Publisher's Note

Investing in the Future

By Naohiro Amaya

Ever since Perry's fleet sailed into Edo Bay back in 1853, the Japanese people have been united in their drive to catch up with and surpass the industrialized countries of the West. Until 1945, this entailed catching up both economically and militarily, but for the last 40-odd years it has been an exclusively economic effort.

Because GNP and export performance were the prime indicators of how well Japan was doing internationally, Japanese companies tended, until very recently, to concentrate primarily on expanding their sales and their export ratios, and the Japanese government on raising the GNP and the export ratio.

Yet while the Japanese government and Japanese companies were pushing to increase exports, they were not in the least interested in expanding imports. Rather, most Japanese companies preferred to rely upon other Japanese companies for the raw materials and parts they needed, being disinclined to deal with foreign suppliers and their strange foreign ways. Likewise, most government bureaucracies, although having both carrots and sticks at their disposal, were very free with the carrots and little inclined to use the sticks on the industries under their jurisdiction, especially when these industries were not internationally competitive.

Today, this catch-up process has succeeded beyond Japan's wildest dreams. The trade surplus mushroomed to gigantic proportions almost before we knew it, and Japan now has a $100 billion trade surplus—something that was unimaginable even just a few years ago. There has been especially strong growth in Japanese exports to the American market, and the United States now takes fully 40% of Japan's total exports. At the same time, the bulk of this $100 billion trade surplus is channeled back to the United States for reinvestment.

There would be no problems with this Japanese trade effort if the American economy were healthy. But it is not. Government and household budgets alike are heavily overspent, the United States has burgeoning deficits in both its trade and fiscal balances, and its overseas debts have snowballed, making it the world's largest debtor nation. And with the economy out of control, the dollar has fluctuated wildly on currency exchange markets—acting far more like a peripheral currency than the key currency it is. In turn, this fluctuation has had a major impact on the Japanese economy.

It is imperative that the Japanese economy be restructured if we are to ameliorate this situation. Japan has to lower its dependence on exports (especially its dependence on exports to the United States) and sharply increase the importance of domestic demand and imports. There is no question whether or not this has to be done. The only question is how it can be done most effectively.

For starters, the market regulations and other forms of protection afforded less competitive industries should be sharply curtailed or eliminated. This is not a politically palatable prescription for many people—especially in agriculture—but we need to shake off the inertia built up over the years by established practices and vested interests and to take a totally new look at our new circumstances, capabilities and needs.

Government expenditures have to be sharply expanded to stimulate domestic demand, even if this does exacerbate the budget deficit. While a general consensus has emerged on this, we have yet to give adequate study to the questions of which industries and areas will have the greatest impact on demand and give us the most value for our deficit. Personally, I think we need an ambitious effort—in stepped-up government spending and in dramatic tax reforms—to stimulate housing investment, environmental infrastructure improvements, basic research, education and cultural amenities. Other people may have other priorities.

But the time has come to make the hard decisions and set about restructuring for the future. And we need to do it now. The time for shilly-shallying is past. Japan has caught up, and it must now take on the responsibilities of leadership.

Letters

Invest in International Understanding

The July/August feature on Japanese overseas investment reminded me of the early days of Japanese investment in overseas manufacturing and my own experiences in joint venture manufacturing in Canada in the 1960s.

In 1964, I was sent by Mitsui & Co. to British Columbia to participate in a wire drawing mill joint venture with some Canadian businessmen. Back then, Japan was enjoying rapid economic growth with strong exports, and Japan's voracious appetite for coal, iron ore, copper concentrate, pulp and other raw materials drew complaints that other countries were just "hewers of wood and drawers of water" for Japan. In part to counter such claims, a group of businessmen proposed a joint venture manufacturing wire drawing and wire nails for export to Japan.

Because the area had a history of difficult labor relations, the Japanese principals were understandably nervous. Yet I knew the president of the local chapter of the Teamsters Union to be both intelligent and friendly. To make a long story short, we selected several prospective workers, asked them if they had a union preference and, upon receiving a negative reply, suggested the Teamsters. When this was accepted, we reported it to the provincial government labor relations commissioner and the union was registered. There is no rule that people in a particular industry have to belong to any particular union.

