Better Economic Relations Toward The New Century (The fourth of four parts):

Future Economic Interaction between Japan and the U.S.

By Tsutsumi Tomio

Changing places

The changes that have taken place in the economic situations of Japan and the United States in the past decade are truly amazing. In the 1980s, there were many jokes about arrogant Japanese businessmen, but now they have completely vanished.

On the other hand, there was a interesting article recently on how a few of the European G-7 leaders refused to wear American cowboy-style clothing at the Denver Summit, presumably because they had got tired of hearing all the success stories about the U.S. economy.

Certainly, the U.S. economy has continued to show an unprecedentedly strong performance over a long period of time. The first objective of this article is to analyze why the U.S. economy has improved so remarkably and, based on this analysis, to consider the strategies Japan will need to pursue in order to extricate itself from its present economic problems and establish a vigorous economy for the next century.

The second objective is to put forward a somewhat unique but important viewpoint.

Usually, trade friction is considered to have a negative influence on the economies of the countries concerned. But nowadays, every time I see U.S.-made cars, I think they have certainly gotten better in terms of quality and fuel-efficiency. Would it be completely wrong if I stated that this is as a result of Japan-U.S. trade friction? In any case, free international competition often has negative impacts on the domestic economy and sometimes leads to trade friction which seems to be painful or a problem in the short run, but may eventually lead to an improved economic situation unless the friction is not managed carefully.

Three common problems

It is my opinion that in this decade, industrialized countries like Japan and the U.S. have been facing problems that closely resemble one another.

Further, their recent economic performance strongly depends on how well or poorly each has coped with these problems, which comprise the following three matters.

(1) First, there is the issue of "mega-competition" riding on the momentum of ongoing economic globalization.

The issue of mega-competition essentially relates to the phenomenon wherein countries with a low standard of living have pursued rapid industrialization policies, causing economic competition or sometimes friction with advanced industrialized nations. The recent prevailing economic competition is unlike any in the past in terms of its magnitude, speed, and characteristics. History has witnessed several cases in which industrialized nations felt a strong impact as underdeveloped countries tried to catch up with them. This time, however, not only such Asian countries as China, the ASEAN nations, and India, but also Latin American countries and nations in the former Eastern bloc regions have set out on their own industrialization drives. The industrialization of these countries is also taking place very rapidly, within just over a 10-year period. The collapse of countries with planned economies has also accelerated the momentum for their industrialization drives.

This ongoing globalization, although having some positive influences, has cast a dark shadow over the economies of industrialized countries, and as a result, economic growth has slowed, accompanied by growing employment problems.

(2) The second problem industrialized countries face is the more profound impact that mega-competition has had upon their basic employment, financial and social welfare systems. These countries, especially European countries, have struggled for a century or longer to build systems in which they established the "delicate balance" of market principles, labor union issues, and social welfare systems.

This issue is deeply related to how they decide to cope with the growing necessity for streamlining their domestic economic systems. In the private sector, many firms are under increasing pressure to review their customary employment practices as demands for restructuring continue to grow. They have started implementing strict rationalization measures by trimming excess workers through such unconventionally drastic approaches as abolishing profit-losing sections, rationalizing ineffective departments, and streamlining operations to cut costs.

On the governmental side, the issue is about the pressing question of the coexistence of the economy and welfare in the face of growing welfare expenditure in advanced countries, and the growing need for a more efficient economic structure.

If corporate taxes, social insurance payments and other expenses imposed on firms by a government are higher than those of other countries, businesses will find their own country more difficult to live in and decide to leave to find more advantageous locations for their plants or offices. This is a serious problem that must be addressed seriously, sooner or later.

