work force and lower average wage costs. The employee's livelihood is intimately involved with the firm's success; thus, strikes are few and high debt levels are less risky than they are in the West. Because employment is for life, employees can only gain from innovations that improve the firm's competitive performance.

High debt levels and little proprietary technology also foster competition. Japanese managers are accustomed to rapid growth and realize the adverse consequences of failing to grow with the market. They invest heavily in anticipation of demand. As investments are uneven, temporary excess capacity is common, but fixed costs are high (fixed labor and high interest charges). Therefore, operation at capacity is efficient even if products are sold at slightly above variable costs (in fact, slightly above raw-material costs). Further, most technology is imported and is available to all producers (often a MITI requirement), so there is no patent protection to hold up prices. Prices are very flexible downward, leading to extreme price competitiveness and rapid industry shake-outs both domestically and overseas. Again, this situation favors the high-growth, low-cost firm.

This competitive process, often called excessive competition, is only really excessive when demand slows, the industry matures, and excess capacity is long term. At this point, the government (MITI) usually helps establish a depression cartel and encourages mergers. But because production allocations are based on existing market shares, the desire of firms to add capacity and to compete for market share in a new product remains unchanged.

In effect, Japan has developed a self-reinforcing business system, encouraged by government policies, that promotes rapid growth by
favoring a rapid reallocation of resources to high-growth firms in high-growth sectors. Industry structure is rationalized when growth slows. As these growth industries have been the more modern, more sophisticated industries, this process has increased Japan’s comparative advantage in higher value-added products. Because the same competitive pressures exist internationally as in the domestic market, Japanese firms have been very aggressive in exploiting changes in their comparative advantage to expand volume and to increase competitiveness relative to domestic and foreign competitors. The net result is a large trade-account surplus.

**Evaluation of the System**

In the operation of the Japanese system, business and government are cooperative and mutually supportive. The measures such as quotas, tariffs, and tax concessions used to protect and encourage particular industries are also found in Europe, the United States, and the LDCs. The number of regulations and the degree of market interference are currently about the same as in other advanced countries. Previously, there was substantial protection, and MITI controlled many raw-material imports as well as technology imports; but the economic situation at that time was quite difficult. Until 1964, the Organization for Economic Cooperation and Development still classified Japan as a semideveloped country, and Japan had a chronic balance-of-payments deficit. Economic success, however, has brought increased business independence and a sharp reduction in both direct and indirect controls, even if growth-oriented management and competitive pressures remain.

Still, import controls and encouragement of new industries imply interference with free international market forces and have been achieved at some cost to the Japanese economy. But it is not government interference with market forces that differs so much from the United States or Europe as direction and emphasis. Japan has defended high-growth rather than low-growth sectors. The United States protects textiles and shoes; Japan protects computers. United States antitrust regulations hinder mergers; Japan encourages mergers in order to create larger, more efficient, more viable firms. The U.S. tax system favors consumers at the expense of corporate investors and a higher savings
rate; Japan emphasizes capital accumulation and higher growth rates. Japan thus favors growth, an upgrading of its economic structure, and increased real wages. The United States tries to cushion change and dislocation by keeping resources in low-wage, low-productivity industries and by short-circuiting some of the rationalization created by competition and merger. The trade-offs in trade discussions between the two countries clearly indicate these priorities.

In either case, it is ultimately a politicoeconomic decision whether interference, control, or distortion of free-market forces and business decisions is justifiable. This is true if the goal is stabilization of the existing economic situation or if it is upgrading of the economic structure as quickly as possible.

Japan has pursued as "infant-industry" strategy on a massive scale. This approach assumes a dynamic world view; yet without rapid growth and industrialization Japan was committed to a permanent poverty gap vis-à-vis the West, a situation that was politically and emotionally unacceptable. Because Japan is a follower, its perspective is naturally different from that of the United States. Japanese leaders followed Western economic development in product sequencing but not always in implementation. In targeting future industries, they observed foreign economies in terms of Japan's needs and discussed the results. Good communications, the country's small size, and its common heritage facilitated this consensus process and actual follow on. But initially they could not leave implementation strictly to the market because in the development stages follower industries need protection. This argument is the accepted infant-industry plan.

