Strength through Competition

Americans claim that Japan remains reclusive in many ways, and that business's propensity to favor old friendships over new impedes market entry. For their part, Japanese suggest that it is time America stopped carping about every setback and made a greater effort to meet the Japanese consumers' exacting standards. Both Japanese and Americans need to adopt a world view more attuned to developments beyond their shores.

Dr. Stephen D. Cohen is a professor at the American University School of International Service and an international economic consultant. From 1969 to 1973 he served as chief economist of the U.S.-Japan Trade Council. In the dialogue below, Cohen and Japan Economic Foundation President Naohiro Amaya talk over differences of opinion on two-way trade and discover some common ground.

Stephen D. Cohen

Naohiro Amaya

Amaya: From what I have read and heard, we seem to agree both that the Japan-U.S. trade conflict is likely to intensify and that the yen will tend to get stronger rather than weaker. Where we differ is in what we see as the reasons for these developments.

Cohen: Whatever the reasons, the statistics on Japanese imports of manufactured goods show a pattern that I do not see for any other country, certainly not any other industrial country. Exporters everywhere have a very difficult time increasing sales to Japan—making a product, putting it in a box and exporting it to Japan.

That doesn't mean that no one can sell in Japan. There are a lot of success stories. But it seems unusually difficult to make a product, send it over here and sell it here.

Amaya: Many foreigners feel that there is some invisible limit on imports to Japan or that the Japanese people are prejudiced against imports. I don't think this is true, but I do grant that imports have not grown as fast as exports have.

Cohen: I applaud Japan's export success. Unfortunately, you can't keep on exporting more and more unless you also increase your imports. Until the Japanese are convinced that imports are of reasonable quality, that there will be after-sales servicing, that it is not unpatriotic to buy imports and that stable business relations can be built with foreign suppliers, we will only see what is a very unfortunate second-best trend—a slower Japanese export growth.

Trade has to be a two-way street.

Amaya: You're right that limiting our imports is going to limit our exports. Trade has to be a two-way street, and it isn't enough to insist that the market is open and that foreign firms just aren't working hard enough. We have to analyze why foreigners think it's so difficult to sell to the Japanese.

Cohen: There are, I realize, some Japanese who sincerely believe that the Japanese market is the most open in the world and that exports would pour in if only foreigners tried a little harder. I don't believe it. The West is not totally decadent or totally unable to make quality products. Nor are the Southeast Asian NICs second-rate exporters. They are very good exporters, and they share most of the American frustrations. The Japanese will buy a new product, but there's a very good likelihood that, within a few years, Japanese industry will move in and start to make basically the same thing. Time after time, companies who have established successful markets here find themselves losing market to Japanese Johnny-come-latelies.

Just because some government regulations have been relaxed and some foreign companies have been successful here does not make Japan an open market. Nor does the fact that some foreign goods sell here make Japan an open market. In a legal sense it's probably open, but not in a commercial or social sense.

Amaya: The relationship between buyer and seller in Japan is substantially different from that in the United States or other countries. Buyer and seller are on an equal footing in the United States, but the buyer generally has the upper hand in Japan, enabling him to set stiff quality, delivery and other requirements. Japanese demand much higher standards of quality and after-sales service.

It is very difficult for Americans who are unfamiliar with Japanese commercial practices to understand this. Japanese are quite comfortable doing business with each other because both sides are used to the same commercial practices. Of course, they are not insensitive to price differentials, but the non-price element is more important in Japan than it is in the United States.

Cohen: For better or worse, if somebody comes to the United States with a cheaper product, people will generally buy it—even if people lose jobs, companies go out of business, and entire industries disappear as a result. I don't believe that Japan is willing to sacrifice entire industries because of comparative advantage. Nor do I believe that Japan has a comparative advantage in everything. Some Japanese give the impression that Japan can make everything better and cheaper. If that is the case, then the law of comparative advantage has expired and someone had better come up with a new theory of international trade.

Amaya: It took about 100 years for the Japanese to achieve an export surplus with the United States. We started trading in the 19th century, and it wasn't until 1965 that we had our first surplus with the United States. For 100 years, when the Japanese wanted to sell to America, they went to New York; and when they wanted to buy from America, again they went to New York. The American businessman could sit in his New York office and wait for people to come to him. Even today, many American businessmen still seem to be waiting for Japan to come to them.

Cohen: Even longer than the 100 years it took Japan to develop a trade surplus is the 2,000 years Japan spent developing in relative isolation. Now Japan is confronting one of the great international trends of history—international economic interdependence. This international economic interdependence is clashing with the social cohesion built up over 2,000 years of relative isolation. It is disrupting the very comfortable relations the Japanese enjoy with one another and challenging a system where maintaining old business relations is more important than forging new ties with the unknown.

