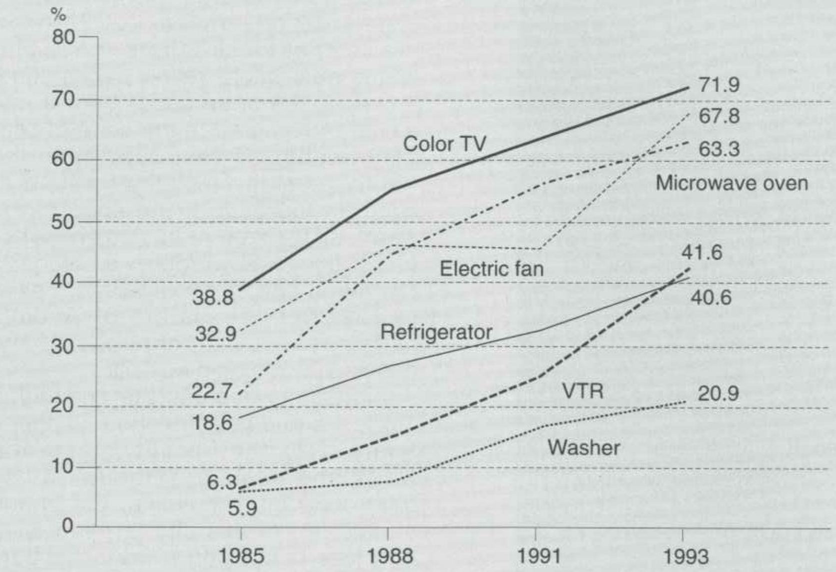
The Distressing Hollowing Out of Industry

By Hamano Takayoshi

With the yen at a strength never before experienced, Japan's already high land, labor and energy costs have increased another notch upwards. Now, as industry is being driven out of the country by high manufacturing costs, there is increasing concern over the issue known as "hollowing out." Can this situation, which threatens to undermine the very foundation of the economy, be prevented?

Home Electric Appliance Overseas Production Ratio



Overseas production ratio = Overseas production/(domestic + overseas) production by (number produced)
(According to industry statistics)

Meaning and reality

Before proceeding further, perhaps we should clearly define what constitutes hollowing out of a manufacturing industry.

A government white paper on economics released in July 1994 examines three aspects of hollowing out: reduction or abandonment of production due to increased competition from imports; no longer commercially-viable production for export, leading to expanded overseas production and eventual ceasing of export production altogether; and as a result of both of the above, production is curtailed and replaced with a low-productivity, non-manufacturing industry.

Hollowing out occurs when any of the three above aspects has an adverse impact on the economy from the standpoint of labor utilization, wage, or productivity. In other words, the white paper states that hollowing out as a phenomenon in itself should be viewed separately from whether it has a damaging effect on the Japanese economy or not. Whatever the case, there is no doubt that the phenomenon is steadfastly tied in with the strong yen.

What is the current situation in Japan? Direct investment in setting up factories in foreign countries by Japanese manufacturers has accelerated recently, and concurrently, production of automobiles and home appliances abroad has risen. In 1993, exports of cars to the U.S. market fell by 8.2% from the year before, but at the same time, U.S. production by Japanese makers rose 8.8%. For the first time in history, U.S. car production by Japanese makers exceeded the domestic export output with 1.54 million cars being produced, and only 1.45 million cars being produced at home. Japanese cars produced abroad accounted for more than 50% of the export for the U.S. market. Moreover, reverse imports to Japan by U.S.-based Japanese makers continues to rise.

Furthermore, according to research by the Ministry of International Trade and Industry, reverse imports of home appliances such as color TVs and VTRs have also been on the increase. Overseas production by Japanese companies remains at just 6% of the total, however, the percentage for home appliances reaches disproportionately high, with 71.7% of color TVs, 67.3% of electric fans, 63.3% of microwaves, 41.6% of VTRs, and 40.6% of refrigerators being produced in factories overseas. These percentages are twice or more than double what they were in 1985, with VTRs showing an amazing sixfold increase during this timeframe.

Consequently, one-in-three color TVs sold on the Japanese market in 1993 were produced overseas. For non-durable consumer items, the 60% share by imported items in the textile market certainly seems alarming. From the viewpoint of the opinions stated in the white paper, one could say the situation regarding automobiles is a manifestation of the second definition—whereby overseas production is increased to maintain competitiveness levels in export markets—though for home appliances it would be the first definition—a backlash against increasing market penetration by foreign products.