The plan has cost foreign producers markets and Japanese consumers temporarily higher prices. But U.S. protection policies have also been partially responsible for the trend. By propping up declining industries through tariffs and quotas, the United States has denied Japanese exporters potentially large markets and has used up negotiating leverage. At some point, therefore, these Japanese industries could no longer grow and ceased to attract resources. Continued growth then required moving faster into the next stage of development. In the short run, protection was needed to get things started and could be justified by U.S. policies. But as industries grew and became competitive, prices dropped and there was a large economic payoff in higher wages, profits, and export earnings. If the additional cost to the con-
sumer is considered part of the total country investment in the industry, the calculated payout appears large (e.g., textiles, steel, shipbuilding, and autos).

Both demand volume in the early stages of product development and total incremental cost are small. Because in Japan prices fall as volume expands, cost continues to be small and eventually disappears. On the other hand, protecting a declining or mature industry is very expensive because demand volume is large and international price differentials are widening. Similarly, forcing six firms to exist when the market only efficiently justifies three is also costly. By fostering interfirm competition and rationalization except when it becomes excessive and counterproductive, the Japanese have minimized their catch-up costs, have increased their international competition, and have promoted their overall economic development. In addition, this policy has created many new and independent (non-zaikai) entrepreneurial firms like Mitsushita, Sony, Toyota, and Honda. Business has benefited greatly from their aggressive management, and this spirit has in turn benefited from the competitive postwar climate. The government has not managed Japanese corporations. Instead, this corporate success has been the collective result of Japan’s managerial initiative and capability in response to a dynamic industrial system.

However, Japan’s growth-oriented managers are confronting a new environment. Japan’s important export industries are now mature, and the number of new leading industries available for development is few. Managers must consider the difficulties of managing a mix of high- and low-growth products and take into account the shifting comparative advantage toward the LDCs in several traditional industries. Revaluations have accentuated this changing competitive context. At the same time, Japan is committed to increasing these imports to decrease both its overall surplus and the bilateral surplus with these countries. Japan’s economic structure has encouraged raw-material imports and manufactured exports, but in the future it will import large quantities of inexpensive consumer goods as well. It will export capital, capital equipment, and technically sophisticated products. Indeed, overseas investment is essential if manufactured imports are to be widely distributed by Japanese firms and if some currently exported value added is to be transferred to production abroad. These actions would imply a major revision in both government policy and business attitudes.
Japan's Evolving Industrial Policy

To meet Japan's internal and external problems, government officials, business leaders, academics, and others have been discussing alternatives since 1970. The consensus policy that has emerged has both a domestic and an international component.

Internal policy—government budget. Japan is currently in a recession, and reflation of the economy requires substantial increases in government expenditures. On a long-term basis, too, major expenditure increases are needed to meet long overdue social-overhead requirements, to reallocate resources to housing, to improve social security benefits, to improve pollution control, to reduce population pressures, and to do many other things required to improve the quality of life. These expenditures must be supported by a new set of incentives to business. Past recessions have usually been the result of tight money policies aimed at slowing the economy and reducing imports. Increased exports compensated for declining domestic demand while correcting the balance-of-payments deficit. However, currently liquidity is high, world demand is depressed, and Japanese exports are less price competitive. Thus, the government plans to increase substantially government expenditures, already up 18 percent over 1972.

In the long term, MITI anticipates that new social-overhead-investment expenditures over the decade will total $60 billion in 1965 prices. To finance this growth in expenditures, the government will issue bonds (mostly to banks) and will raise taxes. Because many firms are cash rich and are not investing at previous rates, they are repaying loans, and their depreciation allowances will shrink. Funds will be reallocated through the banking and tax systems to the new high-growth sector, government expenditures. This resource reallocation is not expected to decrease Japan's growth rate, at least in the short run, as many improvements are long overdue and have created economic bottlenecks. Through 1980, the government anticipates about a 9 percent per annum increase in real GNP. After 1980, the higher capital output ratio of public investments may have some diminishing effect on growth if such investment grows to 7 percent of GNP or about 25 percent of total investment. But if investment rates remain high, growth will continue to be substantial.
The impact of the new expenditures and taxes will be directed at the structural issues noted above. Most important (reflecting the Tanaka Plan) will be the government’s attempt to redirect industry and population away from the Pacific megalopolis between Tokyo and Hiroshima. Inland transportation networks will be expanded, particularly in northern Japan (Tohoku and Hokkaido). New high-speed trains and a tunnel to Hokkaido will be completed, reducing the travel time between Tokyo and Sapporo from seventeen to five hours. The government also plans to build industrial parks, an academic research city, and new nuclear cities (each of about 200,000 people) in the less populated, less industrialized parts of Japan (Kyushu, Hokkaido, and northern Honshu). In its 1973 budget, the Ministry of Construction asked for $30 million to assume construction of the academic city. It also plans to survey approximately 100 nuclear cities.

