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Japan Society
NEWSLETTER

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Highlights: Visions and Books

Holiday Books
In addition to special offers for members on exhibition catalogues from the Gallery, the Society library has compiled a selection of 89 Japan-related books for members to order at discount during the holiday season. The Holiday Book List was sent to members with last month's Newsletter. The books from various publishers cover such subjects as Japanese art, architecture, cooking, business, economics, religion and literature. Please note that only those orders received before January 31, 1981 will be eligible for the discount; after that date the books will be sold at list price.

Study Guide and Educational Filmstrips Available
An educational study-guide on Shogun, James Clavell's novel and the television dramatization broadcast by NBC this past fall, is available to members.

Edited by Professor Henry Smith and published by the University of California at Santa Barbara, Learning from Shogun: Japanese History and Western Fantasy is a collection of essays by noted American specialists of Japanese history, religion, literature, society and arts on James Clavell's treatment of various aspects of 17th-century Japanese history. This book is a useful guide for serious students of Japan. The 150-page softcover volume is available from the Japan Society for $4.00 per copy. New York residents should add 8 percent sales tax.

Over its almost 75-year history, the Japan Society has endeavored to introduce Japan to Americans through its programs and publications and by informing members of similar efforts by other organizations and institutions. Thus, on December 9 the Society was pleased to welcome Professor Edwin O. Reischauer and to present two of eight filmstrips which he wrote for Mass Communications Inc. and Harvard University Press. These, entitled Introduction to Japan, will be a valuable resource to schools and other educational institutions teaching about Japan. Further information on these filmstrips is available from Harvard University Press.

Modern dancer Manuel Aban performed his new work, Made in Japan, last month.
The Decade Ahead: Japan's Economy in the 1980s

William F. Rapp

Last spring I taught a seminar on Japan's economy in the 1980s at Columbia's East Asian Institute. We examined visions of Japan's probable economic evolution in the decade ahead, focusing on the issues of likely importance. We had by then analyzed the economy over the past ten years, assessing to what extent its development represented a change or continuation of previous postwar trends. We then compared this assessment of events with visions for the 1970s written by men like Herman Kahn, Hugh Patrick, Zbigniew Brzezinski, Peter Drucker, Robert Guillain and Henry Rosovsky. The idea was to see where most forecasts had erred or had been on target.

The Optimists and the Pessimists

These comparisons were enlightening. Most analysts had not anticipated slower Japanese growth due to economic forces. Those predicting slower growth had emphasized external political constraints and internal social problems. These pessimists stressed the fragility of the business, political, and social structure and the likely difficulties in handling slower growth. They felt that political pressure would prevent Japan's bicycle economy from increasing its markets abroad at historic rates and that it would then fall badly from lack of momentum.

In turn, Labor, accustomed to constantly rising real living standards and expanding employment opportunities, would become more militant. Thus, highly leveraged Japanese companies would be doubly hit. Militant workers would demand pay raises exceeding productivity while declining cash flows and market growth would make high debt levels difficult to service.

These adverse business developments would interact with the Liberal Democratic Party's declining political power.

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Japanese exports improved their world market position. The potential inflationary spiral was controlled. The LDP retained and stabilized its dominant political position. Thus, the optimists were right about Japanese institutional and economic strength, though wrong about prospective growth rates.

Indeed, Japan's institutions proved to be strong, stable and resilient in terms of crisis management; stronger than the pessimists or perhaps even the optimists had imagined. Japan successfully handled two oil shocks, potential hyperinflation, a major recession and worldwide political uncertainty. Stable institutions thus provided a base upon which economic factors could operate more easily, although one must recognize that economic conditions such as a high savings rate and competitive modern plant and equipment also supported institutional stability. Japan turned out to be more of an "iron chrysanthemum" than a "fragile blossom."

The Economic Continuum

Nevertheless, both forecasting groups did feel the main factors directing Japan's economic and business development in the 1970s would be cultural, business, financial and political institutions. But in fact, the major forces shaping the economy emerged from its natural economic evolution in conjunction with external political and economic events. What the class discovered was that most forecasters had over-emphasized institutional factors, perhaps reflecting an assumption that Japan's economic success was heavily dependent on cultural uniqueness. Therefore, in anticipating future economic developments, they primarily focused on potential cultural or institutional changes, particularly any weaknesses. In this way, though, they missed the importance of some basic economic and competitive factors, those conditions which though supported by and interacting with Japanese institutions are not culturally bound. These operated in the 1970s as they had in earlier periods.

