The Chrysanthemum and the Eagle

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IN SOME WAYS
JAPAN REALLY
IS ODD

Manufacturing Is Not the Only
Economic Activity

Are Money Games Really Bad? “America has become so engrossed in money games and M&As [mergers and acquisitions] that it no longer makes things. That is why its industrial base has eroded, and the country has gone on a consumer spending spree, buying things from all over the world. This is the basic reason for America’s twin deficits. Despite all the talk about service industries and the postindustrial society, it is inevitable that the economy of a country which has forgotten the importance of manufacturing will deteriorate.” These observations by Sony chairman Akio Morita are acute. The situation in the United States is almost exactly what he describes. But I would venture to raise two objections. First, is Japan a purely industrial manu-
facturing country where money games do not exist? Second, are money games really such a bad thing?

Behind the Japanese dislike of money games is a built-in Confucian bias against profiteering or making easy money by manipulating nonproductive assets—buying and selling stocks, companies, or real estate, for example—instead of earning it with the sweat of one's brow. According to this view any money-making activity that is not related to production is the equivalent of gambling. During the 1980s many Japanese viewed the spate of corporate takeovers in the United States with undisguised contempt, as the very phrase money games suggests. But if money games are really bad, Japan's land-flipping deals during the late 1980s were probably the worst example of them. With the mere change of a name on a deed of land, the value of a piece of property was inflated by millions or tens of millions of yen. Between 1986 and 1989 speculation in real estate sent the value of land, especially in the metropolitan Tokyo area, soaring to astronomical heights. The price of residential land went up 19.3 percent in 1986 and a whopping 95.8 percent in 1987. For commercial properties the rise was 35.4 percent and 80 percent in those two years. By 1990 the value of land in residential areas was 262.2 percent higher than it had been in 1983; commercial real estate had increased by 312.3 percent in the same period. During the height of the real estate boom a single piece of property might change hands several times at increasingly higher prices. In extreme cases the same piece of land might be sold two or three times in as many months. This must be the most nonproductive money game of them all. If America is to be criticized for its corporate take-
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overs, then Japan merits the same degree of criticism, or even more, for its real estate deals. In short, Akio Morita told half the truth but neglected to talk about the other half.

The truth is that Japan also regularly engages in nonproductive money games. One would be hard-pressed to argue that land flipping in Japan is good but mergers and acquisitions in America are bad. More to the point, the fact that buying and selling land or companies is a nonproductive practice does not mean such practices have no value. After all, commodities are bought and sold precisely because they do have value. What is regarded as valuable, however, differs from country to country. In America it is companies; in Japan it is land. Japan is about the size of California, but three-quarters of it is mountainous, so the supply of habitable land is severely limited. This makes land extremely valuable, especially in the Tokyo area. America, on the other hand, has a great deal of land; thus, it goes in for mergers and acquisitions, the buying and selling of companies, rather than the buying and selling of land.

If money games are a bad practice, then both Japan and America have been equally guilty of playing them. I do not believe, however, that money games are necessarily bad. At the height of Japan’s bubble economy, when Japanese businessmen were asked why the economy was booming, they invariably attributed Japanese prosperity to the high price of land, not to Japan’s successful exporting efforts. To put it another way, it was not because the economy was booming that land was in such high demand, but the other way around: Because land was in demand, the economy was boom-
ing. People used the vast sums of money they made from land sales on personal consumption or house construction or investments in the stock market or new land purchases, and these transactions boosted the economy. Thus, money games, not making things, were what was behind Japanese prosperity in the late 1980s. In a similar way, what sustained American prosperity during the last decade was the money game known as M&As.

Money games happen as the result of a transfer of ownership. When either land or companies change hands, the economy thrives. From a historical perspective, money games make good sense. Normally, an economy has two sectors, one leading, the other lagging behind. These two sectors change with the times. Nowadays the ultimate nonproductive sector is agriculture. Japanese agriculture is a particularly extreme case, well known for using expensive land to yield insignificant returns. According to the theory of economic development, the decline of agriculture indicates that Japan has made the transition from an agrarian society to a manufacturing society. But until the eighteenth century, agriculture was the most productive sector of all and the source of the world’s wealth.

