



Japan's Economy: 21st Century Challenges Lucien Ellington

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Despite Japan's recent recession, many Americans consider Japan's economy as equal to or even stronger than our own. Such beliefs cause some Americans to buy the conspiratorial arguments about the "Japanese Threat", found in recent fiction by such authors as Tom Clancy and Michael Crichton. While Japan is a world economic power, the Japanese face problems that are unparalleled since the end of World War II.

Many people believe the United States was once the greatest economy in the world, but beginning in the 1970s the Japanese "caught" the Americans. Today, so the assumption goes, the Japanese are superior and America is on a downward economic spiral. Many Americans also believe that through such practices as permanent employment and the seniority system, Japanese business managers have caused worker productivity to surpass the U.S. First of all, Japan never "caught" the U. S. in an economic sense. From the early 1950s until the Arab oil shocks of the 1970s, Japan experienced one of the most impressive periods of economic growth in recorded history. Still, when Japanese output, per capita income, and productivity are compared to that of the U.S., the latter country is much stronger in most respects.

While together the U.S. and Japan are responsible for between 30% and 40% of world output, the overall output of the Japanese economy is only approximately 42% that of the U.S. Japanese per capita income is 83% that of the U.S. Greater U.S. output of goods and services per labor hour, or higher productivity is a major reason our economy is stronger than that of Japan. The American worker continues in the 1990s to be the most productive in the world, as has been true throughout this century.

While the Japanese enjoyed higher annual productivity growth rates than the U.S. in the 1970s and 1980s, America had such a productivity lead that there was no chance the Japanese could "catch" us in this vital economic indice. By the late 1980s, American annual productivity growth rates were again equal to that of Japan. Media pundits misinterpreted the higher annual Japanese growth and productivity rates in certain industries such as automobiles and consumer electronics, and claimed that Japan was more productive and economically successful than the U.S. Productivity concerns constitute one of Japan's major current economic worries. Recently in one of the most accurate measures of productivity, GDP per capita, Germany took Japan's place as second to the U.S. Japan's overall productivity rate is 82% that of the U.S. The United States' biggest productivity lead is in services, but even in manufacturing, Japanese levels are significantly lower than in the U.S. While Japan is more productive in machine tools, consumer electronics, and motor vehicles, estimates are that Japan is a generation behind the U.S. in the telecommunications and software industries.

Productivity problems are a major reason why Japanese manufacturers now have some of the world's very highest production costs. The irony is that many of the practices that have made the Japanese economy so successful in the past, including strong government involvement in the economy and the permanent employment/seniority system, are now hindering Japan's future international competitiveness.

Government Regulation, Productivity, and Trade Tensions

During the Meiji Restoration, government policy-makers, while recognizing the superiority of private markets over public production, never-the-less guided Japan's economic development. Throughout the latter 19th century until now, government bureaucrats have enjoyed wide latitude in regulations. This power was helpful when Japan was struggling to be competitive with a few countries such as the U.S. Now the Japanese must compete against the U.S., other already successful East Asian countries, and a host of newly emerging economic powerhouses such as the Peoples Republic of China, Thailand, and Vietnam. An increased competitive environment calls for maximum flexibility in the private sector, but Japan suffers from a stifling level of regulation. Overregulation is a major reason that Japanese consumers pay on average one-third more for goods and services than Americans. Government regulation also drives productivity down as individuals and companies devote an inordinate amount of time to satisfy bureaucrats.

There are numerous examples of Japan's regulatory problems. If a private bank wishes to open a branch bank in a distant locale, it must obtain permission from the Tokyo-based Ministry of Finance. If a local government wishes to move a stop sign, it must obtain permission from the Ministry of Transportation. The Ministry of Health's Food Sanitation Act requires a total of 21 approvals if a store wishes to sell meat, fish, milk, bread or frozen foods. Government bureaucrats informed Daiei, one of Japan's largest retail chains, that it must apply for two separate permits to sell hamburgers and hot dogs, if the products were displayed in different sections of the same store. The entire retail regulatory system was designed for an economy dominated by small shops. Because small retailer associations have utilized the political process to erect a thicket of regulations, entrepreneurs who wish to open a large store must secure permits from various local and national government agencies. Prospective investors must file approximately 75 applications relating to 26 different government permits to open a large multi-purpose store.