To encourage industry to move, the government has proposed an oidashizeikin, literally translated as “driving-out tax.” This tax will be based on factory or office floor area and will be levied according to metropolitan location. It could cost the steel companies alone ¥4 billion ($13 million) in the first year. Also, the government is considering a head tax on the urban population. On the other hand, it will offer subsidies to firms and relocation allowances to workers to move to prepared sites. A major barrier to industrial and population redistribution in the past has been young people’s desire to move from the country to the large cities. However, recent polls indicate that this attitude has changed. In addition, academics have been relatively underpaid and have needed the arbeito (part-time employment) available in the cities. The new high-speed trains, increased education expenditures (plans call for $30 billion in 1980), and the new academic city will ease pressures on professors to remain near major cities, particularly Tokyo. A massive use of television communication for education, particularly adult education, will further decrease the cultural and educational disparities between the megalopolis and other parts of the country. Some people accuse the government of advocating pollution proliferation, but this program seems to represent an intelligent use of available land. In addition, the government’s pollution-control regulations are becoming increasingly severe, and recent pollution court cases have uniformly favored the plaintiffs.

The other major area of increased government expenditure will
be housing. For 1973, the Ministry of Construction is asking $700 million for loans for housing projects, financing about 312,000 units. It is also planning to subsidize private housing. This program will coincide with the emergence of housing, particularly prefabricated housing, as a growth sector. The total housing plan for 1973 is over 700,000 units.

A major problem, however, is that these expenditure programs, as well as the building of more parks, roads, harbor improvements, hospitals, and sewage, all use land. Further, increased incomes and more leisure (a five-day workweek is receiving special government, business, and labor attention) will increase the demand for resorts, hotels, golf courses, and ski areas. Already scarce land is in even greater demand, and current land prices are rising rapidly. The government recognizes this and is considering steps both to increase the available supply and to reduce speculation.

In addition to the oidashiseikin, the government plans to raise the capital gains tax on land sales by corporations to perhaps as high as 95 percent on short-term sales, and the individual gains tax on land will rise to over 20 percent from the current 15 percent. (The difference is due to the political influence and different economic situation of farmers.) These taxes will be raised incrementally over a two- to three-year period, and the rate increases will be announced in advance. The plan is to encourage land to come on the market before the tax rate rises. The government is also considering reassessing agricultural and vacant land in urban areas as if it were used as residential land. This tactic will substantially raise the holding cost of such property. The tax program will in turn be buttressed by a BOJ limit on the proportion of real estate loans a bank may make and a list of “appropriate” land prices for different areas of Japan. In effect, the new tax and expenditure programs are structurally complementary.

**Internal policy—industrial structure.** The government has targeted for development several new “clean” industries that it considers part of Japan’s future industrial structure: for example, information industries, computers, information centers, consulting, basic research, fashion, ocean-resources development, leisure, housing, medical equipment, and pollution-control equipment. MITI’s paper “Trade and Industrial Policies for the 1970s” predicts research-and-development expenditures in 1980 to be around six times the 1972 level of $2.5 billion. The government is specifically encouraging importation of
pollution-control technology by speeding up the patent-approval process. In the case of computers, the government is promoting the industry in the traditional manner (accelerated depreciation, government loans, tariff protection, and quotas). Thus, the government, by pushing the reallocation of resources toward a knowledge-intensive structure, is emphasizing high-technology and professional-service industries.

While promoting new industries, the government is committed to phasing out or rationalizing declining or maturing industries. As former Vice-Minister Ojimi of MITI has said:

While certain segments of the industrial structure are being encouraged, there must be modification of those industries where productivity is low, where technology is stagnant and where there is reliance on simplistic intensified use of labor . . . .

The solution of this problem is to be found according to economic logic, in progressively giving away industries to other countries, much as a big brother gives his out-grown clothes to his younger brother. In this way, a country's own industries become more sophisticated.