For Japan, too, in the Edo period (1600–1868) the wealth and power of each feudal domain was determined by its kokudaka, the amount of rice it produced. The real strength of the clans derived from the agricultural productivity of their fiefs. Even part of their taxes was paid in rice. In the period when agriculture was the mainstay of the productive sector, the nonproductive sectors were the aristocracy, the warrior class,
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trade, and manufacturing. (This was not manufacturing in the modern sense, of course, but occupations like smithing.) With the Industrial Revolution, however, agriculture declined into a nonproductive sector, and manufacturing emerged as a productive sector. In short, there is a logical progression from the Industrial Revolution to the decline of agriculture and the emergence of the modern state.

As we head into the twenty-first century, however, manufacturing is also ceasing to be a productive sector and is being replaced by knowledge-intensive industries or by service industries. Thus, if the history of the world is a progression from agriculture to manufacturing to knowledge industries, then America’s M&As and Japan’s land-flipping deals might be thought of as advanced forms of this phenomenon and might even make good economic sense. If the practice of making things, which Akio Morita talked about, has already become a nonproductive sector like agriculture, perhaps both the United States and Japan are risking their futures by trying to hold on to manufacturing jobs. Haven’t American and Japanese companies been shifting their manufacturing base to third-world countries where labor is cheap?

This line of thought leads inevitably to the conclusion that money games are the harbingers of the future, the foreshadowings of a postindustrial society that will be the norm for the most advanced countries. That may, in fact, be the case. Heavy physical labor, of which agriculture is an extreme example, overtaxes the body and is the most debilitating kind of work for human beings. The replacement of human labor with machine labor marked the beginning of industrialized society;
today we are perhaps seeing a shift to a knowledge-intensive society that relies chiefly upon human brain power. If that is the case, the fact that we can buy stocks, companies, or land with a single telephone call is completely consistent with the concept of social progress.

That having been said, we will have to consider carefully whether America’s M&As and Japan’s land-flipping deals were, in fact, the leading edge of such a trend or merely decadent and excessive activities, the symptoms of decline. In making such a judgment, we must look back in time to see whether similar practices have existed in the past. Land speculation in Japan is nothing new; there have been two other land booms in the past twenty or so years alone. The first began in June 1972 when Prime Minister Kakuei Tanaka announced his plan to “remodel the Japanese archipelago” by building high-speed transportation networks to tap the cheap labor supply in the rural areas of Japan. As corporations bought up land along the expected routes, land prices soared, but inflation caused by the upward revaluation of the yen and then the first oil shock in October 1973 sent the Japanese economy into a recession. Tanaka’s plans were shelved and many companies found themselves holding land that no one wanted.

The second wave of land speculation occurred ten years later in 1983 and was centered on Tokyo. With the liberalization of the financial and capital markets and Japan’s increasing economic importance on the international scene, companies began to flock to Tokyo in the expectation that the city would become a major international center. This trend sent up the cost first
of commercial real estate, then of residential areas in Tokyo, and ultimately rippled out into the rest of the country.

*M&As and Technological Innovation.* M&As are not a new phenomenon either but occur as part of a set cycle. This is the fourth time the United States has witnessed waves of corporate takeovers. The first major wave of mergers and acquisitions in the United States dates back to the late 1890s and lasted through the early 1900s, when today's large corporations such as USX Corporation and Du Pont first began to use corporate takeovers as a means of expansion. During this first wave of M&As, the American economy was in extremely good shape. Because these M&As poured large amounts of previously idle cash into circulation, they inevitably boosted the economy even further. Thus, if M&As are a bad practice, it is because they cause too much of an economic boom and encourage an increase in imports and a consumer spending spree. This phenomenon occurs simply because more money is available—there is nothing wrong with increased market activity per se. An even greater misconception is that the American economy has declined recently because it has been sidetracked by M&As. In fact, it is precisely because M&As were resorted to so frequently that America was able to maintain economic growth and prosperity during the past decade.