All of the consortium's decisions had to be made by consensus. Communication with Japanese headquarters was especially frustrating due to the lack of fast communication media at that time. But the main mental barrier was Japan's lack of experience in manufacturing ventures with other industrialized countries.

Now the economic environment for overseas direct investment has changed. Japanese companies are more attuned to other societies and their needs, and Japanese management policy seems to be better understood, and even applauded, in the Western industrialized countries. Yet it is still important to make every effort to avoid misunderstandings and to reaffirm our shared participation in the world economy.

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Correction Ahead

I found Hiroshi Takeuchi's analysis of Japan's soaring land prices (July/August *Journal*) very much to the point. As he notes, there is a strong speculative push to today's market, and this speculation is fueled by expectations that land prices will continue to rise.

But there are several factors that may be expected to slow this trend and betray these speculative expectations. One is that long-term interest rates are edging up. This will, of course, make it more costly to buy land with borrowed funds for both speculators and final purchasers. As a result, speculators will be forced to liquidate their holdings even at a loss in order to avoid a continuing drain on their resources; and final purchasers will be even less able to pay the high prices that speculators need to make a profit.

Nevertheless, the strong business demand means that prices for commercial sites will stay at their present plateau. Residential sites, however, are a different story—especially if the government enacts property and other tax reforms to make investment in real estate less advantageous relative to other forms of investment. These changes, the inability of purchasers to pay the price asked and the plateauing of commercial property prices will all work to relieve the upward pressure on residential areas.

While residential properties 50 kilometers or farther from central Tokyo will continue to rise until the end of this year, those within a 25-kilometer radius of the city center will show mixed results—outstanding properties plateauing and less-than-outstanding properties slipping. The mere fact that a site is within commuting distance of Tokyo will no longer be sufficient to make it a good short-term investment. As in the stock market, another liquidity-fueled market where the bulls appear to be running out of steam, Tokyo's real estate investors will have to base their decisions on fundamental value if they want to invest soundly.

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The *Journal* welcomes letters of opinion or comment from its readers. Letters, including the writer's name and address, should be sent to: the Editor, Japan Economic Foundation, 11th Floor, Fukoku Seimei Bldg., 2-2 Uchisaiwai-cho 2-chome, Chiyoda-ku, Tokyo, 100 Japan. Letters may be edited for reasons of space and clarity.

TOPICS

Big Extra Budget to Boost Home Demand

A ¥2,079.3 billion supplementary budget providing the financial means to fulfill Prime Minister Yasuhiro Nakasone's pledge at the Venice summit meeting to boost domestic demand and ease trade friction was passed by the Diet on July 24.

The extra budget for fiscal 1987 calls among other things for additional public works spending totaling ¥1,358.5 billion. To raise funds for such public works, it calls for the flotation of ¥1,360 billion worth of construction bonds and the appropriation of ¥458 billion, a part of proceeds from the sale of government-owned shares in Nippon Telegraph and Telephone Corp. (NTT) sold in fiscal 1986. The budget earmarks ¥101.1 billion for the purchase of two passenger aircraft for government use and other "emergency import" items.

The additional budget, which amounts to 3.8% of the original fiscal 1987 national budget in value, is the largest of its kind since fiscal 1974 when the government, faced with a serious oil crisis, revised its national budget upward by 12.3%. This brings the supplemented fiscal 1987 national budget to ¥56,180.3 billion, up 4.4% from last year's revised budget. Political observers say that the extra budget, especially the increased public works spending, indicates the government has shiftd to a reflationary policy from a financial retrenchment policy.

Economic Planning Agency and Finance Ministry officials stressed that the extra budget is a direct response to pressure from the European Community and the United States for an expansion of home demand and alleviation of the trade imbalances. It will serve as leverage to stimulate business and boost the economy enough to attain the government-set real-term growth target of 3.5% for fiscal 1987, they said.

But some specialists are doubtful whether the measures contained in the budget are adequate to reduce the trade imbalances drastically. They estimate that it will produce a shrinkage of no more than $5 billion to $6 billion in Japan's current account surplus.

