JPRI
JAPAN POLICY RESEARCH INSTITUTE
CRITIQUE

JPRI Critique Vol. IV No. 3: May 1997
Blindside Revisited
by Eamonn Fingleton

Although *Blindside* was published in hard cover in the United States two years ago, I have resisted the temptation to update it because I think that subsequent developments have not in any way altered the main lines of my argument. Quite the reverse: they have tended to substantiate it.

One of the biggest developments of the last two years has been a rising clamor for reform of Japan's administrative system. Various interest groups are advocating sweeping measures that would set Japan unequivocally on the path towards Western individualism. This would by implication serve to undermine the extraordinary collective will to win that has characterized Japanese economic behavior for more than a century.

But for anyone who understands how power really works in Japan, the clamor for reform looks distinctly underwhelming. For one thing, efforts to move Japan toward a more Western style of government must contend with the might of the Ministry of Finance, the highly unWestern agency that is identified in *Blindside* as the main driving force behind Japan's economic growth since World War II. None of the developments we have seen recently is going to do much to cut the MOF down to size. The publicly announced measures to curb the MOF are directed merely at the agency's formal powers, and these powers are not the issue.

Rather, the issue is the MOF's much more important informal powers, which are wielded out of sight of the public gaze and are almost impossible to rein in. That these latter powers are virtually never mentioned by advocates of reform is the clearest possible signal that all the talk of reform is just that--talk.

What of recent apparently sweeping proposals to deregulate the Japanese financial system? On paper these look impressive, particularly as they are ostensibly modeled on London's so-called Big Bang. But there is a catch here: Tokyo is not London. Assumptions that might be valid in London are not necessarily valid in Tokyo. A key difference is that whereas financial cartels are discouraged in London, they are actively encouraged in Tokyo. If the regulators withdraw from the scene, their rule-making functions will be enthusiastically taken over by the cartels, which have their own reasons for limiting entry to the industry and avoiding "excess competition." In practice, a Japanese industry subject to cartel rules is often almost indistinguishable from a highly regulated one. Certainly, free competition on the Western model is still a long way off. The failure of deregulation proponents even to discuss the cartel question gives the lie to the entire exercise.

Looking back from a vantage point in 1997, one thing is clearer than ever: the press's account of Japan's economic difficulties in the early 1990s was absurdly exaggerated. Of these difficulties, by far the most serious was the rising yen, which for a time put great pressure on export industries. Meanwhile Japan's major banks and other financial institutions were bruised by the bursting of the late 1980s speculative bubble in stocks and real estate.

How well has Japan coped? The answer is written all over Japan's fundamental economic numbers. Japanese wages at last count were 74 percent higher than American wages; unemployment was little more than half the American rate; and Japan's exports per capita were more than 50 percent higher than those of the U.S. Judged by wages, jobs, and export growth-probably the three most reliable and universally applicable tests of good economic housekeeping-Japan has outperformed all other major nations in the 1990s.

The export growth is particularly impressive for two reasons: it has been achieved in the face of a huge yen-driven rise in Japanese wages, and expansion of exports has been the central policy-making objective of the Japanese authorities for decades.

Of course, Japan's internally measured economic growth has been slow in the 1990s. But this was an inevitable consequence of the rising yen. In the event, the real wonder is how well the Japanese economy coped with the high yen. As Robert Neff has pointed out, on the standard Western definition of a recession (two successive quarters of negative growth), Japan has never entered an official recession at any time in the 1990s. So much for the *Wall Street Journal*'s description of Japan as being "mired in a deadly slump."

While Japan's slow growth has been the object of much attention, the flip side of the yen's big rise has received much less: every time the yen rises against the dollar, the Japanese economy's size increases relative to that of the United States. Thus although Japan ostensibly experienced exceptionally slow growth in the first six years of the 1990s, the size of its economy as measured in U.S. dollars continued to increase rather rapidly thanks to a 41 percent rise in the yen's value against the U.S. dollar. As of 1995, which is the latest year available to me, Japan's GNP totaled $5.15 trillion-or about 71 percent of the U.S.'s $7.21 trillion. By comparison, Japan's GNP represented only 55 percent of the U.S.'s in 1989, the last year of the global economic boom.