America's second wave of M&As came in the 1920s. If the first wave created monopolies, this period saw the creation of oligopolies—the medium-sized companies that make up America's second tier. During this period, too, the economy prospered until the crash of
1929. In American history, a period of merger and acquisition activity is always followed by a crash. The pattern is clear: As long as corporations are being bought and sold, money circulates and creates enormous prosperity, but when the buying and selling comes to an end and the money stops flowing, there is a crash.

The third wave of mergers and acquisitions came during the 1960s and saw the rise of many conglomerates. The keyword during this period was "diversification." The classic example was International Telephone & Telegraph, which ventured out into many different business areas with great success. Up until that time USX only made steel; Ford only made automobiles. But during the third wave of M&As, the concept of the conglomerate took hold. This period of prosperity continued until the first oil shock of the 1970s, and then it too ended in a crash.

The fourth wave occurred in the 1980s. Many of the M&As in that decade served the purpose of corporate restructuring. The bull market of the eighties lasted until the crash of October 19, 1987—"Black Monday"—when Wall Street awakened to the fact that stock prices had gone too high.

As this overview indicates, not only do mergers and acquisitions have a fairly long-standing history in America, they have a set cycle. What is worth noting in this cycle is the cause-and-effect relationship between technology and M&As. Each of the four waves of M&As occurred after some major technological breakthrough had taken place. The first wave in the 1890s occurred after a period of rapid expansion of America's railroad system; prior to the second wave in the 1920s automo-
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tive technology had been perfected. The third wave in the 1960s followed the appearance of the jet engine; the fourth wave in the 1980s coincided with the emergence of computer technology.

To understand the causal relation between technology and M&As, let us consider the case of the fourth wave. The introduction of computer technology gave rise to business opportunities that had hitherto been inconceivable. These opportunities accelerated the need for corporate restructuring and led to mergers and acquisitions. Thus, one cannot look only at the M&A phenomenon and dismiss it simply as money games; one must also consider the complex series of trends that have produced it. Mergers and acquisitions do not take place in Japan for the simple reason that a takeover is now considered something that is just not done. (As we shall see in chapter 5, this was not always the case.) An even more significant factor is that few companies ever come up for sale. This is another reason that land, not companies, plays the leading role in Japan’s money games.*

Economic Growth Undermines Agriculture. Clearly, both mergers and acquisitions in America and land flipping in Japan were excessive and out of balance. Paradoxically, this very excess is the reason both economies expanded so vigorously in the 1980s. Balanced growth is, in the nature of things, impossible. An econ-

omy can grow only when an imbalance occurs. To be sure, the concept of balanced growth does exist in economics, but it designates an ideal state in which all countries, rich and poor, have achieved the same standard of living through economic development. Fortunately, achieving such a state is impossible, since historical trends indicate that imbalanced growth leads to a higher standard of living.

When an economy achieves a balance, stagnation begins to set in. In economics there is a concept called a "product cycle." Take textiles, for example, where the production base has shifted from Europe to America, Japan, and Southeast Asia in search of a low-wage workforce. A country has always been found that is suited to this particular technology. Thus, a product cycle occurs because of technological and economic imbalances among countries. If the world achieved a balance, countries that produce textiles would disappear. To put it another way, water flows because it moves from a higher level to a lower one. Running water produces energy and does not stagnate. In much the same way, imbalances are what energize an economy and keep it running, and a few M&As and land-flipping deals can serve as a priming agent to trigger the economy. As this mode of reasoning suggests, the concept of balanced growth contains two logical contradictions because, first, there is no growth in a balanced state, and, second, growth creates imbalance.

The same point can be explained by what is known in economics as the "price effect" and the "income effect." Suppose there is a product that costs one hundred dollars. Whether this price is considered low or high will depend on a person's income and the current
state of his or her pocketbook. Even someone who felt that the item was excessively expensive would buy it if the price were lowered to fifty dollars. This causes the so-called price effect. The same person would also buy if the price did not change but his or her salary suddenly doubled. This is the result of the income effect. The action of buying is ultimately the same, but in the latter case it is clearly justified by an increase in income. What causes an increase in income is economic growth. Economic growth is nothing else but a rise in everyone’s income.