They also point to some other problems. First, the ratio of budget revenue covered by national bonds is again rising above the 20% mark at 21.1%. Second, revenue from the public sale of government-held NTT shares is being spent on public works and not to reduce the flotation of deficit-covering national bonds or redeem outstanding national bonds, as had been planned by the Finance Ministry. These specialists further point out that the extra budget, coupled with an uncertain future of the planned tax reforms, has dimmed the possibility of the government placing the national finances back on a healthy footing by 1990.

It is also notable that Finance Minister Kiichi Miyazawa is now trying to perform financial operations basically along his cherished line of "positive finance." As Miyazawa puts it, the government will take advantage of the growth potential of the Japanese economy by flexible fiscal operations and gain a natural increment in tax revenue.

The additional appropriation for public works brings the overall fiscal 1987 public works spending to a level 15.1% above the previous year's—making it certain that public works spending in the fiscal 1988 budget will swell further.

The Finance Ministry, saying that finance does not have much effect of stimulating the economy, had stubbornly held down public works spending in past years. The extra budget may mean a departure from that policy too clear to be explained simply as a "temporary and emergency measure."

Rice Prices to Be Cut

Japanese consumers are likely to be paying less for rice later this year as the government has cut the so-called producer's rice price in an apparent attempt to stave off increased foreign pressures for the easing of restrictions on rice imports.

The decision, which came amid vehement opposition from farmers and Dietmembers representing their interests, calls for a 5.95% cut in the government's purchase price for the 1987 crop to an average of ¥17,557 (about $117 at the rate of ¥150/$) per 60 kilograms. The price cut, the first in 31 years, is generally construed as a step to allay public criticism of the high price of rice at a time when rice production costs are declining.

Under the Japanese food management system, about 60% of rice in Japan is purchased by the government at the producer's price, the price designed to ensure production is maintained. The rice is then sold to consumers via wholesalers at the consumer's price set lower than the price at which the government buys rice from farmers. Both the producer's and consumer's prices are determined by the government based on recommendations by the Rice Price Council, an advisory body to the minister of agriculture, forestry and fisheries.

The consumer's rice price has been lower than the producer's price since 1962. The producer's price cut decided this time will turn an unfavorable gap of 0.4%, or ¥70, between the two prices into a favorable balance of 5.6%, or ¥1,041, in the government's food control account. As a result, deficits in the food account will shrink by ¥65 billion from ¥380 billion a year.

The producer's rice price per 60 kilograms is calculated on the basis of the latest three-year average of production costs divided by the unit yield. Under this formula, last year's producer's price should have been reduced by 6.6%, but the government proposed a lesser cut of 3.8% to avoid abrupt price fluctuations. Eventually, the price was left unchanged after negotiations with the ruling Liberal-Democratic Party (LDP). This was widely regarded as politically motivated manipulation, and the public bitterly blamed the government.

With last year's experience in mind, the government and the LDP consulted each other early on this year and agreed to refer a proposed price cut of 5.95% to the Rice Price Council, which endorsed it in its entirety. This year's price computed under the formula set out above would have fallen by 9.8%, reflecting bumper crops for the past three years and decreases in material prices resulting from the appreciation of the yen.

The price reduction came amid mounting accusations both at home and abroad against the protectionist aspects of Japanese agricultural policy. At home, irritation is mounting because rice prices are five times higher than in the United States. And in a tenacious move to win access to the Japanese rice market, Washington is bringing increasing pressure to bear upon Japan.

A typical rice retailer in Tokyo. The government decided to cut rice prices by 5.95% to stave off the public pressure both at home and overseas.

While maintaining the food control system for self-sufficiency in rice, the government seems to be going all-out to lower the consumer's price and narrow the gap between domestic and foreign rice prices. The reason is obvious: to weather public complaints and market-opening pressures from foreign rice producers.

Trade White Paper

The 1987 white paper on international trade, published on June 16, analyzes various factors behind the Japan-U.S. trade imbalance.

Japan's export volume has been declining and its import volume increasing markedly since the yen began to appreciate against the U.S. dollar in the fall of 1985. But the U.S. import volume continues to rise, while its export volume is on a recovery course. Partly because of the so-called J-curve effect, the dollar-based trade imbalance between the two countries is not improving to any appreciable extent.