Thus the government has an extensive program for rationalizing both agriculture and textiles by reducing the number of farms and firms. The commitment of government resources to these declining sectors is far larger than are the incentives offered to emerging industries because the government is trying to cushion the effects of Japan's rapid resource reallocation and recent revaluation. Also, in new industries, the government leaves more to the working of the private sector. The government has also set up industrial parks for handicrafts, toy manufacturers, and the like to facilitate specialization and rationalization. (This program coincides with the industrial-relocation scheme.)

In the case of still growing but mature industries such as steel, shipbuilding, chemicals, consumer electronics, and automobiles, the government appears to be following a flexible policy using depression cartels, export cartels, and limits on capacity expansions to buffer the effects of the current recession as the circumstances warrant. For example, in shipbuilding, Japanese yards are being allowed to allocate production in cooperation with European yards so as not to precipitate an international price war.

**International policy.** By de-emphasizing exports and by promoting overseas investment, government policy reflects the course of
competitive forces. For instance, because its labor force is not expanding and wages are rising rapidly (about 15 percent a year), Japan’s small, labor-intensive firms can no longer compete with producers in Korea and Taiwan. It is also difficult, because of the high price of land and local resistance, to find land sites for raw-material processing industries, which are often polluting. In addition, foreign governments are requiring Japanese companies to do more raw-material processing in their countries before exporting. Japan’s large steel, chemical, and oil companies thus consider offshore processing attractive.

Small exporters can, however, maintain their markets in the United States and Europe by gaining access to cheaper labor in Taiwan or Korea. Large firms, too, can satisfy foreign-government pressures and can shift some problems by offshore investment. They also create markets for their heavy equipment and technical services, the current basis for Japan’s comparative advantage. Increased imports from these offshore investments both lower the cost of living and decrease Japan’s mounting trade surplus.

The government realizes and encourages the importance of overseas investment in several ways:

1. The ceilings on capital exports have been successively raised (and probably will be removed).
2. Tariffs on manufactured goods from the LDCs have been cut in half.
3. Aid levels will rise to about 1 percent of GNP (about $7.5 billion in 1980) on united and soft terms.
4. The Export-Import Bank will be allowed to lend foreign exchange on concessional terms to small Japanese companies for investment.
5. Revaluation insurance is being proposed to protect investors overseas.
6. MOF is completely revising Japan’s tariff schedule to favor finished imports.

Even MITI is becoming import and free-trade minded. It is presently attacking the monopolistic sole-agent system that allowed several importers to maintain yen prices and to raise dollar revenues after the revaluation. MITI feels more manufactured imports are an important force in upgrading the economy, avoiding another revaluation, controlling inflation, and keeping money wages from rising too rapidly.

Increased protectionism in Europe and in the United States will encourage Japanese firms to invest in the advanced countries to protect existing markets, to expand service capability, and to reduce the bi-
lateral surplus. Trading companies and large consumer durable-goods manufacturers are taking the lead in this area. The government's exchange rate insurance will prevent currency hedging from aggravating the current surplus and reducing the flow of overseas investment. The other side of Japan's overseas investment will be Japan's emergence as an international source of funds. Several multinational firms and foreign governments have already received dollar financing from Japanese financial institutions. The internationalization of Japanese business is both an emerging reality and a policy objective.

Some short-term approaches to ease the balance-of-payments surplus appear less workable. For instance, stockpiling of raw materials is not being undertaken by trading companies, because they cannot sell them. Even if they receive interest-free yen loans, there is no allowance for depreciation, warehouse-space usage, or revaluation. The firms can only lose money and will resist "administrative guidance" if it is costly. But for the long run Japanese policy makers appear to be moving Japan into an appropriate direction both economically and politically.6 Planners seem to take greater cognizance of the international impacts of domestic decisions. They now appreciate Japan's size, importance, and responsibilities in a multipolar economic world. They recognize the need for an acceptable trade surplus of not more than 1 percent of GNP. They are also asserting themselves more in world economic policy.

The latest white paper on trade takes the position that future world trade should be free, nondiscriminatory, and reciprocal, promoting harmony, cooperation, and international specialization among advanced countries. For this reason, Japan is opposed to further extensions of trading blocks like the European Economic Community, to nontariff barriers, and to "voluntary" restraints. Import injury should be solved through industrial adjustments, not controls or exchange rate changes. But the Japanese do not intend to push their view too hard, wishing to avoid major international confrontations similar to those of the 1930s. The government worries only that its long-term measures will not show results soon enough and that it will be forced to revalue again (though it may use an export tax first).

