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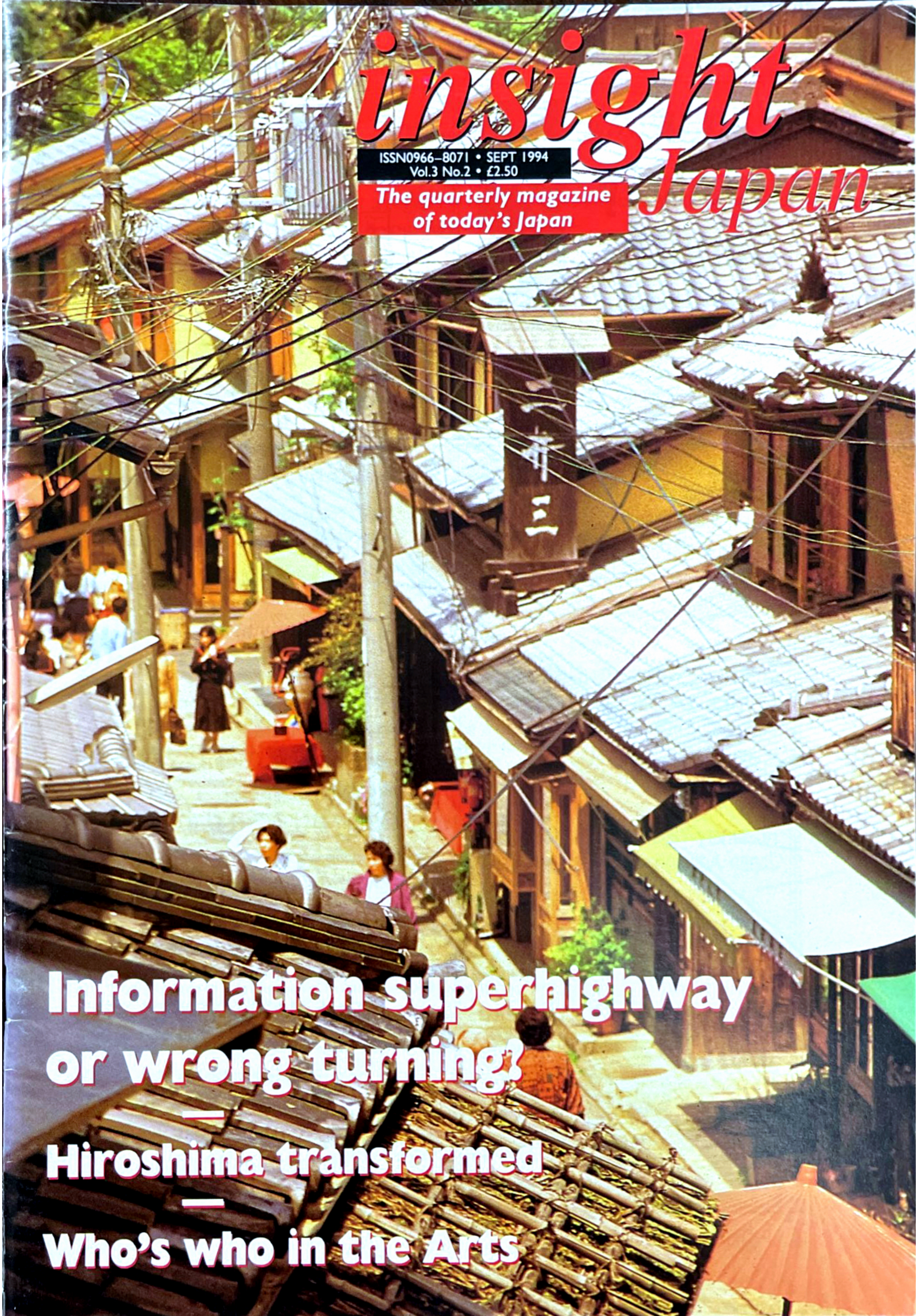

Information superhighway or wrong turning?

Hiroshima transformed

Who's who in the Arts

An economy on the mend – slowly

GERARD LYONS

The Japanese economy is now recovering from its worst recession since the second world war. In the past three years Japan has paid the price for the excesses of the late 1980s and the so-called Bubble economy. Then there was excessive consumption, heavy investment and buoyant credit growth. Land and stock prices soared. It was similar to events in the UK, only on a grander scale. Once the Bubble burst, the economy was thrown into a long recession characterised by weak consumption, retrenchment by companies and tough credit conditions. Now the bad times are over, or so it seems.

The economy hit bottom at the end of last year. Since then activity has picked up at a gradual pace. The Government's official forecasting group, the Economic Planning Agency, has yet to proclaim officially the end of the recession – probably because they prematurely said the economy was recovering last year, only to be proved wrong, and they are wary of making the same mistake twice. Most other forecasters, though, even the Bank of Japan, think the recession is over and the economy is heading for recovery.

