Price Gaps Cannot Be Ignored

By Hamano Takayoshi

Depressed during the recession, overseas tourism has once again regained popularity. The 1994-1995 New Year holiday season saw an all-time high of 570,000 Japanese going abroad. During 1994, it is estimated that one out of every nine Japanese traveled overseas.

One major reason for this increase lies in high domestic prices, driving Japanese to go abroad to enjoy fully the strong buying power of the yen, something they cannot realize at home. Also, if for no other reason, traveling abroad is cheaper than traveling within the country. "The Japanese air industry has responded inadequately to the expectation of the users who are calling for lower fares," reads the *White Paper on Transportation* published in November 1994. The white paper continues with figures of Japanese traveling abroad, which jumped 75 times in the past 30 years to 11.93 million in 1993, and for those of foreigners visiting Japan, which rose only 10 times to 3.41 million during the same period.

Higher-than-overseas prices in Japan are not limited to traveling expenses, but can be found everywhere in consumer life. There are also noticeable gaps between domestic and foreign prices for the same products and services. More importantly, these gaps are widening.

A strong yen and international price gaps

It seems useful to look at three relatively new reports documenting domestic and foreign price discrepancies.

First is the Economic Planning Agency's report, based on consumer price growth in Tokyo and other major international cities, on differences in the cost of living between Japan and abroad. The latest September 1994 survey shows that consumer prices in Tokyo were 1.57 times higher than those of New York—a wider difference than the 1.41 times reported in the November 1993 survey.

Liquor is heavily regulated and even with the strong yen imported products are not being sold at lower prices.

Similarly, in September 1994, prices in Tokyo were 1.54 times higher than those in London, and 1.42 times higher than those in Paris and Berlin, each larger than the previous figures reported in November 1993.

The second is a report which analyzes the reasons behind these price gaps by dividing them into structural factors, and temporary factors led by the overvalued yen. The report was based on data gathered from July through September 1993 prepared by the Research Institute for International Price Mechanisms, an affiliated organization of the Ministry of International Trade and Industry (MITI). The report states that the "purchasing power parity" stood at ¥160-190/$ for that period compared to the market exchange rate of ¥106/$. Purchasing power parity is calculated by comparing how much money is necessary to buy the same product in Japan and the U.S.; for example, if the same three liters of gasoline cost $1.00 in the U.S. and ¥300 in Japan, the parity will be ¥300/$.

If we conduct similar calculations on the prices of daily necessities, we can obtain the purchasing power parity for living expenses. The report concluded that about 40% of the difference between parity and market rate could be explained by a temporarily over-valued yen reflecting surging yen rates in the market, while the remaining 60% stemmed from structural factors in the Japanese high-pricing system. What exactly are these structural factors? The problem lies in certain products (soybeans, wheat, milk, alcohol, etc.), whose prices are controlled through import restrictions, price support measures and new-entry restrictions, as well as in the public fee system. As competition is restricted in these areas, even as the yen becomes stronger, lower import prices are not adequately reflected in domestic prices.

The third report, published by MITI in autumn 1994, concerned price gaps in intermediary materials and machines, and industrial services. The report shows the price gap between Japan and the U.S. stood at 1.14 times for intermediary goods such as raw materials, energy and machine tools, while the gap became wider, 1.63 times, for industrial services such as transportation, communication and real-estate. The gap is such that in some areas, such as international telephone service, enterprises sometime use overseas services instead of domestic services. These surplus costs in production are then transferred to consumer commodity prices as premium, accounting for some of the price discrepancies between Japan and the U.S.

The bottom line is that a stronger yen may lower prices for certain imported products, but it does not really solve international consumer price gaps, leaving Japanese consumers still unable to feel rich. If we continue with the status quo, companies will be forced to leave Japan and domestic industry will hollow out.

Domestic price gaps and price busting

Under these circumstances, many have come to accept the inevitability of reducing international price discrepancies. The Conference on Price Stabilization Policies reporting to the prime minister, submitted in late 1994 an intermediate report on measures to consider for addressing price gaps, with attachments on international price gaps in the housing sector. As is often pointed out, housing conditions in Japan, especially in urban areas, are poor. Building costs for a detached house are twice as high as those of the U.S., even leaving land prices aside. To correct the gap, the report points out, broad measures are required, including standardizing housing parts, rationalizing small- and medium-sized construction agencies, encouraging imports for housing and building materials, and relaxing regulations.

The council is planning to propose further measures for correcting international price gaps on an item-by-item basis, ranging from clothing and cosmetics, foods, services, energy, distribution, building and construction, to producer's goods. However, only indicating measures is unlikely to yield fruitful results. The problem lies in the fact that some companies, and sectors, rely on the existence of price gaps and they are likely to suffer and possibly be unable to maintain employment with reductions in prices. Therefore, despite little opposition toward rectifying international price gaps in general, actual measures in each field will likely be met with staunch resistance. In this sense, international price differences are in reality a discrepancy in domestic prices, i.e. domestic adjustments are needed.

However, the situation is clearly changing with a broad dissemination of price busting, a trend word of 1994 for Japan. The move was triggered by low-priced men's suit stores operating in the suburbs, discount stores, and major supermarkets, and has expanded to include a number of items, from detergents, cola, orange juice, beer, wine and video tapes to home appliances, cars and cellular phones. Major supermarkets are developing private labels which offer decent quality with lower prices. To reduce prices, they skip wholesalers, trading directly with makers, and drastically reduce advertising and other costs. In a report on price busting by Asahi Bank in late 1994, more than three-quarters of their customers surveyed answered: "Price busting will continue into the future." Also, compared to the U.S., where this phenomenon occurred earlier, the report points out that price busting in Japan is only at the infant stage and full-force busting has yet to come.

Imports from Asia, where labor costs are less than one-tenth that of Japan, should increase in coming years and this will certainly remain a driving force for continued lower prices. "Price busting is something like underlying magma," the report continues, "with potential energy capable of shaking up the sleeping volcano of the Japanese social structure." The report projects that corporations will be forced more and more to correct their high-cost structure and that success in cost reduction will become key in determining their survival.

As price busting proceeds further, rigid international price gaps should be forced to shrink. As price busting spreads into various fields, it will not be so easy for the government to raise public fees, including the ever-rising charges for express highways and electricity, currently the world's highest.

It should ultimately be consumer consciousness which determines whether we can change the nature of the Japanese economy, currently in a stalemate amid continuing downward spiralling prices. It was often pointed out that Japanese consumers tend to be less conscious about prices but more conscious about brand names than U.S. consumers. However, following the long and severe post-bubble recession such attitudes are undergoing change. One of the key points for the Japanese economy in 1995, therefore, should be whether consumers can maintain this new awareness in the midst of an economic recovery. JJTI

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Items with Wide International Price Discrepancies

Tokyo price standards compared to foreign cities (times higher) (as of 1993)

Items relative	to New York	to London	to Paris	to Berlin
Rice	2.08	2.12	2.59	2.13
Beef (chuck)	3.35	—	2.19	3.47
Camembert cheese	2.18	—	—	4.41
Beer	2.42	1.43	3.25	1.86
Women's suits (winter)	1.50	2.12	1.78	1.27
Women's overcoat	2.34	2.59	3.00	3.24
Lipsticks	5.29	—	3.72	4.87
Milky lotion	1.70	—	5.52	1.95

Source: CPI Report 1994 (¥111.20/$1)