Implementation Problems and Issues

Although government and business leaders substantially agree on the overall direction of Japan's future structural development, they
have many difficulties to work out in administering and implementing the new policy, particularly in the short run. Indeed, implementing certain programs has turned into a large problem, partly because of inertia in getting a new program started but mostly because there are real conflicts of interests. Although businessmen agree on the long-term logic of Japan's policy, few are willing to have their short-term interests affected. This attitude has resulted in a policy paralysis in which proposals are made but few concessions or actions are forthcoming. There is a feeling that long-term economic forces will work things out. This can be clearly seen in declining sectors such as agriculture, coal mining, and textiles where there is little consensus but rather a grudging acceptance of the inevitable combined with considerable political pressure to postpone and cushion their decline. However, external pressures and internal expectations are unlikely to wait for this long-term evolution. In addition, failure to implement near-term programs is likely to affect long-term policy. This situation, if it continues, could ultimately result in a serious confrontation of political pressures and vested self-interest similar to the Nixon shock. The hope is that there will be a concerted effort to break the concession bottleneck after the Diet election and achieve consensus on a short-term program.

Japan's policy determination has always been a reconciliation of conflicting interests. The Economic Planning Agency (EPA), in compiling the overall economic plan, only integrates the structural plans of the various ministries within an overall economic model. EPA is neutral and has no power or administrative authority, and its plan is indicative, having no legal force. Each ministry submits and is responsible for its own plan.

When industrial policy concerned a few key industries, MITI's policy was in effect Japan's industrial policy. It handled reconciliation among business interests. Now the economy and structural policy are becoming bigger and more complex. There is more to coordinate both in scope and size. Several ministries are now involved: MITI, MOF, MOT, MOA (Ministry of Agriculture and Forestry), MOH, (Ministry of Health and Welfare), Environment Agency, Ministry of Construction and so on, each representing its own interests and constituency.

Despite appreciation of current problems and a consensus on long-term policy, various economic groups and government ministries have different ideas on timing and procedure. Because Japanese minis-
and agencies have little interchange except at the cabinet level, because tasks are functionally assigned, differing viewpoints can delay coordinated action on current multifaceted problems. Only recently have interagency project groups been formed such as the Land Development Plan headed by the Environment Agency in conjunction with MOA and the Ministry of Construction. To achieve future progress, these project teams will have to become more widespread.

For example, MOA recognizes that more food imports are required to control living costs and to increase total imports. But it is also concerned about farmers' livelihood and their ability to competitively produce beef, fruits, vegetables, and dairy products, which are considered possible replacements for traditional rice cultivation. They thus agree with MITI regarding the speed of agricultural liberalization.

In addition, MITI feels obliged to support major industries and is insisting on aid to the LDCs. MOF objects as increased aid flows will then decrease Japan's surplus. MITI is also resisting MOF's proposed raw material tax as it discriminates against efficient export industries but does encourage imports. On the other hand, neither MITI nor MOA wants an exchange rate revaluation.

MOF is attempting to break this impasse by applying pressure both on MOA and MITI. But MOF's political influence has been ceded. The new ruling faction does not belong to the MOF bureaucratic tradition of Kishi, Ikeda, and Sato. MOF is thus applying pressure by allowing official exchange reserves to rise, threatening another reaction. It has cut back dollar loans to city banks and has limited foreign lending abroad. By so limiting banks, however, MOF has discouraged the use of foreign exchange.

In addition, potential borrowers of yen in the Tokyo capital market (Mexico and Australia) have withdrawn their proposals. Thus, yen will not flow abroad despite a marked decrease in restrictions. FT's program is not credible and in fact worsens the short-term payments surplus. Similarly, the policy discourages overseas direct investment due to potential exchange losses. Business will wait until after revaluation. This frustrates the government's long-term plan to increase direct investment. More importantly, without direct investment, export earnings are not transferred abroad, and imports will not increase as they.
While government programs are moving in this contradictory manner, it is apparent that the government’s control and impact are less than in the past. Economic success has decreased business’s responsiveness to monetary and fiscal influences. Lower growth rates in many industries and a payment surplus have increased cash flows and have made credit more available. MITI’s control over raw-material and technology imports has also decreased substantially. Business leaders feel an increase in their relative power and are prepared to buck the government. MITI has already been forced to partially backtrack on its dispersion plan and to postpone the oundashzetsukin due to business pressure. Steel firms complained they had no place to move, and subcontractors felt they could not easily establish new facilities. Workers were also not prepared to hurt their children’s education by moving to the country. The program has thus been considerably restricted in terms of area and type of firm since its proposal.

