Implications of Japanese Competition for U.S. Business

- The option of close relations of Japanese economic power with either Mainland China or the Soviet Union as an alternative to the U.S. relationship carries enormous cost and risk.

- The primary implication of Japanese competition for U.S. business is that we must devise appropriate strategies and competitive responses to their products and industries. They aren't going to change their successful game plan, so we must respond creatively if we are to compete successfully.

BY WILLIAM V. RAPP
Boston Consulting Group, Inc.

Close cooperative relations between Japan and the United States are essential to maintain a secure U.S. position in the world. On this relationship depends the security of the North Pacific, and a viable order in the 1970s in Southeast Asia.

Fast becoming an economic superpower, Japan is a key market for U.S. goods, and has been a dependable ally in maintaining the world monetary system. The option of close relations of this economic power with either Mainland China or the Soviet Union as an alternative to the U.S. relationship carries enormous cost and risk.

Over the past two decades, while Japan has moved from the status of client to that of associate of the United States, the relationship has remained close and cooperative. This has been so despite the inevitable strains associated with the shift in relative status. This has been true even though the two countries have rather little in common. Neither history, religion, culture, language nor race provide a basis for an identity of interests, in sharp contrast with such nations as West Germany or the United Kingdom. It fact, economic interest and their associate, military interests, have provided the real basis for the U.S.-Japanese alliance.

Yet relations now appear to be highly tense. This is more

(Continued on next page)
Japan Competition

[Continued from preceding page]

The Japanese Market for U. S. Products

($ million)

U. S. Exports to Japan 688 1,355 2,016 2,016 4,410
U. S. Trade Balance (with Japan) -251 +209 -359 -1,141 -1,242

NOT ALL BENEFIT

It is obvious, though, that not all U. S. firms and industries will benefit equally from the achievement of this goal. Eventual U. S. payments’ balance, if achieved, will be the result of changes in the relative competitive position of some but not all U. S. industries. Thus Japan will remain high- ly competitive in many important products as Germany did after its currency appreciations.

Trade by its nature follows an un- even pattern and changes in comparative advantage are constantly taking place in specific products and industries. If these changes in products or industries are not economically significant, such changes can be accommodated at a fixed exchange rate without upsetting the overall balance of trade. However, if the products or industries are economically important, such a loss in comparative advantage and subsequently in absolute advantage at a fixed exchange rate can result in seri-

ous balance of payments disequilib- rium, causing currency adjustments. Thus, steel, automobiles, and textiles cannot be regarded by the world economy as the type of business to be pursued in ballastings. At the same time, some industries and products are gaining comparative advantage. They can affect more than offset the losers depending on their economic size.

The trade balance, must be the result of an interaction of particular commodity flows affecting specific industries and states. The implications of Japanese competition for U. S. business therefore vary with each prod- uct or business. One may regard Japan as a large potential market, an important competitor, or both. Textiles, for instance, may be regarded Japanese competition somewhat differently than U. S. Steel.

MATTER OF CONCERN

For this reason, the Administration’s and the U. S. business’s interest is focused on revaluation as a solution to U. S. competitive disadvantages is a matter of concern. They expect too much from purely macro-economic policy variables balancing total eco- nomic systems. And they fail to ad- dress many real competitive problems in our industrial structure and govern- ment-business attitudes that affect individual firms and industries.

In addition, we have failed to ask ourselves critical questions concerning our ability to compete internationally. Particularly, we have not asked ourselves whether that which was obviously overvalued only a few years ago is now severely undervalued. And why it is very likely to become under- valued again in the near term even if revalued now. Or why automobiles that were overpriced and underpriced in 1958 are now heavily challenged by Detroit and will prob- ably continue to do so.

1. Are there any essential charac- teristics in terms of growth rate, indus- trial cost decline, or rate of innova- tion that will produce a continuing bias in Japan’s favor in its trade rela- tions with the U. S. and its relative competitiveness worldwide?
2. If we assume trade to be brought into equilibrium by either ex- change adjustments, tariff differentials or other variables, does the U. S. know which of its industries and ex- ports are the most competitive, and how does it compare in the world market access and which the least important?
3. If there is a continuing basis for trade friction between the two countries that is visible, these ques- tions need to be answered and acted upon.