Japanese regulators even control leisure activities. For example, when a golf club member wants to play, but cannot get a reservation because the club telephone is busy, he or she can invoke 1993 government guidelines that guarantee that all club members are able to play a certain number of times a year. The above examples represent only the barest tip of the iceberg. Regulation both drives productivity down and prices up, and contributes to the ill-will many foreigners feel toward the Japanese. Too many regulations directly contribute to Japan's large trade surplus. While Japan has low official tariffs, many other regulations are written so as to favor Japanese manufacturers and specifically prevent foreign access to domestic markets. This type of so-called "informal trade barrier" often will take the form of environmental or consumer safety regulations that are impossible for foreign manufacturers to satisfy. Regulations, such as the large-store-opening-laws, while not intentionally designed to keep foreign goods out, never-the-less have this effect.

In any economy, large firms, because of more sophisticated distribution networks, carry more foreign goods than smaller stores. Due to government regulation, in Japan, there are fewer large stores

and consequently, foreign goods available to consumers than in other comparable economies. This condition is a cause of trade tensions.

Currently in Japan a consensus has seemingly emerged that if the country is to remain internationally competitive, raise productivity and lower consumer prices, much unnecessary regulation must be ended.

Are "Lifetime Employment" and Seniority Endangered?

Japanese "lifetime employment" is a 20th century innovation. The first experiments with the concept occurred in the years preceding World War I. A few Japanese companies, in an effort to retain workers, began guaranteeing permanent employment in exchange for loyalty. After World War II, large numbers of Japanese companies began to adopt so-called "lifetime employment." Analysts of the Japanese economy often use quotations with the term "lifetime employment" because only about one-third of workers in the private sector enjoy this benefit. These workers are usually male and are employed in large companies.

While not as wide-spread as foreigners believe, the impact of "lifetime employment" should not be underestimated either. Even Japanese companies that do not practice permanent employment are more reluctant to lay off workers than U.S. or British firms. There is no question that "lifetime employment" is one of the reasons for Japan's postwar economic rise. Large companies that utilized this practice were assured of a stable workforce. Also, because the fortunes of workers with permanent employment were tied to the company, employers were also confident that for the most part their workers would be loyal and hard-working. Perhaps even more importantly, employers who utilize permanent employment practices enjoy a tremendous education and training advantage compared to either domestic or foreign competition. Since in large companies management has been confident that many employees will still be with the company long into the future, a strong incentive is present to spend a substantial amount of time in education and training.

Despite its past advantages, there is mounting evidence that "lifetime employment" practices are a reason why the Japanese economy now faces long-term problems such as stagnant productivity growth rates and high costs.

While the official Japanese unemployment rate is under 3%, a Sumitomo Research Institute report estimates that the real rate would be over 6% if workers who make little or no contribution to their companies were taken into account. A recent survey of Japan's ten largest companies indicated that every one of these corporations reported significant numbers of workers who were no longer needed, but, were still retained because of "lifetime employment." The range of surplus workers in each company varied from a low of 5.4% to Nissan's whopping 26.7%. Japan could afford the luxury of unneeded employees when there was little international competition but, as mentioned earlier, the competitive situation has intensified significantly. Japanese companies that are burdened with employees they can't layoff are facing costs that cause great disadvantage in international competition. In early 1994, long-time Japanese industrial leader Toyota, while not ending permanent employment for new workers, became the first large company to create a class of college-educated workers who would be hired without the guarantee of permanent employment. While the Japanese will probably retain more of a commitment to so-called "lifetime employment" than is the case in

other capitalist countries, many expect corporate leadership to greatly modify the practice in order to better compete.

The seniority system, through which employee pay is based upon years of service, is closely related to permanent employment. Throughout the economic boom years characterized by heavy manufacturing, the seniority system was good for the Japanese economy. It helped to insure individual long-term commitment to a company. Now that Japan is moving toward high-tech and services industries, serious questions are being raised about the value of the seniority system.

While encouraging loyalty and hard work, the seniority system tends to discourage innovation and risk-taking, the very qualities that are vitally needed in high-tech and service industries. Studies of promotion in Japanese companies illustrate that those who don't fail at tasks tend to get promoted. Employees who are willing to take risks are generally not rewarded. In quick-changing high tech industries such as computer software, telecommunication, and pharmaceuticals, a workforce with a critical mass of risk-takers is essential. Business environments that simply reward those with the most experience are not conducive to the creation of innovators and risk-takers. Japanese business leaders are examining ways to reward workers based on merit instead of seniority.

Barring a major catastrophe such as war, Japan will still be an economic superpower for the foreseeable future. Still, such practices as extensive government regulation of industry, permanent employment, and the seniority system, will likely undergo substantial modifications as Japan enters the next century. While deregulation and modification of long-term employment practices is no easy task, the Japanese are capable of devising positive solutions to these structural economic problems. Throughout history adaptability is perhaps one of the most impressive aspects of Japanese culture. The next few years will certainly put that adaptability to the test.

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