A warning from experts on Japan: unless the U.S. learns to compete in the world marketplace, it is going to be in trouble.

What It Takes to Meet

by WILLIAM L. GIVENS and WILLIAM V. RAPP

With the U.S. economicizzle of the Seventies, not much is heard anymore of the once-famous "American challenge" to Europe. Instead, it's now the "Japanese challenge" to America. During the decade, Japan has outshone the U.S. in just about every imaginable measure of economic performance. The Japanese are now close to us in G.N.P. per capita, and will probably be well ahead by the end of the Eighties.

A number of thoughtful Americans are now warning us that unless we compete more effectively with Japan, the worsening economic mismatch will jeopardize our standard of living and erode our national strength. Among the most dedicated of the people bringing this unpleasant message are William L. Givens and William V. Rapp, former colleagues in the Boston Consulting Group and recognized experts on the Japanese economy. Rapp is a vice president of Morgan Guaranty Trust Co. Givens is head of his own consulting firm.

Assistant managing editor William Bowen recently held extended discussions with Givens and Rapp. As readers will see in the excerpts that follow, neither of them is in any sense anti-Japanese—on the contrary, they admire and respect the Japanese. But as Americans, they want their country to respond effectively to the Japanese challenge.

Bowen: By now, Americans generally must be aware that the Japanese have been running rings around us in economic performance. But not many Americans have a clear idea of why. The Japanese, themselves, tend to explain their success in cultural terms. You two explain it as a result of superior economic policy. That's a more encouraging interpretation, of course. Americans couldn't, and wouldn't want to, adopt Japanese culture, but they might be able to adopt something like Japan's economic policy. Let's talk about that policy, and where its superiority lies.

Givens: Before we do, I would like to try to clear away some misconceptions. It is tempting for Americans to look for something unique, or at least very different, in the Japanese system to explain Japan's economic success. We hear people ascribe it to various things: different work ethic, low defense expenditures, questionable trade practices, the so-called advantages of having had to rebuild after World War II, and so on. This kind of explanation ignores the big advantages we've had, in terms of market size, natural resources, capital, technology, and the strengths of our own system. And it contributes nothing toward the restoration of our competitiveness. At best it provides an excuse for a continuing bad performance.

We should shake off the notion that the trade imbalance between the U.S. and Japan is the result of dumping and other unfair tactics, and that if the Japanese can be made to play fair, the problem will go away. That's clearly not the case—we've been playing the game badly. The real problem is a serious erosion of American competitiveness. Yes, of course, there has been dumping, and the Japanese have also done other things that have gone beyond the pale, but the extent to which we can attribute the massive trade imbalance to those is relatively minor.

Japan's emergence as a global industrial power is the product of a highly rational and sophisticated economic policy. If there is a single critical difference between Japan's economic performance and ours, it is that: intelligent economic policy. There are two fundamental principles of international-trade competition that have been the cornerstones of Japanese economic behavior but that somehow have never been reflected in our policy initiatives.

One of these is the overriding importance of global market share. Generally speaking, the producer with the greatest volume—and this, of course, is dependent on his market share—will have lower costs, owing to economies of scale and greater breadth and depth of experience. In other words, his productivity will be higher.

The Japanese have competed on a global basis, and have achieved very impressive levels of industrial productivity. Take motorcycles, for example. I have some figures that go back a few years, but if anything the point would be even stronger today. These figures show that typical U.S. and European manufacturing facilities produce between 20,000 and 30,000 units annually, with output per worker ranging between ten and thirty units per year. Japanese facilities produce from 300,000 up to two million units per year, with output per worker between 150 and 300 units, roughly ten times the American and European productivity. Admittedly, this is an extreme example, since the Japanese virtually own the world market for motorcycles. But it does make the point: if our industries don't make the effort to achieve world-scale production, they won't be able to compete, even in the U.S. Already the average Japanese worker in industry produces more than his American counterpart, and the gap is widening in favor of Japan.

