



insight

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Japan

Who'll look after the aged?
—

**The Japanese in Brazil: why they
went, why they're coming back**
—

What to look out for in 1994

Hard hit companies competing harder

How competitive is Japanese industry? The answer to this could be a crucial factor in determining how deep the present downturn in the Japanese economy will be, explains GERARD LYONS.

There are really two main aspects to competitiveness: the ability to compete on price and on quality. In the past Japanese companies, particularly in the auto industry and consumer electronics, have been able to compete very effectively in both areas. Low priced, good quality goods were the hallmark of the Japanese. Although the quality of Japanese goods remains high, there is mounting evidence that Japanese companies are finding it more difficult to compete on price.

The main factor that has hit Japanese companies has been the strength of the yen. The yen has been appreciating for several years. Although most Japanese firms expected a strong yen in their corporate plans, the scale of appreciation in 1993 caught them by surprise. Since the start of the year, the yen's effective rate has risen by over 20 per cent.

In previous years when the yen was appreciating Japanese industry was able to cope because of the continued strength of domestic demand. Industry was still able to sell in a buoyant home market. But this is not the case now. The 1993 appreciation has coincided with weak domestic demand. Japanese industry is thus facing a double whammy. The strong yen has squeezed margins. The weakness of demand has led to a fall in output, triggering a large cyclical fall in productivity and a corresponding rise in unit costs. Profits have thus been severely squeezed. Problems have been particularly acute for large manufacturing firms. Their profits have already fallen for three successive years, by 1.6 per cent (in 1990), 23.6 per cent (1991) and 31.0 per cent (1992) and a decline is inevitable this year.

Movements in the so-called 'real' exchange rate can give a guide to competitiveness. Adjusting movements in the yen for changes between costs in Japan and overseas, there has been a 'real' appreciation of the yen of over 40 per cent in the last three years. This suggests there has been a major loss of Japanese competitiveness, particularly in the last 12 months: either the yen must weaken to correct it, or Japanese industry must retrench and cut costs.

Japanese costs and inflation have been low for some time. The trouble now for Japan is that the disinflationary international environment is suppressing costs and inflation elsewhere. The rest of the world has caught Japan up. Thus necessary cost cutting by

Japanese companies could result in job losses on an unprecedented scale.

Yet there is still evidence to suggest Japanese industry is in a healthy state. For instance, a recent study by the European Commission found that the European automotive components industry achieves only, "a third of the productivity of the Japanese".

Surely one could argue that Japan's record trade surplus illustrates that industry is competitive. The trouble though is that the strong yen itself and the weakness of demand in reducing imports have accounted for the rise in the trade surplus. In volume terms, Japanese export growth has not been dramatic.

Often the debate on competitiveness tends to focus solely on the price or cost issue. However, it is no use arguing only that wages and costs must be kept down. A low cost producer of low quality goods will not compete in the high income countries of the west. Companies need to be low cost producers of high quality goods. The key to this is high investment. The Japanese have continued to invest heavily in the last three decades. But now about one-fifth of their capital stock is idle, lessening the need for new investment. By contrast, many of the south-east Asian countries are trying to copy Japan's post-war success. These, the so-called 'tigers', are taking advantage of capital inflows to invest heavily. This is already posing a competitive threat to Japan and to the EC.

All this could suggest that Japanese industry was very competitive, particularly in the early to mid-1980s. The latest appreciation of the yen, and the weakness of the Japanese economy, have removed some of Japan's competitive advantage. It would, however, be premature to write off Japanese industry. In recent months a number of large companies have announced that they are moving production from Japan to overseas. In particular, many companies are looking to south-east Asia in order to take advantage of low costs. This would be one way for them to overcome their recent loss of competitiveness. A far better way would be for the government to relax fiscal policy further, boosting domestic demand, and at the same time try to force the yen weaker.

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