A New Stage in Price Destruction

By *Hamano Takayoshi*

It may be safe to say that commodity prices in Japan are extraordinarily stable. Consumer prices in fiscal 1999 were down 0.5% from the previous year, marking the largest year-on-year decline in the past 30 years when statistical comparison is possible. Since the April start of fiscal 2000 (April 1), prices have been moving slightly below the year-earlier level, proving that prices have been moving in a stable manner.

Wholesale prices in March 2000 rose slightly for the first time in eight and a half years excluding the effect of an increase in the consumption tax in 1997. The rise, which was nominal and represented only a turnaround from minus to plus, indicated no change in the extraordinarily stable price picture.

Factors behind the extraordinary price stability

A Price Report for 2000 released by the Economic Planning Agency (EPA) in July cited a delay in the recovery of consumer demand amid a general recovery in demand as the main factor in the exceptional firmness of prices in Japan. The report said that consumers loosened their purse strings but the amount of money in the purse hardly increased.

The report described the current downward price trend as "undesirable" in one way. But it said lower prices are not necessarily undesirable and could be "desirable" in another way. It referred to a desirable downtrend as a supply-side phenomena resulting from intensified price competition spurred by price cuts in imported consumption goods or by a distribution revolution.

According to the report, the current desirable price downtrend, resulting mainly from the distribution revolution, is a form of "price destruction" differing from the price destruction of the first half of the 1990s.

Below, I will analyze the difference between the current trend of price destruction and the price destruction of the first half of the 1990s.

Convenience stores cut the price of beer by an average of 9%

The phrase "price destruction" originated from the title of a novel, *Kakaku Hakai* (meaning "price destruction" in Japanese), by the popular writer Shiroyama Saburo, whose works mostly deal with the business world and business people.

"Kakaku hakai," which became a catchphrase in Japanese business circles in the first half of the 1990s, does not mean mere discount sales but rather the marketing of commodities or services at extraordinarily low prices, in large quantities and continually for a certain duration. Behind the phenomenon lies drastic changes in Japan's economic structure, particularly in the distribution system.

The price destruction of the first half of the 1990s affected a wide range of commodities, from foodstuffs and sundry goods to home electronics, including beer, videotapes and tissue paper. Japanese consumers at that time were oriented toward low-priced products in reaction to big-ticket consumption during the bubble period. Furthermore, an influx of low-priced imported goods on the back of the yen's appreciation and the emergence of discount stores accelerated the price destruction trend.

During this period, private-brand commodities that were much cheaper than national-brand commodities emerged on the shelves of department stores and supermarkets across the nation, while suburban menswear chains boosted earnings through the marketing of low-priced products. Their marketing strategies, which made headlines, were based on the purchase of low-priced imported commodities in large quantities. In this way, they avoided unsold stock and achieved low prices at the expense of (commodities') diversity. Price destruction was impossible in sectors which focused on diversity.

But the EPA price report for 2000 said that price destruction is now "deepening and widening."

Deepening and Widening of Price Destruction

It is "deepening" in the sense that prices are being slashed even in sectors previously deemed immune to price destruction. This phenomenon is evident in the fashion industry, which is sensitive to seasons and fads, and runs the risk of unsold stock.

In the field of casual clothing, where competition is becoming particularly intense, the emergence of discount specialty shops has forced department stores and supermarkets to set low prices.

Family restaurants and other fast-food chains are also undergoing changes. They used to find themselves hard-pressed to engage in price competition due to the high percentage of labor costs in total expenditure. Now, first-food chains, among other outlets, have gone so far as to halve their prices.

The prices of medical goods, cosmetics, stationary goods, toys and rice hardly declined until the early 1990s. But due to deregulation, coupled with some other factors, their prices have started to fall or their markups have been decelerating.

The markdown of these commodities is characteristically being achieved without sacrificing their quality or lineup. Makers of these products are trying to cope with both high quality and a broad lineup with low prices.

It is also pointed out that in the service sector, tickets to concerts and plays are often sold at a discount.

The "widening" of price destruction refers to the fact that the practice, previously observed by discount shops, has now spread to other retail outlets such as convenience stores. In the fall of 1999, one major convenience store chain after another cut the price of beer, which is their core commodity, by an average of 9%. Similarly, major supermarket chains expanded discount sales of clothing, furniture and foodstuffs.

The EPA price report noted that discount shops, which initiated price destruction, themselves are being affected by the trend and their performance is polarized. These moves represented a new stage in price destruction which resulted from a new distribution revolution, according to the report.

A 100 yen (about a dollar) discount shop, which initiates price destruction

What is behind the distribution revolution and where is it heading?

The EPA price report cited the following three factors which prompted the distribution revolution:

1. Consumers are becoming sensitive to prices, but at the same time want to enhance their livelihood. Such consumer needs must be met.

2. Competition is intensifying.

3. A technological revolution is taking place in the distribution sector.

Take gasoline prices as an example of intensification of competition. One survey showed that average gasoline prices in one prefecture range between 89 yen and 109 yen per liter.

Gasoline prices are on the rise as higher global oil prices offset the effect of deregulation of the gasoline market. Nevertheless, service stations in areas where competition is intense due to the opening of too many new stations find themselves hard-pressed to raise prices.

Technological innovation in distribution is represented by the widespread introduction of electronics, which is in a way an Information Technology (IT) revolution. Electronic technology has enabled supermarkets to economize manpower, speed up procedures for the acceptance of orders, reduce dead stock and slash sales costs across the board.

Will commodity prices remain stable even after an economic recovery?

There would be no sudden upsurge in prices. But we can hardly be optimistic about future price moves.

The Bank of Japan in August abandoned its "zero interest rate" policy as the central bank felt confident that the Japanese economy has reached the stage where deflationary concern has been dispelled. The government and the business sector criticized the move for hurting the nascent economic recovery and threatened to interfere with the Bank of Japan's independence. It seems to me that Japanese people are very sensitive to deflation but rather tolerant of inflation. Such a unique Japanese attitude is in stark contrast to Germany, a country which is extremely wary of inflation and where even the finance minister is not allowed to make remarks interfering with the independence of the central bank.

In the wake of the EPA price report, the Price Stabilization Policy Council, a government advisory body, released a freedom of information guideline as part of its reform of public utility rates. The guideline, which will be applied to all public utility sectors, explains in layman's terms the basis of calculations of public utilities and the concept on which public utility rates are based.

Public utility rates are uncompetitive. Public utility projects thus tend to be inefficient and could lead to higher commodity prices. In this connection, the guideline is important.

We cannot take an optimistic view that prices will remain stable forever.

Consumers are a key player on the demand side of market functions (demand and supply). They are sensitive to prices, as is evidenced by the fact that consumer attitudes played a key role in the distribution revolution which triggered price destruction. As such, we can hardly judge price trends without taking into account consumer attitudes, that is, their sensitivity to prices. JJTI

Hamano Takayoshi is a professor at the Faculty of Humanities, Miyazaki Municipal University.