The effect on employment

What effect is overseas production by Japanese manufacturers having on the

Japanese economy? Although unemployment continues at its all-time high of 3%, this may just be the first-stage, with the long-term effects not yet known. Nevertheless, it is still too early to guess which direction the yen will go, with not too many companies producing profitably at its current, high exchange rate.

The results of a September survey of manufacturing industries conducted by the Ministry of Labor revealed that by December 1993, 70% of the companies surveyed were currently expanding or planning to increase their overseas production in the future. Furthermore, 40% of the companies foresaw overseas production as making up more than 30% of their total production by the year 2000. Simultaneous with shifting production overseas, more than 40% of the companies forecast that their domestic workforce would have to be reduced in some way, although not by layoffs (almost none of the companies surveyed stated they intended to do this) or voluntary retirement schemes (only 10% of the companies surveyed stated these would be initiated), but by such methods as reducing new hirers, cutting back or ceasing altogether employment of personnel from other companies, and/or curtailing the hiring of temporary staff and part-timers.

Whilst shifting production to overseas locations, companies are also planning to transfer some of their domestic production to higher value-added products, as well as diverting into new fields. To enable this to happen, companies responded that they intended to further develop personnel skills. Shifting production to higher value-added products and diverting into new fields is all very well, nevertheless, it will be difficult to achieve without bold ideas as well as a newly invigorated spirit of enterprise within each company.

According to an Economic Planning Agency report completed at the end of October, productivity is low in industries which are overburdened by numerous regulations, and higher in industries where regulations are fewer. Reducing this discrepancy by 20% in areas that have lower productivity than the U.S. should, according to the report, make it possible to increase the net GDP by 1.6% annually over a five-year term. The report also notes, however, that an additional labor force of 670,000 people would have to transfer from centers of low productivity to those of high productivity for this to be achieved.

While the government is reported to be contemplating more regulations to prevent an emaciation of Japanese domestic industry, it remains to be seen how the Japanese economy—which in the past has demonstrated an almost elastic ability to adjust itself in moments of crisis—will confront the situation it now faces.

The positive aspects

It must be said that, from the viewpoint of newly-developed nations in Asia and elsewhere, a hollowing out of Japanese domestic industry is by no means such a bad thing. Japan developed and prospered after the Second World War by borrowing the modern technologies of America and Europe. As "big brother" to newly-developed countries, Japan is now in the position to share with these nations its technology and a division of its labor. This is already taking place, for example, where home appliances are concerned—new products are researched, developed and parts made in Japan, while the end-product is assembled in Asian nations.

Advanced technology or high value-added products continue to be manufactured in Japan, with the production of low-value products being left in the hands of the newly-developed countries and then exported to Japan. Not only can Japanese manufacturers contribute to the growth and prosperity of developing nations, it is the perfect opportunity for them to decide on a suitable location, from a global viewpoint, for production. Rather than produce and export from Japan, producing locally enables companies to respond more effectively to the needs of the marketplace it is producing in, as well as create local jobs. Of course, it is important to ensure that the traditional characteristics of Japanese products are maintained, such as good workmanship and high quality. It has been said, though, that even with a Japanese company's label, if a product is not actually made in Japan, then it cannot be relied upon. However, this renders the concept of localized production meaningless.

It is generally stated that production technology/manufacturing techniques preventing the production of poor-quality items do not merit status as "inventions," so therefore cannot be patented. Furthermore, a point that has to be considered is whether technology developed in uniquely Japanese circumstances can actually be properly utilized in overseas production facilities.

As an indication of what course to follow to forestall an industrial hollowing out, it might be best to see how America has evolved in the post-1980s. In the years of the strong dollar of the early '80s, with production shifting overseas and reductions in employment, America faced the threat of industrial emaciation. However this was brilliantly fought back in the fields of automobile and semiconductor production.

Another American countermeasure worthy of note is the way in which the country diversified into, expanded, and strengthened new service industries such as computer software development, information services, and entertainment—thus creating jobs and staving off the danger of industrial emaciation. Though there is the problem that salaries in these new industries are lower than those in the manufacturing sector, increased unemployment has been kept in check. In order for a similar state of affairs to manifest itself in Japan, it would be necessary to establish an environment in which barriers concerning entry into new businesses are either eased or outrightly abolished.

Indeed, whether one likes it or not, the continuing shift towards overseas production is in itself a very strong incentive to effectively counteract industrial hollowing out, and that is a paradox in itself. JJTI

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