For example, high savings and investment, concentration on global market share and product cycle strategies work successfully in any environment and have for foreign competitors emerging from different institutional frameworks. Indeed, given Japan's cultural stability, such economic and competitive fundamentals have been largely responsible for Japan's postwar economic evolution and will generally determine the economy's course for the 1980s as long as they operate. Yet it is also true that the impact of these and related factors in a changed global environment had been somewhat different than during the high growth era of the 1950s and 1960s.

In approaching the outlook for the 1980s, we therefore first assumed that short of a major world conflagration,
Japan’s “voodoo” economics, which represents nothing more than the effects of high savings and investment leading to a higher compounding real growth rate, will also enable it to increase real defense expenditures while improving social welfare.

Impacting everyone, Japan would continue to competently manage its social problems and institutional development. Second, we looked at the economy in the 1980s as part of a continuum emerging from Japan’s development in the 1950s through the 1970s.

What was the nature of this continuity? At the end of the 1960s, Japan’s economy was booming. Earlier economic development policies were coming to full fruition. Investment levels were high; exports and the balance of payments surplus were growing, real growth was double digit, wholesale price inflation was minimal and so on. The only direction to go seemed up. Yet by 1974, this was changed. Many would blame the oil shock, but this only exacerbated a situation already brought about by the economy’s successful evolution.

In the 1950s and 1960s, Japan’s economy had been built on high rates of investment in capital-intensive business like steel, shipbuilding, chemicals and autos. These investments were supported by a high real rate of savings, leading to rapid increases in productivity and improved cost-price competitiveness. Increased competitiveness translated into expanding markets and market share at home domestically and later overseas once domestic markets matured. This led to more investment demand. All in all, a non-inflationary beneficial growth cycle.

The Negative Impact
But there was a limit to how much lower prices could expand markets and to what extent foreign governments would tolerate rapidly rising Japanese imports. In the LDCs (less developed countries) and NICs (newly industrializing countries), their own development plans called for expanded steel, auto, ship and chemical production. In the advanced countries, mature, highly unionized industries strongly resisted restructuring and declining employment. Further, Japan was expanding faster in real terms than the world as a whole. Thus, potential markets did not keep up with its capacity expansions.

By 1973, it was apparent that many basic industries fueling Japan’s postwar growth were maturing. Further, large capacity expansions became unwarranted. Since machinery and equipment investment demand in 1973 was 19 percent of GNP and itself had supported accelerated postwar growth in total demand and GNP, reduced investment plans in major capital intensive industries had a dramatic negative impact on economic growth. Yen appreciation between 1971 and 1973 also made its contribution, as did continued high savings rates. A rising yen stabilized Japan’s export volume, reducing potential real market demand and capacity requirements. Rising dollar prices in turn increased the balance of payments surplus, leading to more yen appreciation. The high savings rates which had supported high non-inflationary investment rates were of course deflationary given falling desired investment, also adversely affecting planned investment.

The rapid rise in oil prices and the global transfer of income to OPEC only exacerbated the problem. Adverse trade balances caused rethrenchment in Japan’s overseas markets and greater resistance to more politically sensitive Japanese imports affecting large unionized industries. Particularly hard hit was the demand for tankers and Japanese steel. Nor was this situation eventually offset between 1974 and 1977 by the effect of higher oil prices on Japan’s trade balance and, in turn, yen depreciation. Investment requirements have just not kept up with the country’s ability to generate savings.

Developing Knowledge-intensive Industries
In this context, the government, especially MITI (Ministry of International Trade and Industry), began to rethink the economic structure. The objective was to reduce energy dependence on oil while improving living standards in terms of the quality of life, income levels and employment opportunities. The result was MITI and the Industrial Structure Council’s vision for the 1970s, emphasizing the development of knowledge-intensive industries like computers, management consulting, fashion, medical equipment and financial services, while phasing out not only labor-intensive production like textiles but capital-intensive industries like steel and shipbuilding too. Such a structure logically emerged from Japan’s natural inter-industry progress from simple labor-intensive industries like textiles to more capital-intensive industries like steel to more skill- and technology-intensive products like computers.

These cleaner industries would improve the quality of life by providing more interesting, higher paying jobs for the better educated labor force while reducing pollution, to which people were increasingly opposed. It would also reduce pressures from the LDCs, the NICs, and other industrial countries against expanded exports of steel, ships, autos and the like. In sum, a seemingly ideal solution to Japan’s domestic and foreign political-economic difficulties.

In fact, there were some problems: First, these new industries were not capital-intensive, so that excess savings continued to depress demand despite massive government deficits. Second, major steel, heavy machinery, chemical and auto companies with significant political clout were not about to be “phased out.” Therefore, Keidanren (Federation of Economic Organizations) soon produced its contra-vision, emphasizing intra-industry development. In this scenario, Japan’s base industries would continue to evolve competitively by constantly modernizing and upgrading their domestic facilities, by producing more sophisticated products, and by supplying equipment, engineering and management services abroad. Thus, they would still invest domestically, though employment and GNP contribution would decline as productivity improved with little net capacity expansion. New capacity would take place abroad instead with such foreign investment providing a market for their services and equipment.