The other cornerstone is the critical importance of the higher-technology industries. Not all industries contribute equally to the national welfare. Some of them, the higher-technology activities, characteristically have higher levels of productivity and generate higher individual incomes. Japanese policy has recognized this and has been directed toward constantly upgrading the economy by influencing the
the Japanese Challenge

allocation of resources out of low-productivity industries and into those of the higher technologies.

By contrast, our policymakers have been so preoccupied with the short-term need to generate jobs that they've given little consideration to the quality and the longer-term value of those jobs to either the national economy or the individual workers themselves. We have consistently protected our lowest-productivity industries, often long after they lost international competitiveness, and have done virtually nothing to encourage the flow of resources into the higher technologies. Over time, if this pattern continues, the Japanese will move up the scale of technology and productivity faster than we will. And we will find a large part of our society competing in turn with the Koreans, the Taiwanese, the Filipinos, and later on with the emerging economies of Africa and Latin America, while the Japanese (and the Germans) move into a league of their own.

Rapp: Japanese businessmen have come to look upon the domestic and export markets as adjacent parts of a global market. In the early years after World War II, they tended to view exports only in the traditional way, as a means of paying for imports, and that was the initial dynamic impelling the government to have export-promotion policies. But as those policies bore fruit, the Japanese manager began to see the benefit of exports in terms of his domestic and international competitiveness. One of the reasons the government now finds it rather difficult to do anything about restraining export growth is that Japanese managers are so aware of the importance of exports for competitiveness. It's an ingrained part of their whole perception of the world.

Givens: Americans should not kid themselves into thinking that the Japanese, having been so successful, will start eating up before long. If anything, the competition will get keener in years ahead.

For one thing, Japan has come to be a major technological innovator. At the beginning of Japan's emergence as an industrial power, virtually all of the technology, virtually all of the new-product innovation, was imported. The fact that Japan is now making the transition from follower to innovator is extremely significant for the future.

Another major change in Japan's competitive dynamics is that the Japanese are now in a position to use direct overseas investment as a strategic tool. They will use it to shift some of the lower-value-added kinds of skills offshore, continually upgrading the industrial mix in Japan, yet maintaining control of the product and control of the industry. One of the things they're doing here is shifting into the U.S. economy a lot of manual-assembly jobs in consumer electronics, which frees up more of the Japanese labor force to do higher-value-added things. Japan is coming into a long period of labor shortage. They have also, because of rising education levels in Japan, found their workers less and less comfortable and happy in the low-value-added kinds of skills that have brought Japan to where it is today. Because of a strengthened currency, because of a trade surplus that has brought in large foreign-exchange reserves, Japan is in a position now to use di-

"The Japanese virtually own the world market for motorcycles."
rect overseas investment in some very interesting ways.

**Rapp:** One very important sector where the Japanese are going to be giving us tougher competition is the computer industry. That's their next target industry.

**Given:** The Japanese perceive the computer industry as the watershed competitive area of the Eighties, just as steel was in the Sixties. It is manifestly a Japanese national policy objective of the highest priority to become the global leader in the computer industry also. Leadership in computers, combined with the country's other competitive advantages, would virtually assure Japan's economic leadership well into the next century.

It isn't just the computer, moreover, that I think we need to be concerned about. It is the entire microprocessor technology. The upgrading of the whole spectrum of electrical and electronic products by virtue of the use of microprocessors is an area where I think the Japanese are going to present an extremely strong challenge. In addition, the incorporation of those technologies into Japan's industrial system is going to increase productivity even more.

An extremely important point here is that moves are being made within a government policy context that tends to provide encouragement, that tends to recognize the advantage of those kinds of trends and tendencies and to provide incentives for moving in that direction. Whereas in our situation, we have virtually no government policies.

**Bowen:** Bill Rapp, you spoke of computers as being "their next target industry." It's not easy for Americans to understand that. We don't have any target industries. That is, the society as a whole, or the business community, or the American government doesn't have any target industries.