I found remarkable agreement in Tokyo in July about the outlook for the economy over the next eighteen months. All forecasters, including myself, expect the economy to improve during the remainder of this year and gather momentum during 1995. This is likely to be a very different recovery from those Japan has traditionally experienced, when the economy has rebounded strongly from a recession. This time, recovery will be mild.

IN THE 1980s Japanese industry was the driving force behind the economy, exporting widely and investing heavily. But this recovery will be driven by consumption, helped by tax cuts and increased government spending. Investment will not figure highly, partly because there was so much investment in the 1980s that large numbers of factories and a vast amount of equipment is lying idle. But, more interestingly, it is also because Japanese companies are looking to invest increasingly abroad.

Production that previously took place in Japan is earmarked for overseas – mainly elsewhere in Asia. This process of 'hollowing out' (and we are likely to hear a lot more about it in coming years) came up in many conversations I had in Tokyo. There are widely diverging views as to whether it will have a positive or negative impact on Japan's economy. While there is general consensus about the outlook over the next eighteen months, there are wide differences of opinion as to where the economy will move after that.

There are many reasons why Japanese companies are finding it attractive to invest heavily elsewhere in Asia: the low level of costs in countries such as China, the desire to be closer to buoyant future markets and because Japan faces a future labour shortage, on account of the ageing population. The yen's current strength is speeding up investment overseas.

There are many optimists who do not think this trend will damage the economy, who regard it as positive for company profits, allowing low cost production to be shifted overseas. But others are concerned that things would not stop there. They fear that high quality production could also shift out of Japan and Japan would suffer as it lost high paid, high skilled jobs abroad. This would leave Japan with heavy industries such as steel but a declining manufacturing sector being replaced by service sector jobs. As the US has found to its peril, this shift not only weakens the economy; it also results in many lower paid jobs being created.

WHATEVER THE EVENTUAL IMPACT, it will certainly drive Japan closer in economic ties with the Asian economic area. This is already being seen in trade, where last year Japan's trade surplus with Asia exceeded that with the US for the first ever time. Historically, Japanese industry has been so flexible it is difficult not imagining it being able to continue to adapt and benefit from Asia's growing economy.

In recent years there have been many concerns that Japanese firms would not be able to cope with the strengthening yen. Everyone I spoke to in Tokyo still views the strength of the yen as the biggest risk to the economy, yet there is a general belief that Japanese industry will cope with a stronger yen. And the more I see, the more likely it appears that this will be the case. At the start of last year an official survey showed firms had a "desirable" exchange rate of \$1:¥125. This seems to be a moving target. By the start of this year the desirable rate had shifted to \$1:¥117, and the latest evidence suggests \$1:¥105.

The stronger yen has of course made it more difficult for Japanese firms to compete. It has also created a more favourable environment for foreign firms to penetrate the Japanese market, as the Japanese now find foreign goods to be relatively cheap. Growing deregulation is encouraging this process. The best example of this is the so-called discount stores, which sell foreign goods cheaply. With a desire for bargains, the selling environment is tough, prices continue to fall, and foreign goods are winning a bigger share of the Japanese market.

Deregulation is central to solving Japan's long-running trade dispute with the US. Clearly stronger growth in imports is important for the trade dispute, but the immediate problem is that Japanese exports are also growing, benefiting from the improvement in world trade. So, the trade surplus remains high and so far this year is above 1993 levels. The risk of the present trade dispute with the US escalating cannot be ruled out. Trade tensions with the US have remained high despite some progress. The US has gained its desired 20 per cent share of Japan's semiconductor market and in mid-August, Japan and the US signed a trade deal on intellectual property rights, mainly regarding patents. But key problems persist, namely America's insistence on numerical targets and greater openness in Japan's economy. Essentially the Americans want some yardstick by which they can judge whether Japanese concessions are working. Everyone in Tokyo believes the trade surplus will decline, but it may not happen this year and certainly not quick enough for the US. The threat of trade sanctions persists. Although the trade dispute is an ongoing problem, it is not a major concern, as most expect some sort of compromise. Still, it could come as a nasty surprise if trade sanctions were imposed.

THERE IS MORE CONCERN about Japan's fiscal position. Bureaucrats at Japan's Ministry of Finance have always been worried about the budget, but they are not alone in their concern. Political uncertainty continues to delay tough decisions such as the need eventually to raise Japan's consumption tax (now 3 per cent) and tackle some of the vested interests keeping government spending high.

The ageing population points to the need for large future pension provisions which the country may not be able to afford on the basis of current fiscal projections – implying a much higher tax burden for the future generation of workers, who will be much smaller in number. The Japanese are right to be concerned about their fiscal outlook, but at least these key issues are being discussed openly. Europe has similar problems about future pensions and welfare provisions, but the debate is far less than in Tokyo.

Concern about future pensions and taxes also touches on what is likely to become an increasingly important issue in Japan – the quality of life. When Japan's economy was booming, most people accepted that economic success was being achieved at the expense of the quality of life. The recession has changed things, and there is a general view that the quality of life needs to be improved.

The good news for the world economy is that Japan is on the mend, but things may be slightly different in the future. Japan faces not a healthy recovery but a long convalescence. ☐

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