(3) The third problem we have been

commonly facing is how to cope with the information technology revolution. As the bleak employment situation continues, interest has naturally grown in these countries in the creation of systems that produce quality jobs. Among Japan, European countries and the U.S., there is not much difference in the degree of awareness about this important trend or the necessity for it, but these nations differ in their approaches depending on their national policies, comparative advantage and flexibility in economic and labor systems. The differences between Japan and the U.S. in their recent approaches to rapidly advancing information technologies can be keenly felt. In particular, when compared to U.S. initiatives to stimulate its economy by aggressively utilizing advanced information technologies, Japan lags noticeably behind in regulatory policies in this sector and utilizing new technologies. I will come back to this point again later.

Six causes of the strong U.S. economy

When one analyzes the world economy over the past 10 years from a macro-economic point of view, the strong performance of U.S. business stands out. On the other hand, EU nations have suffered from high unemployment rates and Japan from zero economic growth for three years in a row.

Seen from a micro-economic point of view, the U.S. clearly has more information-related manufacturers and its service industry is concentrated in higher-growth sectors than Japan or Europe. Taking the viewpoint that there are certainly things we can learn from the U.S. success, I would like to take a closer look at its performance.

Basically, the good macro-economic performance of the U.S. in recent years is attributed to the fact that the U.S. has managed to deal with the above-mentioned three common problems quite well, although some matters, including medical care or other social welfare issues, await future solution. Let me explain more precisely the causes of the recent success of the U.S. economy. In my view, the following six factors have contributed to the strong U.S. economy:

Firstly, Reaganomics in the 1980s promoted large-scale tax reductions including corporate taxes, and also proceeded energetically with extensive deregulation, which forced the service industry and others to become more streamlined. In total, these policies resulted in reduced economic burdens, both public and private, for U.S. firms.

Secondly, the manufacturing sector, since the last half of the 1980s, has been reviewing its production processes, implementing quality control measures and efficient inventory systems on a large scale. In these processes, U.S. manufacturers strove to learn the Japanese way of manufacturing and to improve on it in actual use. These efforts have paid off handsomely, as they have resumed their former leading position in the economy.

Thirdly, from the end of the 1980s to the early 1990s, corporate downsizing and workforce reduction continued, trimming down operations to such an extent as to coin the expression "jobless growth." This expression means that this economic recovery has been good for corporations and bad for workers. Up to that time, it had been thought that the U.S. economy had recovered simply because of more efficient management and improving manufacturing processes, which had also happened in the past.

Fourthly, U.S. manufacturers' impressive performance is largely attributable to the rapid technological advancement that has taken place in the area of information and telecommunications. In the 1990s, many outstanding firms sprang up in the areas of high technology and information, and they have become a driving force behind the recent strong economic growth of the country. These new developments in technology and business have made people realize that they should not view the good performance of the U.S. economy simply as a revival of its past glory, and that a new era has begun.
(Note) I do not agree with the recently discussed "new economy theory" insofar as it postulates a theory of permanently higher stock prices, a theory of the end of economic cycles, and a theory of the end of inflation.

Discussing it from the viewpoint of structural reform theory may be worthwhile, even though there is no statistical proof yet available for support.

Fifthly, with the aim of maintaining the value of the dollar as a key currency, the U.S. Government generally has adhered to the policy of keeping the dollar at a high level in the international exchange market. This policy has attracted capital to the U.S. and combined with the country's highly developed financial systems to push up stock prices and invigorate the U.S. finance industry.

Sixthly, these factors have given rise to a favorable economic cycle or "cycle of virtue." The rapid advancement of information technology amid the bullish economy has given birth to "the prosperous Silicon Valley," which in turn has led to "the revitalization of Wall Street" with infusions of foreign capital, high stock prices and the strong dollar.

Why is the U.S. economy so successful in creating new industries?

Further, analysis of the industries that support the strong U.S. economy reveals the following:
(1) First, it is clear that the information industry leads the U.S. economy.

Semiconductor production is among the fastest growing industries in the entire U.S. manufacturing sector. In the service sector, the fastest growing industry is satellite-related business, followed by electronic information services and then data processing services.
(2) Second, the rapid development of these industries can be explained by their unique situations in both the demand side and the supply side.