**Given:** Doesn't have an economic policy.

**Bowen:** Yes—we can't very well have target industries if we don't have an economic policy. So it's very hard to understand in an American context what a phrase like "their next target industry" means.

**Given:** We should be able to articulate that on the federal level—articulate at least some broad general economic objectives. But we've never undertaken to do that, at any level.

**Rapp:** We can set targets sometimes, and reach them, too. In the early Sixties, for example, we had the goal of putting a man on the moon, and we did.

**Bowen:** That was an example of the point that if you have a clear purpose, you can muster the means. Having a purpose seems to me to be essential to the whole thing. But as a society we're not at all clear about what the purposes of economic policies should be. I don't think keeping up with the Japanese is a goal that's going to rouse many Americans.

**Rapp:** But if Americans don't rouse themselves to compete effectively, they're going to be hurting, economically and socially. Reallocation of resources toward so-called liberal causes is going to come to a grinding halt, if it hasn't already, as a direct result of the fact that we're not generating the productivity increases to sustain them.

**Given:** There's no way in the world we're going to solve this problem by spending less. It has to be resolved at the
"The tragic thing is that even now we have no policy context in which to resolve the steel problem. It continues to bleed us."

productivity end. We're losing our ability to pay for social programs that are important to us.

Rapp: This gets into the whole question of supply management as opposed to demand management. In order to match the Japanese, we have to reorient our economic philosophy to realize that we not only have to have demand, which in a sense was our problem in the 1930's, but also have to supply the demand. An important obstacle to adoption of an appropriate policy framework by the U.S. is that there's an awful lot of intellectual capital invested in certain kinds of economics and certain kinds of approaches to our problems, and this is going to be very difficult to overcome. The situation is almost the opposite of what we had in the 1930's, when we were starting to bring in Keynesian economics. The Japanese saw early on, after World War II, that the Keynesian approach was not proper for their economy, and they went back to a much more classical approach, looking to increasing supply and investment. They recognized that if they were going to do that in a non-inflationary way, they had to increase savings. So they instituted policies to that end. Now we need to do the same thing, and that's going to require a fundamental shift in attitude.

I would like to pick up on something that Bill Givens mentioned a while back. He said we try to protect our declining industries. It would be more accurate to say that government policy favors an allocation of resources to lower-productivity industries. We don't actually succeed in protecting these industries. We probably hurt them, because we don't give them incentives to compete, to become more efficient.

Givens: This is a good place to comment on the American steel industry, which to me is the most painful example of our lack of a policy. The so-called Japanese economic miracle has been associated in the minds of many Americans with light industry, consumer electronics, cameras, and things like that. The fact is, it's been based on achieving global superiority in steel. Once the Japanese were able to achieve superiority in steel, a lot of other things fell into place—ships, motorcycles, automobiles, a whole wide range of machinery.

The pattern has been fairly predictable. The Japanese get into an industry by importing the technology. They protect that industry during the initial phases, until they have achieved competitive cost positions. They begin exporting into third-world countries, to which most of our producers are largely indifferent. By that means, they achieve additional global market share, which enables them to bring costs down further and then to come at us head-on in our own domestic markets. And once that cycle has been completed, they repeat it at a higher level of technology.

The Japanese achieved significant cost advantage over us in steel in the 1960's. A perceptive American policy at that time would have recognized this as a matter of major strategic importance for the nation. We should have urgently taken steps to restore the competitive position of our steel industry by restoring our relative productivity. Instead, our reaction was to attribute Japanese gains in our market to dumping, and to do what we call saving American jobs by imposing import quotas on Japanese steel. Perhaps this did save some jobs, at least in the short term. But it also artificially raised the price of steel for other American producers who used steel in their products. This made it harder for them to compete with the Japanese—and other foreign producers—in automobiles, machinery, and so forth.

At the same time, the quotas we negotiated were on a volume basis, that is, expressed in tons. So the Japanese quickly shifted out of basic steel and into higher-value products. In this way, they were able to maintain and even increase dollar volume by upgrading their export mix into the U.S., while freeing capacity in the basic steel products to open up new markets in other countries, notably China.