Therefore, though many programs such as increased construction, improved social facilities, and housing are proceeding, programs related to industry relocation, structural change, and a reduced surplus are in trouble. The difficulties of policy implementation, however, may be best appreciated by a few industry examples that also illustrate more specifically basic policy principles.

Agriculture. Agriculture is Japan’s oldest declining sector. Human and financial resources have continually been shifted into higher growth areas, primarily manufacturing, since the nineteenth century. Within agriculture there has also been a shift of production and resources, reflecting economic growth and new consumption patterns (higher protein diet). The per capita consumption of rice has declined, and dairy products, wheat, fruit, eggs, poultry, and meat have taken its place. But Japanese agriculture is still very labor intensive. The average farm is only 1.1 hectares compared to 117 for the United States, and the agricultural labor force averages 1.4 per hectare. Just since 1960, the agricultural population has declined from 12 to 8 million (from 27 to 15 percent of the working population). As most of the young people have gone to the city to work (only 3 to 4 percent of the new labor force enters agriculture), the average farmer’s age is very old, and women account for 62 percent of the farm laborers. Even among farmers, more than 50 percent earn more than half their income from
other employment. Still, farm families have considerable political power due to their disproportionate representation in the Diet. Therefore, despite the high cost of food in Japan (a Japanese diet in U.S. prices costs substantially less than in Japanese prices), the obvious need for increased imports, and rising consumer discontent with higher food prices, the government continues to support agriculture in the short term while attempting to cushion and induce rationalization in the long term.

The high average age of the agricultural labor force means that in the long run the above problems will solve themselves as the farming population continues to decline. The government is encouraging this trend by offering farmers pensions to retire. But in the short run, the problem is fairly intractable. Given Japan's lifetime employment system, it is very difficult to transfer the current agricultural labor force into industry, and planned construction increases will use only some farmers. The government feels obliged to support these people in the meanwhile. The primary form of this social security is the rice subsidy. The government supports the rice price in the market on the one hand and pays farmers not to produce it on the other (¥35,000 per one-tenth of an acre plus ¥5,000 if they produce something else, usually fruits and vegetables).

The government is also encouraging rationalization of farming units, but this is difficult because of high land prices. The government's approach is thus twofold: (1) the tax measures noted earlier to encourage land sales and (2) the formation of cooperative farms. MOA is also trying to encourage new crops, but there is no clear substitute for rice, and these are areas of the greatest potential import competition. Finally, farmers feel more comfortable producing rice, which is stable and secure and requires no new techniques.

It is anticipated that agricultural liberalization and rationalization will be quite slow. This process will probably be completed around 1980 when the farm population is about 8 percent of the labor force and MOA has lost much of its political power. This change will be gradual in spite of substantial pressures from trading companies that have invested in overseas grain production, from manufacturing firms desiring land and moderate cost-of-living increases, and from consumer groups, foreign countries, and other ministries. A compromise may be worked out using income subsidies in combination
with imports as an alternative to price supports and supply restrictions. But this is tentative and is likely to happen first with meat products. However, the distribution system from the farms to the cities will be improved, making domestic products somewhat cheaper in the marketplace.

**Textiles.** The government is spending about $3 billion a year to rationalize agriculture. It is also spending about $700 million to rationalize the textile industry, and the reasons are somewhat similar. Japan’s oldest industry has a very large number of small firms. Rising wages, revaluation, export quotas, and slow domestic-demand growth have combined to make these producers increasingly uncompetitive. Yet, as in the case of farmers, their political power is considerable. In many cases the two interests are combined because farmers’ part-time employment has often been in traditional sectors like textiles, handicrafts, and toys. The smaller and medium-size firms are resisting MITI’s industry emigration policy, while the very large firms and the trading companies see rationalization and overseas investment as in their interest. It gives them a larger market and a lower-cost production source. But smaller firms will suffer.