LONG-TERM DEVELOPMENTS

In the same way that the U. S. balance of payments deficit hasn’t just vanished, the world monetary problem, neither is Japan’s rapid economic growth and increasing competitiveness over a wide range of products a recent or temporary pheno- menon. In addition, it is apparent that Japan has followed a more nor- mal development pattern, even if more successfully and more rapidly than other countries.

That is, in Japan initially produced and exported green tea, rice, tea, copper, and raw silk; primary prod- ucts just like LDC. Conversely, she was an importer of manufactured goods, capital, and technology; she is a typical LDC. As Japan has grown, she has begun producing for foreign use, and then exported, increasingly capital- intensive goods like steel, textiles, than steel, then machinery, and so on. At the same time, her im- port structure has shifted corre- spondingly with a greater proportion of imports being either raw materi- als and food or very sophisticated equipment and fabricated commodi- ties; a normal life cycle evolution with respect to the economy as a whole as well in each individual product.

This, in turn, implies change in industrial and economic structure and organi- zation. These changes in tum imply changes in comparative advantage. Rapid growth only accelerates the speed with which the process evolves. Thus, gives Japan’s historically rapid growth relative to the U. S. and Europe, and especially since World War II, is a process that has not been marked shifts in compara- tive advantage at the expense of the U. S. and Japan. So today’s Japa- nese exports — steel, autos, color TV, superairplanes, and cameras — bear little resemblance to the raw silts and cotton textiles of the prewar period.

Japan’s wage levels have ap- proached European levels, her com- petition is nowhere in sight, and future projections have naturally increased across a broad product spectrum while higher wages can only be justified by firm's scale. They have successfully acquired manufacturing technologies from the West and have been able to absorb them. Since Japanese investment levels are relatively high in manufacturing and consumer goods, Japanese employ- ment opportunities and wages will also continue their relative rise. Many U. S. firms can therefore expect increased or even greater competition from high-quality Japanese products.

LOSSING ADVANTAGE

On the other hand, increased em- phasis on capital and technologically intensive industries requires a con- siderable shift of U. S. light indus- try as well as agriculture. Japan’s textile and handicrafts indus- tries have been losing comparative and absolute advantage to countries like Korea, Taiwan, and Hong Kong. President Nixon has already recent economic moves as well as the revaluation of the yen can only ac- ceptively us. Even President Johnson, therefore, that Japan will increase her exports, but should consider that which Japanese products are also well and food, while putting continued em- phasis on upgrading her own employ- ment structure. Indeed, this pattern has been stressed as a specific object of government policy. Government policy makers under-
November 30, 1971

Concentration in U.S. Imports and Japanese Exports (1969-70)

<table>
<thead>
<tr>
<th>Year</th>
<th>Japan's Per Cent U.S. Imports</th>
<th>Per Cent Manufacturing Imports</th>
<th>Per Cent Textile Imports</th>
<th>Per Cent Clothing Imports</th>
<th>Per Cent Steel Imports</th>
<th>Per Cent Auto Imports</th>
<th>Per Cent Motorcycle Imports</th>
<th>Per Cent Consumer Electronic Imports</th>
<th>Per Cent of U.S. Exports To U.S.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>13.6%</td>
<td>14.7%</td>
<td>21.2</td>
<td>21.6</td>
<td>26.6</td>
<td>21.9</td>
<td>12.3</td>
<td>79.8</td>
<td>3.5</td>
</tr>
<tr>
<td>1970</td>
<td>13.6%</td>
<td>14.7%</td>
<td>21.2</td>
<td>21.6</td>
<td>26.6</td>
<td>21.9</td>
<td>12.3</td>
<td>79.8</td>
<td>3.5</td>
</tr>
</tbody>
</table>

**VERY LARGE MARKET**

On the other hand, Japan's investment and growth is generating a very large market with substantial consumer purchasing power. In real terms the Economic Planning Agency expects an 11.5% growth rate over the decade. Given a 4.5% inflation rate and a 10% upward yen realisation, this implies a $470 billion GNP by 1975 and per capita incomes of $3,800 as compared to a U. S. $1,790 GNP, given a nominal growth of 6.8%, of $1,950 trillion and per capita incomes of $6,050. Therefore, by 1975, due to higher Japanese investment levels and growth rates, per capita incomes will be about 65% of U. S. levels as compared with 55% in 1968.