The tragic thing is that even now we have no policy context in which to resolve the steel problem. The cost of protecting steel, in terms of our overall domestic productivity and trade balance, is incalculable. It continues to bleed us.

Rapp: Our whole approach of protecting successive levels of industry as they become noncompetitive is self-defeating. There is no way we can create a protective system that they aren't going to be able to find some way around. And every time we do this, we're undermining the next level up. We'd be better off importing carbon steel from the Japanese and at least producing competitive structural or competitive automobiles.

Bowen: It's a mind-shaking thought that Japan's superior economic performance derives in large part from recognition of so elementary a concept as the importance of market share in achieving economies of scale. I can't believe that American businessmen or economists have trouble grasping that concept. And yet the Japanese act on it effectively, and we don't.

Givens: There are a lot of reasons why we have not been able to translate manifestly valid concepts into concrete
"Our adversary relationship between business and government is artificial, not natural."

actions. One impediment is our network of self-imposed legal and philosophical constraints. Our antitrust laws, and our interpretations of them, have been a major constraint for American companies competing for global market share. What began basically as economic theory has taken on a moral dimension. We tend to see these things in moral terms, as if government-business cooperation were somehow immoral and conspiratorial.

If you think about it, there is absolutely no moral issue here at all. There is nothing moral or immoral about any particular degree of government-business cooperation, or lack thereof. Our adversary relationship between business and government is artificial, not natural.

Bowen: Sure it's artificial. It's a result of certain mind-sets. But mind-sets can be very resistant to change.

Givens: But they do disappear, for example, in wartime. And I would contend that the institutions we defend in wartime with military power are now equally at risk from deterioration of our economic position.

Bowen: One mental obstacle to rousing ourselves is the notion that we can cope with the Japanese challenge by protecting our domestic market.

Givens: It won't work. Protectionism masks economic problems in the short term and aggravates them in the long term. It makes our industry seem more competitive, in the domestic market, without providing incentives to become really competitive. And it tends to make foreign competitors even more competitive, because it forces them to reduce their costs.

The truly disturbing notion about dealing with Japan, one that some politicians are fond of, is the idea that if the Japanese don't wheel in some cord, we and Western Europe are going to initiate a massive boycott, and just drive them out of business.

Rapp: We should bury that idea. In the first place, I have some doubts whether we really have the political will to shut Japan out of the U.S. If we can't meet the challenges of getting our own act together to compete, can we really reach the psychological critical mass to undertake that kind of trade war? And even if we did, the Japanese response would be to invest in Brazil, in Korea, in Taiwan, and then we would have to extend our protection, or their products would come into the U.S. anyway. I mean, when you start running this out, the whole scenario becomes very difficult to implement. And if we're going to keep Japan as our major ally in the Pacific, the scenario becomes ridiculous. The Japanese are intelligent, and they realize this.

Bowen: One fundamental point we keep coming back to is our lack of a policy. Beyond all institutional differences, there is a basic underlying difference: that the Japanese have a policy and we don't. We have plenty of government involvement in the economy, but there is no overall guiding policy. The term "policy context" has come up in the discussion. I would like to explore what it means.

Givens: I would say it's a way of thinking about the economy that enables the government to treat individual industries differently, so as to optimize the economic environment for the good of the society at large. A basic aim of the policy context is to create an environment in which more desirable industries can thrive and in which resources shift out of less desirable industries and activities.

Economic policy in the sense that we're using the term should not be confused with socialistic planning. What we have in mind is not policy formulated in isolation by a group of omnipotent political authoritarians. Government economic planning in Japan is what is referred to as indicative planning. The government comes up with a program, which it proposes to industry. It's a program that for the most part has been formulated with the participation of industry, and it's essentially a guide to the direction in which the government thinks the economy ought to go, rather than a mandatory map telling companies and industries just what routes they have to follow.