MITI, however, seems fully committed to its policy. Japan’s average textile tariff is only 8 percent, and imports have risen 114 percent p.a. between 1965 and 1970 (over $260 million imported in 1971). MITI has earmarked $250 million to purchase surplus equipment and $450 million as relief losses for the U.S. textile agreement. It is setting up industrial parks for textile producers. It is encouraging mergers. (The three largest fiber producers, Toray, Teijin, and Asahi Chemical, recently concluded a rationalization agreement.) Finally, it is promoting overseas investment even by smaller firms, giving them information and guidance. Small firms are also eligible for concessional foreign-exchange loans from the Export-Import Bank for these offshore investments. The effectiveness of all these programs is not yet apparent, but they indicate the level and degree of commitment MITI is showing in the face of powerful political opposition.

**Steel, shipbuilding, chemicals, and automobiles.** Older industries such as agriculture, textiles, coal mining, and handicrafts are actually declining and are receiving major government assistance
in cushioning the effects of transition. But many major industries are also becoming mature. This faces MITI and government policy makers with a need to prevent dumping overseas or excessive competition domestically. In such cases, MITI usually arranges a depression cartel with permission of the Fair Trade Commission. It is illegal for manufacturers to do this by themselves. Thus, steelmakers have been enforcing production cutbacks of 15 percent since November 1971 and have curtailed planned capacity additions. Shipbuilders are advocating cutbacks in cooperation with European yards and are slowing operations at newly completed docks. The chemical and petrochemical companies have been particularly hard hit. Production increased only 5.4 percent in 1971 compared to 20 to 40 percent p.a. until that time. There is also excess capacity worldwide. Some petrochemical companies have had to stop plant operation altogether. In May 1971, a special law for restructuring the industry was passed allowing management guidelines, a depression cartel, and mergers. Even the auto industry, which is still growing, in 1971 for the first time faced a decline in domestic demand. But attempts by MITI to rationalize production through mergers and model reduction have failed due to industry resistance. Firms have to face serious difficulties before seeking government-sponsored rationalization.

**Computers, housing, medical equipment, pollution-control equipment, and other new areas.** Given the economy’s continued growth, new industries are merging, which MITI and other government agencies are promoting. But there seem to be conflicts of interest both within these industries and among ministries. For instance, Japan is trying to develop its space program, but has had difficulties in developing reliable rocketry. Therefore, the Communications Ministry wants to buy U.S. rockets to put up a satellite system and has MOF support, but Japan’s Space Agency, space contractors, and MITI want the Ministry of Construction to wait until 1977, when Japan will be able to produce its own rocket. The problem has not yet been resolved.

Similarly, MITI is fighting with the Ministry of Health and Welfare over developing medical equipment. The Health Ministry wants to proceed cautiously because of deficits in the National Health Plan and the risks of inadequate testing. MITI sees health as a future growth field. In prefabricated housing, MITI is quarreling with the
Ministry of Construction, whom MITI feels is not properly using Japan's housing program to rapidly develop prefabricated housing or to standardize production. Since MITI views prefabricated housing as a natural follow on to steel, shipbuilding, and automobiles, it has formed its own housing section even though it has no legal control over this industry. Computers of course are under MITI guidance and have been supported as a future growth industry in the traditional fashion. But here there has also been conflict, that is, with the Postal Service, which controls telephone lines. Both MITI and the Postal Service wanted control of time-sharing services. The Postal Service retained its position but only after agreeing to a strict performance timetable. In the future growth industries, much remains to be worked out.

**Conclusion**

Examination of Japan's industrial policy has revealed several important points. This policy has been a positive response to the need for industrial development and the structural problems generated by economic growth. But it has guided economic forces and not tried to control them. Japan's success has been due to her intelligent and aggressive business management operating in a growth-oriented system. The government's role has been to support this system, to provide enough protection to get an industry started, and to prevent "excessive" competition. In addition, Japan's policy is symmetrical, explicitly using market forces to promote high-growth sectors and discourage low-growth sectors. It is also symmetrical in its domestic and foreign aspects, not fostering policies domestically that are at odds with long-run international objectives.

Japan's industrial policy has been the result of the interaction of opposing and conflicting viewpoints among ministries and various segments of society. For a long time, this policy was growth, export, and industrial-investment oriented and was formulated and implemented by MITI through its interaction with the business community. It appeared quite consistent and homogeneous to outside observers. Conflicts and difficulties, though apparent, were kept to a minimum.