This market will thus have a large demand for sophisticated capital and consumer goods as well as services on the one hand and for raw materials, food, and cheap manufactured goods on the other. Food imports will increase due to both balance of payments pressure and due to a decline to keep the cost of living down. Cheap manufactured imports will increase due to balance of payments pressure from the GATT and because JOCs are growing faster than Japan in producing these goods, thus gaining relative cost position.

Therefore, the competitive challenge offered U. S. firms is how to take advantage of this large and rapidly growing market and how to defend themselves against increased Japanese competitiveness in industries like textiles, steel, electronics, petrochemicals, etc. It is apparent that Japan is committed to a gradual hot firm course aimed at eliminating both their various special export incentives and protection from imports from foreign investment in most major industries.

In the mid-1970s, Japan could well be the least protectionist country in the world as far as the most competitive products are concerned. Excessive attention to issues of declining real importance can only make these businesses suffer the most. Competitive advantage, therefore, is reflected in Japan's leading position in the world. This is a problem which will be discussed in the following section. We're dealing with a number of Japanese businesses that have a low cost in the market, and we're looking at the impact of those businesses on the market. We're looking at the impact of those businesses on the market by way of the Japanese's low cost in the market. We're looking at the impact of those businesses on the market by way of the Japanese's low cost in the market. We're looking at the impact of those businesses on the market by way of the Japanese's low cost in the market. We're looking at the impact of those businesses on the market by way of the Japanese's low cost in the market. We're looking at the impact of those businesses on the market by way of the Japanese's low cost in the market. We're looking at the impact of those businesses on the market by way of the Japanese's low cost in the market.

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were far less profitable in terms of after-tax return on sales (5.6% compared to 8.1% for the U.S.) but provided a higher return to shareholders (19.7% compared to 11.6%).

Thus the generous use of debt by Japanese firms in effect ensures their growth rate from their profitability as long as they are able to cover debt service and dividend pay-out. This practice permits the continued flourishing of rapid growth even though sales are made at significantly lower margins. It is a competitive fact that Japan's business environment reduces the risk and makes tolerable for large companies a debt level that would in fact be unsustainable and intolerable risky in the U.S. environment. The fact that risks associated with high debt levels are reduced since the central bank stands implicitly guarantees of the debt position of major companies.

One consequence of this financial policy, however, is the great financial pressure on the Japanese company which results from the obligation to service its high debt level. High interest charges contribute to a generally high level of fixed costs compared with the U.S. company. When combined with the fixed nature of Japanese labor costs, employment being hired essentially for life, the proportion of fixed costs in total costs becomes quite high.

These fixed costs result in what might be called a "full-capacity policy." That is, since most costs are fixed, there is considerable incentive to operate at full capacity as long as the product can be sold at prices somewhat above variable costs—in fact, somewhat above raw material costs. Since break-even is high and cannot be significantly reduced in the short run, management is constantly pressed to lower prices as necessary to ensure continued full operation as long as these prices do not drop below variable costs. Taken together with Japan's financial practices, this "full-capacity policy" means the Japanese firm is able to price lower while maintaining required levels of return and a high growth rate, and has a powerful incentive to price lower in order to maintain full capacity.

PRICING IMPLICATIONS

These facts about Japanese companies must be seen in the context of very rapid economic growth. This is because it has been shown for a variety of products, total cost and thus prices in constant dollars (or yen) will decline with a characteristic amount each time accumulated production experience (total amount ever produced) doubles. This is true for both industries and individual companies and has been observed in many countries, including the U.S. and Japan.

For most products, the unit cost decline is about 25% to 50% for every doubling of accumulated experience. And with experience rapidly expanding markets have the incentive to invest in anticipation of demand in a national economic sense, this makes for a self-fulfilling prophecy—investment to anticipate of demand creates the economic conditions that bring about increased demand. For the individual company, however, it means that since capacity does not increase smoothly but rather

Competitive Comparison

Automobiles 1954-70 (65-70)