Rapp: Basically, that's true, but perhaps we should also point out that the government does undertake more direct intervention. It does so through tax policies, and in some cases, as in the computer industry or the semiconductor industry, it has offered direct subsidies to develop certain kinds of technologies.

But this sort of thing takes place only in selected areas of the economy, usually either on the frontiers or on the declining side. And even in those areas where government bureaucrats are exercising more direct influence, companies still have the right to resist. And some do. There was considerable resistance in the automobile industry a while back, when the official policy was to get the companies to come together to form two or three internationally viable competitors. The government wanted Isuzu to merge with Nissan, continued
"What is at stake is a lot more than the trade balance. We're really talking about the viability of our economic system."

but Isuzu didn't want to be absorbed. Much to the chagrin of the Ministry of International Trade and Industry, Isuzu sold approximately 35 percent of its stock to General Motors, which was definitely not part of Japan's policy. So it's not a controlled situation.

Given: The key point here is that the policies have to be implemented through the regular democratic legislative procedure. They have to be reviewed by the Japanese parliament. They are subjected to review, discussion, criticism by the press, and by the public. It's simply not done by fiat.

I have another point I would like to make in this connection. It strikes me as very important for Americans to appreciate the difference that the relationship between government and business makes. We tend to think of interaction between government and business as being essentially an adversary relationship. And what makes the Japanese policy-formulation process fundamentally different from ours is that it is undertaken in a spirit of cooperation. The two sides, or all the sides, work together to arrive at a consensus.

Rapp: I don't think we should leave any implication that Japanese companies don't compete with each other. They are intensively competitive. And the dramatic reductions in yen prices in manufactured goods during the last twenty-five years give testimony to that kind of competition.

But what the Japanese recognize, I think, is that competition in the marketplace does not necessarily mean that you can't have cooperation elsewhere, whether working with the government or even with competitors.

Bowen: What happens to us if we don't rouse ourselves and respond to the Japanese challenge? What then?

Given: The Japanese have a greater sense of urgency than we have, but not a greater sense of urgency than we should have. We are in fairly serious trouble, and nothing that this Administration is either doing or apparently thinking about is going to get us out of it. The Administration's response to the Japanese challenge has been to allow a disastrous deterioration of the dollar, and to exert political pressure on the Japanese to export less and import more—all without regard to the root cause of the problem, the decline in our own industrial competitiveness. I don't believe we could stand four more years of such policies.

Whether we recognize it or not, we are approaching a situation where our economy is simply not going to be generating the resources we require to operate our democracy at a level that we'll find adequate. What is at stake is a lot more than the trade balance. We're really talking about the viability of our economic system. Our chronic trade deficit is merely symptomatic of a long and sustained decline in our relative productivity as a nation, and an erosion of our position in the world.

With current policies, we may be able to slow down the growth of the trade deficit, perhaps even achieve a temporary reduction in it. But without a restoration of American competitiveness, there is simply not a prayer that we won't continue running a very sizable trade deficit vis-a-vis our industrial trading partners. As this happens, and as we continue to try to compensate for it, the dollar will continue to deteriorate in value.

When we devalue our currency to enhance the trade picture, we also devalue all those other parts of the economy that we don't necessarily want to devalue or to export our skills, our facilities, our technology. We enable interests in countries with appreciating currencies to come into the American economy and purchase, let us say, scarce commodities, American talent, American skills, American companies, at prices that to them are continually declining.

This also makes it increasingly difficult for American business to invest abroad. It makes foreign skills and technologies and real estate and resources increasingly expensive to us. And this, in turn, reflects back into our inability to compete in international trade. All of this is going to mean greater and greater difficulty in funding the programs it takes to keep our democracy moving. And here I'm talking about the entire gamut of social welfare—Medicaid, Social Security, food programs, education, programs that are basic to the functioning of American democracy. It's also going to mean increased difficulty in funding our military programs. So overall, what we see happening here is a deterioration in the ability of our economic machinery to sustain our political and social machinery, and therefore in our ability to fulfill our national aspirations and achieve our objectives for ourselves.