The white paper estimates that Japan's trade surplus and America's deficit will not shrink more than \$13.9 billion and \$20.7 billion, respectively, despite the exchange rate adjustments up to the end of 1986. On this basis, it points to the need for stabilizing exchange rates, improving national economic structure—which has tended to generate trade imbalances—and ensuring collaboration among nations in macroeconomic policy.

As structural factors responsible for the expanding U.S. trade deficit, the paper enumerates a decline in U.S. industry's competitiveness; increased imports caused by lower production capacity resulting from inadequate investment; an increase in overseas purchases of parts and intermediate goods by the manufacturing industry; and an emphasis on short-term profit making by U.S. management. The paper thus urges the U.S. manufacturing industry to make stepped-up self-help efforts in order to reduce the U.S. trade deficit.

As a structural cause of Japan's trade surplus, the white paper notes that since the end of World War II, Japan has followed a policy of specializing in star export items, such as textiles, steel, TV sets, automobiles, VCRs and semiconductors. For its international competitiveness, Japan owes much to cost reductions made possible by mass production, it points out.

According to the paper, some Japanese industries resort to the strategy of setting profit ratios at low levels in an apparent attempt to break into new markets or expand their market shares. These industries, burdened with increased fixed-cost expenses, are liable to require substantial export sales in order to turn a profit, the paper observes.

The paper recommends that in order to lessen its reliance on exports, Japan should convert its economic structure so that it centers on domestic demand and at the same time help to promote international division of labor among newly industrializing countries in Asia. It further urges advanced countries to strive to correct the global trade imbalance through international collaboration in economic policymaking.

Midsummer Gift Sales

Retailers cashed in handsomely on the customary midsummer gift, or *ochugen*, sales this year. Sales topped the previous year's level by an estimated 10% to 15%.

In Japan, there is a long observed custom to send gifts to business superiors, acquaintances or seniors twice a year—in midsummer and at year-end—in return for favors and goodwill shown toward them.

In summer, households are said to buy an average of five *ochugen* gifts, each worth about ¥4,000 (\$27 at the rate of ¥150/\$). Spending on summer gifts in the country as a whole is estimated at ¥600 billion or more. The gift-shopping binge normally comes after salaried people are paid semiannual bonuses.

The majority of summer and year-end gifts are bought at department stores because they offer good door-to-door delivery services. Naturally, the gift seasons are very important for department stores, as they give a considerable boost to their annual sales. One Sunday in early July, some 280,000 persons thronged to one particular department store in central Tokyo.

According to department stores, the best-selling *ochugen* items are beer, seasonings and other foodstuffs. At one department store, such foodstuffs accounted for 90% of its total sales. Imported beer is also gaining in popularity, thanks to reduced prices and increased imports, both stemming from the high yen. Most major department stores sell about 100 brands of beer imported from some 20 countries. Imported beer has been well accepted on the Japanese market, with its share in total beer sales having risen to 30%.

Also selling well is ham, which used to be unpopular as a summer gift item. The credit for this goes to the much improved system of delivery in which refrigeration is used to prevent any deterioration in quality.

Strange though it may sound, mineral water stole the show this year on the summer gift shelves. The mineral water boom was apparently spurred by water shortages in the Tokyo area and the public's increased health consciousness. One department store set up a special "mineral water corner" where some 20 brands were put on display. Among other unusual items on sale at department stores in the Kansai area was a set of goldfish with goldfish bowl and an air pump deliverable to the customer's door.

Also, the way people order midsummer gifts has changed a lot. One of the popular new methods is via their own personal computer terminals: It's no longer necessary for those having PC terminals to go to crowded department stores to place gift orders. Orders can be placed even at nighttime via the terminals. All the customers have to do to place an order is to select department store information pages via their PCs and punch in their ID numbers and passwords. Goods thus ordered can be paid for later with credit cards or by direct deposit in the stores' designated bank accounts.

Sales of the customary midsummer gift registered a 10% to 15% increase over last year.

Photo: Kyodo News Service