<table>
<thead>
<tr>
<th></th>
<th>U.S.</th>
<th>Japan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulation Rate p.a.</td>
<td>4.3</td>
<td>3.9</td>
</tr>
<tr>
<td>Real Industrial Growth</td>
<td>10.0</td>
<td>(7.5)</td>
</tr>
<tr>
<td>Annual Decline in Constant Dollars or yen (88% Experience Curve)</td>
<td>-8 (—7)</td>
<td>-7.9 (—6.8)</td>
</tr>
<tr>
<td>Inflation Rate</td>
<td>2.6 (4.1)</td>
<td>5.6 (4.3)</td>
</tr>
<tr>
<td>&quot;Permissible&quot; Growth Gap</td>
<td>1 (3.4)</td>
<td>.3 (3.0)</td>
</tr>
<tr>
<td>Annual Change in Cost in Current</td>
<td>1.8</td>
<td>.9 (—2.2)</td>
</tr>
<tr>
<td>Competition's Cost Advantage*</td>
<td>5.7</td>
<td>(5.6)</td>
</tr>
<tr>
<td>% Exceeding Fixed at Y360= $1.00.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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Comparison of automobile industry:

as compared to older, more mature products, since the new products have a much smaller experience base, and a higher growth in demand. The accumulated experience of these products can be doubled very rapidly and costs will fall accordingly. In more mature industries, the effect of inflation may obscure the constant dollar decline in cost.

To obtain an accurate picture of the experience effect one must factor out the effect of inflation by measuring the current dollar unit costs deflated by the GNP deflator against the accumulated volume produced. One can then estimate future dollar (yen) costs at various levels of experience by deflating constant cost projections by the expected rate of inflation.

It is this rapidly apparent that an individual firm's cost position within an industry depends on its growth relative to that of the entire industry or its market share. And conversely, an industry's ability to lower costs for a given amount of production will depend on the degree of concentration within the industry.

The implications of the cost-experience phenomenon for the individual Japanese firm are therefore that growth determines the ability of the firm to accumulate experience, and hence both domestic and foreign. Now Japanese firms have been 10 years of uninterrupted growth at rates virtually unprecedented in history. Further, their Government is committed to continued rapid growth, and their credibility is strongly reinforced by experience. Indeed, the Government's growth estimates have usually fallen short of realized rates.

STRONG CONFIDENCE

There is thus strong confidence that demand will increase rapidly. And with experience rapidly expanding markets have the incentive to invest in anticipation of demand in a national economic sense, this makes for a self-fulfilling prophecy—investment to anticipate of demand creates the economic conditions that bring about increased demand. For the individual company, however, it means that since capacity does not increase smoothly but rather

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expands in large periodic increments, there will be periods of temporary excess capacity. And it is evident that Japanese management is likely to be keenly aware of this excess, and will be vigilant in restricting capacity expansion. The result may be a period of reduced output and lower prices, with a consequent increase in demand and a return to full capacity utilization.

From the point of view of the Japanese company, precaution with investment and market share in the domestic market is entirely reasonable. At Japanese growth rates, failure to maintain market share will very quickly lead to a disastrous competitive position. Japanese industrial output has been growing in real terms at 13% to 14% per year. This means in the modern sector most industries are doubling in size every five years or less. Put another way, if a competitor enters a market without reducing the sales volume of other companies in the field, he will hold half the market in only five years.

Given the experience curve effect, the cost implications of this kind of market share loss are clear. The same phenomenon would of course occur in the United States, but since U.S. growth rates are generally much lower, management's appreciation of the effects of the market share loss is much less. In the Japanese context, however, the compressed time frame and rapid run-ups in demand make it appropriate for management to accept market share as a primary objective, even at the expense of short-term profitability. Some other special characteristics of the Japanese business environment reinforce this attention to market share. As Japanese industry swings away from labor-intensive toward capital-intensive industries, the effects of scale on cost are increasingly clear. Further growth and market share have a direct effect on labor costs. Since employees are hired directly from school for their entire careers, and since their pay is essentially a direct function of their age, the average labor cost for a Japanese company is directly related to the average age of its work force. A rapidly growing company is being brought large numbers of young people; as the average age of the work force drops, labor costs also drop. Conversely, a slow-growing company in Japan has as a work force aging steadily. Its labor costs are steadily rising. The payoff for growth is immediate and clear.