Amaya: Relations among people tend to be more tightly knit in Japan than in most other countries. Societies are like water. American fish swim in clear waters, but Japanese waters are heavier, more viscous, because of our history and culture, and it's not so easy for us to change.

Cohen: There's nothing wrong with Japan's export success. What bothers me is Japan's import failure. Germany exports as much, if not more, manufactured goods as Japan. Yet we don't hear the kinds of things said about Germany that we do about Japan.

Why? Not because of exports, but because of the very genuine perception that the Japanese do not reciprocate and that the Japanese have greater access to foreign markets than foreigners have to Japanese markets. If you continue to insist on manufacturing virtually everything here in Japan, it will be at a cost to yourselves and your export customers.

Amaya: Many responsible Japanese know how important it is for us to increase our imports and reduce our trade surplus. We know we must change our practices and values. But at the same time, other people, including Americans, should be studying Japanese psychology, business practices and markets more seriously.

Cohen: Yet there are people in Japanese business and government who remain reluctant to change what has so far been a successful formula. Certain Japanese government ministries like to suggest that the government has lost its influence with Japanese industry, but there is still communication back and forth between government and business.

Amaya: Of course, there are many Japanese and thus many different attitudes regarding exports and imports. Yet a growing number of Japanese realize that it is not necessarily a good thing to be too successful. In my opinion, the export success that we worked so hard for for 100 years is now beginning to turn into failure.

The Maekawa Report (formally the Report of the Advisory Group on Economic Structural Adjustment for International Harmony) is evidence of how Japanese thinking is changing. People realize that we have to change if we want to have good relations with the rest of the international community. Thus this report suggested that we should reduce our excessive dependence on exports and shift the emphasis to domestic demand—items such as housing, sewage, roads, schools and other infrastructure improvements. We have to restructure the Japanese economy away from foreign demand to domestic demand. The problem is that Japanese politicians, like American politicians, have constituencies with vested interests that object to changing the economic or industrial structure. Change is painful for many people, and these people pressure the politicians for protection. So politicians of all stripes—LDP (Liberal-Democratic Party), Socialist or Communist—are quite reluctant to get out in front in pushing for implementation of the Maekawa Report's recommendations. In Japan, just like anywhere else, it takes time to change the industrial structure.

Cohen: I worry that Japanese and German economic authorities will be too slow to respond to what I see as a growing need to stimulate their economies. By my calculations, the real interest rate in Japan right now is about 15%. That gives Japan one of the most restrictive monetary policies in the world today. If the Japanese economy isn't stimulated, we will simply see more of what you've already seen: deflation, yen appreciation, slower growth and slower imports in a kind of a vicious cycle.

Amaya: To a certain extent, the misalignment of the dollar-yen exchange rate that has been at the crux of the trade fricion between our two countries has been substantially improved. This should help us restructure, stimulate domestic demand and expand our imports.

The stronger yen is good for the Japanese economy—even though excessive volatility is disruptive—but there is no guarantee that the yen will stay strong against the dollar. Capital transactions are a very important element in this, and there is no guarantee that yen will continue to flow to the United States.

Cohen: Even with the strong yen, I suspect the decline in Japan's exports is going to be very gradual. There are many products where Japan is the only real source, and I think many Japanese companies will be able to maintain sales volume despite the yen's appreciation. Thus the yen is likely to continue to appreciate until more and more Japanese goods are priced out of the market. In the short run people will look at the bilateral balance and ask why nothing's happening. In the medium to long term, we'll begin to see some adjustment.

Yet slower exports are no substitute for faster imports. Even if Japan's exports are priced out of the market, I think we will see what I call the semiconductor syndrome continuing. No matter what happens to Japanese exports, multinational corporations believe that they have to be successful in selling to the Japanese markets.

Slower exports are no substitute for faster imports.

Amaya: The Japanese mindset is changing. It is changing slowly, but we cannot be isolated from the outside world forever. The yen's sharp appreciation might hurt some Japanese exporters, but they will adjust or switch to other sectors. Time will solve, or at least alleviate, the issue. It's just that I don't know how long it will take, or whether America will be patient enough to see this process through.

Cohen: One of the healthiest trends in recent years has been that Japanese competition has put the fear of God into most American companies and made them realize that there is some very good competition out there in the world market and that there are markets beyond American borders. Not too long ago, most American businesspeople and economists thought that reality ended at the water's edge. Now, more and more, the U.S. business community is taking a world view. They appreciate the kind of competition that is out there, and this is contributing to the pressure for access. I don't see how any major industrial company can grow and succeed internationally if it can't challenge the Japanese competition in its home market. Businessmen ignore the Japanese market at their own risk, and I'm not sure how long a company that allows its Japanese competition to operate from a protected home market will be in business.