Economic and business success, however, has resulted in decreased government controls, a relatively more independent business
community, and a wider range of structural goals. Under the new economic conditions, policy objectives, formulation, and responsibility is more dispersed while the government’s influence, particularly MITI’s, is weaker. This situation combined with vested pressures to continue the old system has led to serious short-term implementation problems despite overall agreement on the economy’s long-term evolution. These implementation difficulties have been especially apparent in the international sector. Exports and the surplus have continued to grow, but only limited concrete actions have been taken, increasing the frustrations of Japan’s trading partners, particularly the United States. Japan agrees that something must be done and has indicated the direction of her structural reforms. But nothing seems to happen due to the conflict of internal political and economic interests. Unfortunately, the United States and Europe are unlikely to wait the four or five years it may take for economic forces to move Japan in the new direction she logically anticipates, that is, raising of her economic structure, encouragement of food and less sophisticated manufactured imports, and expansion of overseas investment.

It is this conflict between the logic of her new long-term industrial policy and the difficulty of taking specific short-term actions which will create problems for Japanese policy makers domestically and internationally over the next two to three years. Even more importantly, some positive steps have to be taken to ensure that short-term implementation failures do not obviate Japan’s new and appropriate long-term goals. However, in a democratic society and a mixed economy, major changes in economic policy and in business orientation do not take place easily or immediately. This is Japan’s current dilemma.

Notes

1/ Given a lack of domestic raw materials or a technological base, Japanese import requirements are high. Japan imports 100 percent of its oil, 84 percent of its coking coal, 98 percent of its iron ore, and 100 percent of its cotton. In fact, about 84 percent of its imports are industrial raw materials, food, or fuel. In addition, since World War II Japan has paid around $3 billion for foreign technology, and licensing continues on a large scale despite increasing domestic research and development expenditures. (Payments are about ten times revenue.) Japan must import to sustain its economy.
2/ These are results of the annual opinion polls conducted by the government since 1957 concerning people's views on their quality of life. The sample was stratified to include about 20,000 men and women over twenty years old. Sixty percent felt the growth policy was no longer appropriate.

3/ This situation is clearly indicated in a report entitled "Trade and Industrial Policies for the 1970s" and prepared in May 1971 by the Sangyoo Koozoo Shingikai (MITT's Advisory Committee for Industrial Structure). The effect of the Nixon shock was to accelerate the policy-planning process that was already under way. It forced Japanese government and business leaders to recognize that Japan's economy and industry were now of sufficient size to have an impact on the United States and Europe.

4/ Prior to his election in 1972, the new Prime Minister, Kakuei Tanaka, wrote A Proposal for Remodeling the Japanese Archipelago, which is now a part of the new policy. Its central theme is to relocate industry and population away from the Pacific megalopolis. The new council consists of top government officials, politicians, and academics. An interesting demonstration of the consensus process is that the group includes K. Ishikawa, a labor leader and outspoken critic of Tanaka's program.

5/ Japanese firms' high debt usage is a function of high investment rates. As high investment rates are fundamental to Japan's growth, high debt levels of major Japanese firms are implicitly backed by the Bank of Japan. Debt levels have been reduced as firms have lowered their investment levels. High debt levels have also disguised the profitability of Japanese firms, which are as profitable as American firms in terms of return on shareholders' equity.

6/ This policy is most clearly laid out in two reports by MITT's Advisory Committee for Industrial Structure: "Trade and Industrial Policies for the 1970s" (May 1971) and "An External Policy in the 1970s" (June 1972).

7/ Conducted by Nihon Keizai Shimbun [Japan economic journal].

8/ The rate of increase in imports recently crossed the rate for exports. This indicates a reduction in the surplus in about 1.5 years. This view is supported by an examination of trading companies' orders for future delivery. But short-term dollar exports remain high, and reserves are growing.

9/ About twenty agricultural items are currently subject to quotas.

10/ Small and medium-size firms who serve mostly the domestic market (e.g., not textiles or handicrafts) were not badly affected by revaluation except as major firms lowered prices to avoid dumping charges.

11/ Depression cartels are not used to keep prices high domestically while lower prices are charged overseas. Rather, they are combined with export cartels to set minimum prices in both markets. Dumping at home or abroad is seen by MITT as a counterproductive result of excessive competition.