ALL COME TOGETHER

All of these factors then come together to create a business system in which rapid growth in demand stimulates rapid investment; rapid investment and thus maintained or increased market share translates directly into visible cost advantage; high-fixed costs ensure that the additional capacity will be fully utilized; and financial and competitive pressures are such that margins in excess of the financial requirements for growth pass into firms in high-growth businesses. Under these conditions, it is hardly surprising that price becomes the primary competitive weapon.

It is also evident that the Japanese firm is under considerable pressure to translate into immediate price reductions the cost improvements resulting from rapid growth. The common phenomenon in the U.S. of a "price umbrella" being held over the market by the leading producer for an extended period is unusual in Japan. The risk of loss of market share is too evident and too urgent. Thus Japanese prices tend to follow costs directly down the experience curve. This phenomenon, together with rapid growth, makes Japanese goods increasingly price competitive in world markets quite apart from other aspects of Japanese price behavior already noted.

WORLD COMPETITION

However, a Japanese firm's ability to lower costs after domestic demand has slowed as well as its ability to begin initial production depends (and has depended) on factors outside Japan as well. That is, most Japanese production has satisfied domestic demand for products produced elsewhere first, usually in the United States. U.S. firms have therefore already begun or gone through the industry's development phase and have a cost/experience advantage relative to Japanese firms.

Initial Japanese production is thus dependent on transportation cost differentials and/or Japanese Government protection (tariffs, quotas, and subsidies). Once Japanese firms begin production, however, their relative international competitiveness with respect to the U.S. or some other advanced country depends on Japan's ability to accumulate relative experience, i.e., to increase the world market share. More specifically, Japan's relative future cost and competitive position will be a function of:

- The initial production costs in Japan and the U.S.
- The rate at which the U.S. and Japan are accumulating experience.
- The amount by which costs decline for every doubling of accumulated experience (i.e., the slope of the experience curve).
- The relative inflation rates (i.e., differences in GNP deflators).
- Their exchange rates.

Given the value of each of these factors, one can determine the relative and changing cost positions of the two countries for a given industry. For example, if Japan accumulates experience at a rate of 1.5 times a year, it will double its accumulated experience in five years. If Japan's costs decline by 20% with every doubling of experience, a 1.5 accumulation

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ation rate will exactly offset a 4.6% rate of inflation.

Thus, Japanese industries with accumulation rates above 15% and/or cost declines of 20% or better for every doubling of experience will have lower costs in current dollars in the future than at present if the Japanese inflation rates are 4.6%. These industries will therefore be able to lower the actual price of their products in current dollars as well.

Since the cost of transferring a given technology decreases over time and since technological factors and industrial organization are roughly equivalent in Japan and the U. S. for the same industry at a given point in its evolution, initial production costs in Japan are lower than in the U. S. and slopes of their experience are similar. (Current costs, however, are normally higher in Japan.) Therefore the U. S. can maintain its long-term price competitiveness in a product if it has introduced only by some appropriate combination of a more rapid accumulation rate, lower inflation rate, or continuous deflation.

Assessing this situation for any particular U. S. industry involves calculating the "permissible" growth (accumulation) rate gap allowed by a foreign competitor's (higher) rate of inflation. It equals the inflation differential divided by the mathematical slope of the experience curve. Given current costs and prices, if your growth gap exceeds this "permissible" gap you are losing relative cost position. If it is smaller, you are improving. A smaller inflation rate differential and/or a steeper experience curve narrows the "permissible" growth gap for a particular industry. And since there are significant inter-industry slope differentials, a higher Japanese growth rate will have a different relative cost impact on different industries.

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in these industries. This process was in turn accelerated by the narrowing of the inflation differential between the U. S. and Japan in the late 1960s which dramatically narrowed the "permissible" growth gap for many mature U. S. industries, most notably automobiles.

Since U. S. and Japanese inflation rates are now roughly equivalent, the yen is no longer overvalued, and import liberalization will soon be complete, the U. S. is destined to a continuous need for deflation relative to the yen unless it can increase its growth rate in key industries. This is because a currency appreciation only raises a competitor's relative prices one time so that if comparative government and business policies do not change, there should be no change in the relative long-term growth rates, and relative annual cost changes should continue as before. Or, looking at the problem somewhat differently, deflation represents an expense investment by the U. S. in hoping world market share. Failure to support such a program by appropriate marketing and investment policies domestically and overseas will result in the failure of many U. S. firms and industries to permanently increase their accumulation rate and improve their relative cost position. Thus, another deflation via a via the yen (yuan) becomes inevitable.