Of course the dollar made a strong recovery in 1996, rising by nearly 13 percent against the yen. But this hardly indicates a change in the underlying trend. After all, although the dollar has lost more than two-thirds of its value against the yen in the last twenty-years, in eleven of those years it actually rose. After a precipitous fall in the first half of the 1990s, a bounce was predictable--and I, for one, predicted it. As of this writing, however, this bounce is almost at an end. Although the dollar may be spiking upwards towards the ¥120 level in the first months of 1997, it seems destined to suffer marked weakness later in the year. In fact, I expect the dollar to drop quickly below ¥100, on its way to a new area of stability in the ¥85 to ¥95 range. By 2000, I expect to see the rate below ¥70--and this, of course, will be a crucial development in that, other things being equal, Japan will by then have passed the United States to become the world's largest economy.

Why am I so pessimistic about the dollar? There are many reasons but one of the most compelling is that American neglect of its foreign trade imbalances gets ever more egregious. Far from addressing the underlying problems in American manufacturing industries that are at the root of the trade crisis, American commentators and policy-makers are now increasingly talking about abandoning manufacturing completely to embrace a new world of so-called post-industrial services. They talk enthusiastically about opportunities in, for instance, computer software, Internet databases, and financial trading. There is only one problem with these and other post-industrial businesses: they are extremely poor exporters.

In truth, a country that waves goodbye to its manufacturing industries is waving goodbye to its ability to pay its way in the world. But the issue here is not just persistent trade imbalances. An even more powerful factor is the continually burgeoning underlying strength of the Japanese economy. This strength is bolstered particularly by Japanese industry's huge investment spending. Japanese corporations have typically been investing two to three times as much per worker as their American counterparts in the 1990s. That makes possible remarkable productivity growth, which in turn is the main reason why in every new cycle of yen strength, the dollar falls to even lower levels on foreign exchange markets.

Of course, for now my forecast that Japan will overtake the U.S. by 2000 remains highly controversial. But one thing is beyond dispute: Japan is far and away the U.S.'s most significant challenger for leadership of the world economy in the early twenty-first century. Recent talk that China is close to replacing Japan as the world's second largest economy is based on highly unrealistic assumptions about China's internal economic workings. The way to get the two giant East Asian economies into perspective is to look at their external impact. The chief yardstick of this impact is trade. Here the numbers are quite reliable and on the latest figures available--for 1994--China's worldwide exports totaled just $121 billion. This was less than one-third of Japan's $397 billion and less than one-quarter of the U.S.'s $513 billion. Even if Chinese exports continue to grow as fast in the future as they have in the recent past (a big if), it will take China nearly twenty years to draw level with Japan's 1994 position.

Thus for the foreseeable future Japan will remain the U.S.'s most important foreign economic concern. But, unless their feet are held firmly to the fire by public opinion, American officials are unlikely to be any more effective in the future than they have been in the past in tackling the singularly frustrating and confusing issues raised by Japan's very different economic modus operandi. This is why it is crucial for the American press to improve its coverage of Japan. The American press may be the world's best, but in writing off the Japanese economic challenge in the early 1990s, top American correspondents displayed great naivete, a lamentable lack of preparation for their assignments, and a quite shameful tendency to present dogma-based misperceptions as facts. Their mistakes took the pressure off American trade diplomats and in the end the United States lost at least five

JPRI is pleased and honored to announce that its Research Associate, Dr. Kozy K. Amemiya, author of *JPRI Working Paper* #25, "The Bolivian Connection: U.S. Bases and Okinawan Emigration," has just been awarded a grant by the Japan Foundation to continue her research into this important topic. She will use the grant to revisit Colonia Okinawa in Bolivia, as well as Sao Paulo, Brazil. And she will be using the recently declassified archives of USCAR (the U.S. Civil Administration of the Ryukyu Islands).