Rapp: I agree with all that, but I want to say that even if there hadn't been a Japanese challenge, we would still be facing these problems. Even if Japan hadn't existed, I think it's fairly clear that companies in countries with more forward-looking policies, such as Germany, would have taken ad-

continued
“Without rapid increases in productivity, we’re going to fall further behind.”

The executives of major corporations drop our name... consistently when discussing the professional administration of their unemployment compensation program. Our tailored, integrated systems relieve their portion of complex and often confusing administrative duties and assure them of the lowest possible business expenses for unemployment compensation. We can do the same for you.

Gates, McDonald — a name worth knowing. Telephone or write now.

GATES, MCDONALD
ONE NATIONWIDE PLAZA
COLUMBUS, OHIO 43226
435-257-341
OFFICES IN MAJOR CITIES ACROSS THE COUNTRY

FORTUNE SUBSCRIBER SERVICE

PLACE LABEL HERE

Change of address? Please give us 4 weeks advance notice. Attach the label for your old address to the top of your new address below.

Ending a new subscription? Check the box for your new address below.

Gives us the proper time to correct your record. An incomplete subscription may be interrupted.

Listing your last name only on your mailing label. Attach the label for your last name only to the top of a new address below. We can remove your first name from the list, upon the appropriate request.

Please send FORTUNE for 1 year at $24
(1) New subscription or (2) Renewal. Payment enclosed. If blank, send address.
(3) Please enter my name on your mailing list.
(4) Please remove my name from your mailing list.

Name
Address
City State Zip

118 FORTUNE June 18, 1979

continued
to restore economic competitiveness. In that case, the Congress would have to have been influenced and elected by the same sorts of public vibrations, and should be responsive to the kind of policy initiatives that we've been talking about here.

My greatest fear would be that some politicians would simply use terms like productivity and investment as slogans, and believe that some sort of generalized recognition of the importance of productivity would solve the problem. We are not going to sloganize our way out of this mess. Adequate levels of productivity improvement and investment can be achieved only within an appropriate and carefully thought-out economic-policy context.

Bowen: What would an appropriate policy context, or policy framework, for the U.S. look like?

Rapp: A policy framework has to be linked to highly specific goals. The last time we had such an economic goal was when Kennedy set the 4 percent unemployment-rate goal in the early 1960's, and I think it could be argued that in those years we had much more direction to our policies—and had a much better program in terms of capital investment and all things that followed from that—than we have ever had since. That goal may or may not have been appropriate, but at least it was a number, something to shoot at. And the policies followed. I would argue that setting a goal like trying to achieve a 25 percent savings rate in the 1980's, or trying to get our rate of productivity gains up to 4 or even 5 percent, would in itself be a tremendous step forward. We also have to recognize that different industries have different economics, and begin to treat them differently in our policies.

Givens: As Bill Rapp says, we must have explicit policy objectives, expressed in quantitative terms, such as real-income levels and productivity growth—the kinds of things that measure our national economic strength in a positive way. Purely negative goals such as limiting inflation and unemployment and reducing our trade deficit are both psychologically and economically wrong. I believe it is incumbent on the President to articulate positive goals as a function of national leadership.

And we must have coherent programs, initiated by the Executive Branch and implemented by the Congress, to accomplish these objectives, through tax incentives and so forth. These programs, of course, have to be mutually reinforcing and consistent over time. And they must be based on an accurate understanding of the dynamics of international competition. If we are unable or unwilling to develop an effective economic policy to restore our competitiveness, we will become a second-rate power.

May 9, 1979

Through a wholly owned subsidiary

Dainippon Ink and Chemicals, Inc.

has acquired approximately 84% of the Common Stock of

Polychrome Corporation

The undersigned acted as financial advisor to Dainippon Ink and Chemicals, Inc. and as Dealer Manager of its tender offer.

Smith Barney, Harris Upham & Co.
Incorporated