Let me elaborate further on the second point.

Am I the only person who is surprised to find U.S. shops or service industries giving remarkably better ser-

vice to their customers, compared to that given in the 1980s? Cleaners can get our clothing back to us at the exact time they promised. Trains in the U.S. were notorious for never being on time but they have begun to change this bad image into one of reliability. Then there are the mail delivery services offered by various U.S. companies, which are utilized extensively by business, based on their reliable and punctual delivery.

What I want to say here is that these improved services are exclusively attributed to prevailing utilization of advanced information technology, computerization, and network applications. The extensive introduction of these systems has created a vast amount of demand for information industries.

It could be said that this demand stems partly from the fact that there was considerable room for the U.S. service industry and manufacturers to improve their efficiency and quality. This situation has raised the level of demand not only for computers and other hardware, but for software as well.

On the supply side, U.S. businesses as a whole (particularly Silicon Valley) are providing an ideal base for the growth of the information industry and other industries which require agility and flexibility. In addition to low barriers for new entries, the job mobility of workers and engineers in the U.S. is overwhelmingly greater than in Japan or Europe.

Furthermore, buying and selling of companies through M&A and other means is also frequent. What is important here is that the existence of both a labor market and a corporate market makes it possible and easier to create such new industries as information industries and software industries.

There also exists a "support system" which makes it easier for the emergence of new businesses and companies, as can be seen in Silicon Valley.

There are ample venture capital and financial backers in the U.S. who can provide crucial financial support. Further, there is a highly developed stock market (the NASDAQ market, the pink-slip market). More importantly, there are institutional investors such as pension funds supplying necessary funds to the market. The advanced financial system in the U.S. enables prudent institutional investors to put their money into venture businesses. To provide technical support, ad-hoc mutual support provided by the many engineers and researchers in Silicon Valley is of fundamental importance. Last but not least in importance, there is regional support for new companies. In Silicon Valley, Stanford University has been playing a major role in fostering new industries. In addition, new companies receive various regional assistance in their product sales and labor supply, as well as help to defray their initial operating costs. For example, in many cases, they are helped by accounting offices, law offices, and realtors in exchange for stock options.

Photo: Kyodo News Service

"The Prosperous Silicon Valley": Rapid growth of the information industry has revitalized Wall Street

Background of the struggling Japanese economy

Now let look briefly at some of the issues which lie in the background of the struggling Japanese economy, since I wrote a detailed article on this subject in a previous edition. Basically, Japan's economy has not been able to overcome the above-mentioned three problems common to the industrialized nations in the 1990s. Compared to the U.S., firstly it could not succeed in streamlining companies and labor. In the sector of non-tradable goods and service industries in particular, competition is by nature limited to the domestic market and, to make matters worse, is reduced or controlled by domestic regulations. As a result, strong and extensive efforts for streamlining could not be undertaken until quite recently.

Secondly and more remarkably, Japan lags far behind the U.S. in its approach to information technologies and their utilization. This makes it painfully clear that the Japanese regulatory system in this sector is out of date, though it has improved somewhat recently, and more basically, that the Japanese economic system is not favorable to new industries and new businesses. Combined structural problems of (1) a high-cost structure based on inefficiency in non-tradable goods and service industries and (2) systems that make it difficult for new businesses to emerge. are slowing down considerably the pace of economic recovery or of economic growth.

These serious problems are made worse by the following factors:

- the current education system, under which it is difficult to mold people with the creative thinking essential for new technologies;
- a research and development system which is not able to secure sufficient quality human resources and funds, and does not use them efficiently;
- the financial market system, i.e. a lack of effective capital procurement means needed to convert new technologies into business opportunities.

What to learn from the U.S.