HAS NOT MET CONDITIONS

Therefore, comparison of Japanese and U. S. industrial performance over time shows that the U. S. has not met the obsolescent necessity to maintain its competitive position in a wide range of industries. It has developed or in which it has been a successful follower. The logical result has been the international erosion of the product and industry life cycles described earlier. The key has been, of course, U. S. industry or firm's failure to capture increasing world demand (either because of international trade barriers or its own strategic errors).

It has thus last would market share to competitors in follower countries like Japan who began production and proceeded down their own experience curves with lower initial production costs than in the U.S.

The U. S. has even facilitated this
cross by licensing and patent agreements. To catch up, though, Japan must accumulate experience at a rate which is faster than the current U. S. accumulation rate for a sustained period.

After domestic development the successful Japanese follower will usually increase his export market share first in less developed countries, where there is no domestic competition, where demand is growing, and where the U. S. has no innate advantage.

These exports serve multiple competitive functions. They impair the ability of the U. S. to accumulate experience and lower costs relative to Japan. At the same time, they enhance Japan’s ability to accumulate additional experience and lower costs. Competitively, there is a double experience-cost effect. This can be very important if the Japanese domestic market is relatively small and therefore short-run; if the costs must be lowered further to stimulate additional demand. Further, these exports develop Japan’s overseas marketing experience.

PRODUCT OBSOLESCENCE

The repulsion of this "follows" process in other countries (LDOs) is limited only by the rate of product obsolescence, the minimum demand size for efficiency and the ability to enter the cycle by capturing the growth in world demand represented by their growth in domestic demand. This is generally possible due to protective domestic changes in U. S. and other LDOs. Inflation or an appreciating currency obviously accelerates decreases in competitive advantage for mature businesses, e.g., Japan’s textiles or handcraft industries. The product cycle thus reflects the diffusion of technology from one country to another, and the impact of competitive accumulations of experience in different economic environments.

Because this is an ongoing process, it is unreasonable to expect that a particular country such as the U. S. or Japan can continue do dominate any given industry forever. The Japanese seem to understand this process intuitively as indicated by their willingness to phase out and rationalize declining industries, such as cotton textiles or sewing machines, in favor of newer, higher-growth products. In fact, it is a high-growth industry which the Japanese have protected and continues to protect by means of controls on imports and foreign investment.

In this way, Japan consciously pursues a policy to constantly shift its economic and industrial emphasis from low-growth, less sophisticated products toward high-growth, more sophisticated products. This very rational policy has contributed substantially to Japan’s postwar economic success. On the other hand, U. S. policy—which, in direct contrast to Japan’s products low-growth, declining industries while leaving high-growth industries on their own—has been self-defeating in terms of resource allocation, growth, and meeting Japanese competition.

Yet, the migration of low-cost production sites from one country to another does not prevent particular firms or industries from maintaining competitive position worldwide or from protecting the sales, engineering, management, etc., personnel as well as upgrading factory workers to more sophisticated employment if they unbundle marketing and management functions from sourcing decisions. A sound international competitive strategy makes use of but does not try to oppose economic forces.

POLICY IMPLICATIONS

The above analysis has immediate and profound implications. It is of course not easy to discuss Japanese managerial behavior without running the risk of seeming to justify the Japanese approach. U. S. producers are in fact at some inherent competitive disadvantage. Japanese companies with costs similar to Western producers can price lower while being as profitable to their shareholders and financing faster growth—which in turn leads to lower costs, and under Japanese conditions this is promptly translated into lower prices in the export market. This advantage, unless adjusted for by a higher rate of inflation in Japan than in the United States, must in fairly short time be balanced by a change in the exchange rate. The alternative—that U. S. companies might adopt Japanese financial practices—is not available given government-business relations in the U. S.

This does not rule out however a more critical review by U. S. firms of their own export pricing policies. It would seem appropriate for example that roughly as many "dumping" charges should be brought against U. S. firms as are registered by U. S. firms against foreign competition. The current disproportion suggests that U. S. companies are not as aggressive as their foreign competitors in pricing to international markets. In addition, U. S. anti-trust policies—which have prevented various industries from combining into more competitive economic units better able to accumulate experience—have only exacerbated the unfavorable competitive situation.