In this way, Japanese firms would manage the competitive evolution of the product cycle, would retain the high value-added skill-intensive employment in Japan and would reduce energy requirements. A consensus between these views was reached by 1978-79. MITI en-
sentially adopted Keidanren’s position as they realized knowledge-intensive industries like computers and semiconductors required a demand base to become internationally competitive. This demand would be created by major industries’ need to modernize domestically and to invest in new plant and equipment abroad. They finally realized too the need to balance intra-industry and inter-industry development and to improve overall investment levels.

Looking to the 1980s

Given this consensus and emerging congruence in government-business strategies, what are Japan’s likely economic expectations for the 1980s and what are the implications for the U.S.?

1. Japan’s vulnerability to trade-related shocks should decline. Essentially, Japanese firms add value to imported fuel and raw materials. Since base prices for these are usually internationally determined, constantly improving productivity in value added should keep Japan competitive. As Japan turns more and more toward high technology equipment and services supported by investment and government aid, Japan’s trade conflicts should decline. Export surpluses should also ameliorate as foreign investment substitutes for exports and as investment related imports rise.

2. In addition, Japan’s energy vulnerability should decrease as alternative sources like coal and nuclear energy are developed and as industrial growth becomes less energy-intensive. In effect, Japan can pay for higher oil prices and substitute capital for oil by transforming its industry and energy use.

3. Capital needs should be high for new, growing industries, increasing it and its modernizing base industries, overseas investment, foreign aid, oil substitution, energy conservation and social overhead. This should eat up excess savings and reduce the need for government deficits. Indeed, the government may have to impose a value-added tax to reduce its deficit and further encourage savings.

4. Higher investment rates and annual productivity increases, now running 9 percent per annum, supported by greater capital formation should maintain real growth at 5 percent or better. This should exceed those for other industrial countries like the U.S. by 2 percent per annum. Over a generation, this means a 50 percent greater increase in real GNP. Such higher real growth not only facilitates the change desired but implies reduced social friction as greater real resources are available to meet all international and domestic objectives, including improved competitive position, rising real incomes and more social services. In fact, Japan’s “voodoo” economics, which represents nothing more than the effects of high savings and investment leading to a higher compounding real growth rate, will also enable it to increase real defense expenditures while improving social welfare.

5. An aging and better-educated labor force should not be a problem since less young people proportionately will be entering the labor force, and most workers will be extending their retirement age. In addition, because many retiring older workers will be in agriculture, there should be significant easing in subsidies and greater willingness to increase food imports. This will decrease both living costs and trade frictions.

In sum, Japan’s new industrial strategy and probable economic evolution should not only meet its domestic and international goals but should improve its institutions’ ability to handle whatever problems and uncertainties arise.

Potential for Conflict

U.S.-Japanese economic relations and corporate competition will, of course, confront some problems. The following are potential areas of conflict:

1. World competition and Japan’s liberalization in high technology manufacturing industries like computers, semiconductors, telecommunications and aerospace will be important issues. Japan will try to build on its existing strength in plant and equipment sales, consumer electronics, automobiles, etc., as demand segments for distributed processing and microprocessors.

2. Also confronting policy makers will be future competition and the need for significant Japanese liberalization in high technology and/or knowledge-intensive service industries like software systems, management services and systems, banking or insurance. The issue of national treatment will probably be central here.

3. A particularly difficult policy problem will be U.S. market competition with exports from Japanese investments in third countries like Brazil, Mexico, Korea and Taiwan.

4. There also will be competition in mature industries from new, highly productive Japanese plants in the United States, because U.S. businesses in many cases have inefficient capacity (e.g., autos, TVS, ball bearings).

5. There will be greater competition for global resources including energy. However, there is an opportunity to use Japanese capital to develop alternative energy resources in the United States for the economic, political and security benefit of both countries.

Whether economic tensions between the two countries on balance will become more intense or will moderate largely depends on U.S. policies and actions in solving its domestic economic problems. Particularly critical will be increasing America’s savings and investment rate to around 25 percent of GNP. This is what will probably be required to be competitive. Japan’s game plan and economic direction for the 1980s are largely decided. Its economic forces and policy consensus are now in motion. The U.S. response is what is unknown. Therefore, the eventual competitive dynamics of the relationship in the 1980s and into the 1990s are still obscure. The final outcome will be up to us.