Amaya: When someone like [Chrysler Chairman Lee] Iacocca, for example, criticizes Japanese policy and Japanese trade practices, he is being very nationalistic; yet he is very much the internationalist in planning investment and production.

Japanese manufacturing companies are much more timid about investing overseas. It's easy for an American company in Singapore, Hong Kong, Thailand, Korea or anywhere else to find English-speaking personnel, and this makes it easy for the American company to recruit locally. But it's very difficult for a Japanese company to find people who can speak Japanese and understand Japanese culture. So Japanese companies tend to be less multinational. Japanese companies are still hemmed in by national borders, and the result is an increasing trade gap between our two countries.

National borders don't exist for the American multinationals. They invest wherever it's profitable, and this is leading to the deindustrialization of America, which in turn contributes to your snowballing trade deficits.

There is an inconsistency between what the American government says and what the American multinationals do, and this is one of the reasons the American economy is having so much trouble. Indeed, I wonder if it's possible for America to correct its balance of payments deficit and American multinationals to maximize profits at the same time.

Cohen: This is a very complicated issue. The statistics are not clear enough to allow anybody to give an absolute answer. You can't say unequivocally that foreign direct investment does this or that to the national economy.

The U.S. government position is very simple. American multinationals and foreign multinationals should make their own decisions on where they manufacture and on intra-corporate transactions. The U.S. government says that we should avoid market distortions, let the marketplace work and let American and foreign companies decide where they produce.

I don't know exactly how the multinationals' search for profits affects the United States. It would be interesting to see detailed breakdowns on the exports of American parent corporations to their overseas subsidiaries and then match those figures against imports from overseas subsidiaries. The Commerce Department has tried to do surveys like this, but I don't think there is any clear statistical evidence that multinational corporations import much more than they export.

Yet there is a very good possibility that one of the reasons American companies have trouble exporting to Japan is the relative lack of direct investment here. I'm not saying Japan should welcome foreign companies with open arms. Yet if there were more American investment here, these subsidiaries would probably be very good customers for exports from their American parent companies.

Europe is a good example. Before the dollar became overvalued, the United States ran a consistent surplus with western Europe for many years. Personally, I have seen very few American-made products on the European market. Yet if you look at the trade figures, the U.S. is exporting much more than soy beans and corn to western Europe.

It is possible that many of our manufactured exports to western Europe are components and parts going from American parent companies to their subsidiaries in western Europe. But I can't prove this one way or the other because the statistical evidence is ambiguous.

There was a big push to outsource, to move to low-cost labor countries, during the early 1980s because of the exchange rate misalignment. Hopefully this trend is diminishing now with the exchange rate reversal. As exchange rates make it easier to survive in the world marketplace, American companies are likely to decide that it is no longer critical to invest overseas.

We don't welcome U.S. deindustrialization.

Amaya: Much depends on how you measure industrialization. If you use the ratio of manufacturing to GNP, you cannot prove deindustrialization. But if you use the U.S. share of the world market for manufactured goods, you will see a decline that may indicate deindustrialization.

Cohen: The deindustrialization concept is very interesting, but it can't be proven by any statistical means. If you look at manufacturing as a percentage of U.S. GNP, it is about the same today as it was 25 years ago. Almost all of the new jobs are in the services sector because productivity has allowed U.S. industry to grow with fewer workers. If you want to call that deindustrialization, feel free. But the statistics are simply not there to prove that manufacturing is declining as a percentage of GNP.

The U.S. comparative advantage is clearly moving to services, but I don't think Americans, or Japanese, should worry too much about the so-called hollow corporation that is headquartered in the U.S. but does its manufacturing overseas. It's really a case-by-case thing depending on industry and company.

I would suggest taking a look at the statistics a year or two after the exchange rate correction. U.S. market share in manufactured goods declined in 1983, 1984 and maybe even 1985, but I think that will correct itself to some extent with exchange rate realignment. There has been no clear decline in the U.S. market share in manufactured goods over the past 20 years except in those years when the exchange rate was clearly out of touch with commercial reality. If U.S. market share doesn't improve in a year or two, then we can start talking about deindustrialization.

I feel American industry is coming out of these problem years a little stronger than some people think. There are some Japanese who think the United States is going the way of England and self-destructing, but I don't believe it. Instead, I suspect American industry is just a little smarter and a little stronger than some Japanese give it credit for being.

Amaya: I hope you're right. We don't welcome U.S. deindustrialization, far from it. We want to see a healthy American economy as the cornerstone of a stable world economy. ●

The American Center invited Dr. Cohen to Japan and was responsible for making this dialogue possible.