It is not surprising that some people advocate adopting the U.S. system as a whole, while others say that before deciding to adopt the U.S. system, its shortcomings as well as its strong

points have to be considered, and point out that the U.S. way of doing business based on market principles has created a large income gap and further widened it. It may also create tension in a society where the stronger conquer the weaker while weakening the bond between workers and management and destabilizing the workplace as a result. In conclusion, this is not a question of which approach is better. These business practices are deeply rooted in the values which the people of the nation have nurtured throughout its long history.

These systems are interwoven and they cannot be replaced merely like pieces of a machine.

To put it simply, I must emphasize that we should not jump to any conclusions based on the performance of the past 10 years and that there are many things Japan and other Western countries can learn from the U.S. economy.

What strategies should Japan pursue?

As for Japan's future economic strategies, my conclusions are simple and as follows: Firstly, Japan should learn as much as possible from the success stories of the U.S., and on the other hand, it should be aware of what to learn or what not to learn from the Japanese point of value judgment. Secondly, the Japanese should be aware of what Japan's relative advantages are and should make full use of these advantages in developing their economy. Thirdly, they should analyze in what direction the Japanese economy is tending to move, or come up with a future vision of the Japanese economy.

Future vision of Japanese industries

Let me begin with the third point. When we take a look at an image of the future Japanese economy, we can see that its industrial structure will be shaped by changes in future demand and in the ability of the supply side to respond to changes. The following two factors are likely to stimulate future demand in promising areas.

(a) Demand-pull type: Despite the fact that Japan's per-capita income is the highest in the world, many Japanese people do not feel that way. This is because they have a "sense of something lacking." To fill this void, demand is expected to increase in the following areas: housing, environment, health, welfare, life and culture, distribution and services.

(b) Supply-push type: New technologies are expected to create demand in such areas as information/telecommunications, new energy, new production technologies, and corporate support services.

The next question is what industries are likely to benefit from these demand increases? We can expect future development of several industrial structure patterns with varying characteristics. Some of the main points are as follows:

(a) The service industry is expected to grow considerably. This will not mean hollowing-out of the manufacturing sector, but, rather, consolidation of manufacturing and services, or mutual stimulation, leading to a "synergy effect" contributing to their further growth. This phenomenon is not unique to Japan, but a universal one. This idea is and will be very important and valuable when we consider the future interaction of the Japan and U.S. economies.

(b) It is the information and telecommunications sector where this trend or phenomenon can be seen most clearly, and will accelerate as the economy develops further.

(c) As the global market expands amid growing competition with developing nations, business in a country, whether in manufacturing or services, is increasingly required to specialize in things it is good at. By this I mean that the larger market tends to seek further specialization.

Making full use of Japan's advantages

As for the second point of future strategy, Japan currently is in the midst of "economic structural reforms" to reshape the Japanese economy into one with vitality for the next century. A number of concrete measures have been implemented and will be taken. When formulating concrete measures, it is important that they closely reflect the relative advantages of the Japanese economy, such as a high rate of savings and ample capital, a high level of production technology in the manufacturing sector, and a domestic market with a high income level.

Future of Japan & U.S. interaction

As mentioned earlier, information industries and software industries are the driving force for future economic development, but unfortunately Japan lags well behind the U.S. and has much to do in order to develop such new businesses as information industries. Therefore, while Japan should not take a hasty approach, it is vital that it proceed with drastic reform plans that make the best use of its inherent economic advantages. More concretely, Japan should change its economic system to accommodate these new industries and should simultaneously make use of Japan's manufacturing power to mesh with the U.S.'s advantage in the software industry or information industry. The service sector in the U.S. and the manufacturing sector in Japan can develop with each other and accelerate their pace of development through mutual cooperation or stimulation.

Accordingly, Japan could not compete with the U.S. in the field of software or information industries in the future. The history of Japan-U.S. economic relations shows us clearly that competition or even trade friction can create better economies and bring benefits to both countries, if managed well.

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