The U. S. has also failed to respond with any integrated trade strategy, or basic understanding of the competitive process, and has instead continued to react on the basis of ad hoc political pressures. These pressures have naturally favored declining industries rather than growth industries, where we tend to be overconfident. Given this competitive challenge, the U. S. can only respond effectively by thinking its way through some necessary changes in its present business practices and government economic policies.

More specifically, the U. S. has tended to give away experience by investing overseas rather than exporting. This is a second-best solution to the problem of access to foreign markets from the point of view of U. S. costs and contribution to GNP. In some cases, overseas investment is indeed the only way to gain or maintain access to foreign markets, but in general U. S. firms simply prefer to invest overseas rather than export.

This is probably a logical preference: its large volume of exports to the contrary, the U. S. is not really structured for export. The U. S. export distribution system is fragmented and expensive, and there have been legal restrictions on the integration of firms which have served to reduce costs. In addition, U. S. anti-trust laws deter cooperation by U. S. firms in export marketing and in the creation of joint ventures.

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Japan Competition

(Continued from preceding page)
cooperative trading companies which would spread overseas marketing costs over several products. Further, the U. S. currently tends to think of competition only in domestic terms; it needs to extend its view to worldwide competition.

Such a change in outlook implies a reversal of traditional U. S. policy—protecting only declining industries, as is done now, to protect only those industries whose growth rate is faster than that of the GNP or of industry as a whole. The U. S. needs to be more conscious of the benefits to be derived from the huge U. S. domestic market, from U. S. R & D capability, and from high growth. The U. S. market is twice the size of Japan’s and will remain so, even if per capita purchasing power becomes the same. This means that the experience base and the potential cost advantages of the U. S. will always be greater than Japan’s if it equivalent industry concentration exists in the two countries. By protecting this base, the U. S. should be able to remain competitive if it exports effectively, capturing world market growth. Conversely, it is essential for Japan to have access to this huge U. S. market if she is to maintain cost advantage and continue to grow after her own market becomes saturated. Her alternative overseas markets are limited, at least in the near future. These markets are growing fast but they cannot provide the quantitative amount of growth required to add to Japan’s increasingly larger experience base at a rate which will continue to lower costs significantly. However, effective penetration of the U. S. market, the largest and most developed in the world, can provide significant additions to Japan’s experience base.

One must therefore conclude that a rational negotiating posture for the United States would be to force Japan to pay for access to certain U. S. markets with access to certain of her own markets (e.g., access to U. S. auto market in exchange for access to Japanese computer market). Such a program would play on the weak points in the evolution of Japanese industry or firm’s competitive development: initial production, initial export development and initial penetration of the U. S. market. The primary implication of Japanese competition for U. S. business is that we must devise appropriate strategies and competitive responses to their products and industries. They aren’t going to change their successful game plan so we must respond creatively if we are to compete successfully.

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The Bond Buyer

JAPANESE PASSENGER CAR PRODUCTION PRICE-EXPERIENCE EFFECT 1954-70
(1958 prices)

<table>
<thead>
<tr>
<th>Year</th>
<th>Accumulated Experience</th>
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<tbody>
<tr>
<td>1954</td>
<td>100,000</td>
</tr>
<tr>
<td>1955</td>
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<td>1956</td>
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<tr>
<td>1963</td>
<td>1,000,000</td>
</tr>
</tbody>
</table>

Institution Investor

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normally operates on his own and in competition with the others. In addition, each makes 90%-and-banked markets both to the public and to one another. An investor wanting to buy or sell will normally check two or three dealers to get the best price. Variation in price, like spread between bid and asked widest, may run from 1/4 as much as 1/4 point on actively traded issues. The Treasury market system, though less accommodating to the individual investor, has two advantages over the specialist system. First, it uses the natural force of competition to keep everyone honest and spreads between bids and offers narrower; and second, there are 20 market opinions rather than one. In addition to some variety of opinion about whether prices will rise or fall, there is constant interest rate and historical price spread arbitrage to buying and selling a motivation other than bulletli-ness and bearishness.

The human engineering principle of replacing regulated monopoly with