But if the economy grows and incomes go up, will everyone be happy? Human nature being what it is, the answer is “not necessarily.” An increase in income leads to greater consumption, and when this happens, people start shifting to higher priced goods. This shift is due to what is known in economics as the “elastic income effect.” Just such a phenomenon occurred in Japan in the late 1980s. Thanks to the high yen and economic prosperity, Japanese incomes rose steeply. First-class cars on the Shinkansen Bullet Train were full; suddenly young office workers were taking their vacations abroad. Even school trips were to foreign destinations. The world’s top brand names sold like hotcakes; indeed, products did not sell very well unless they were expensive. (This is another reason for the difference between Japanese prices and world prices that has led to so much Japan-bashing.)

Japan has certainly become more affluent; it is now the world’s largest creditor nation. One might think this is cause for celebration, but, in fact, it is where the idea that “growth creates imbalance” comes into play. When people choose luxury goods, they reject less so-
phisticated products. This makes the industries that produce such items and the people employed in these industries unhappy. Economic growth, therefore, does not profit everyone in the country; it merely creates new imbalances in the short run.

Statements by Japanese politicians to the effect that both agriculture and automobile manufacturing, mom-and-pop stores and supermarkets will enjoy steady growth are merely political promises and quite incompatible with economic theory. Just as balanced growth for all countries is impossible, balanced growth for all sectors of the same economy is equally impossible. Economic growth creates imbalances and weeds out businesses and entire industries. In Japan, for example, charcoal-making has nearly died out and the charcoal stove has just about disappeared. Young Japanese in their teens and twenties have never known the warmth of coal-heated footwarmers. Most of the textile industry has moved to South Korea, Taiwan, or Hong Kong, or to the member countries of the Association of South-East Asian Nations (ASEAN) or places like Costa Rica.

In the most extreme case, if Japan continues to aim at economic growth and increased income, Japanese agriculture will ultimately be destroyed. With the rise in incomes and the standard of living, the Japanese are no longer consuming as much rice as they used to and are eating bread or meat instead. As the consumption of gourmet food grows, rice consumption will probably drop even further. And as the range of available foods becomes wider, rice will no longer be the main staple of the Japanese diet, but simply a side dish to be eaten in small amounts with steak or fish.

It could be argued that if people really want to eat
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rice, it would make better economic sense to buy it cheaply from abroad. The Japanese government’s vow not to import a single grain of rice, then, would be only a political gesture aimed at the farming lobby. Were economic development Japan’s sole objective this argument would be persuasive because in terms of economic development, Japan’s present agricultural policy clearly does not make sense. (In fact, Japanese policies vis-à-vis farming have as much to do with the country’s cultural agenda and with preserving the political status quo as they do with economic issues. The Japanese have a great respect for the traditional role of rice farming in Japanese life. On the practical side, farming districts have always been bastions of support for the Liberal Democratic party.) Japan’s Staple Food Control Act dates back to 1942 during World War II when the price and distribution of food staples were put under government control with the aim of preventing speculation, maintaining a steady supply, and regulating price fluctuations. Under this system the Japanese government purchases rice and other grains, sets their prices, and controls distribution. Because the government buys rice at a high price from producers and sells it to consumers at a lower price (albeit one far higher than in other countries), the deficit in the food control special account has been growing steadily. The concept of maintaining self-sufficiency in rice became a national security issue in the 1970s. The “food security” argument was first advanced as a reason for blocking the liberalization of rice imports. If Japan were dependent on imports for some or all of its grain supply, the argument goes, food shortages might occur in the event of war.
In short, Japan’s basic stance on the rice issue is that rice is a kind of domestic public good. However, rice can also be seen as a private good that can be freely traded. The United States holds the view that rice is just another international trade commodity like cars or consumer electronics and, like other such items, less expensive goods of better quality will naturally prevail in the marketplace. The paradox of Japan’s Staple Food Control Law is that under the present system farmers have been protected, but agriculture is being destroyed. For a native of Akita Prefecture such as myself, the beauty of the rice paddies will always be a vivid symbol of my childhood home, one of the major rice-producing centers in Japan. But each time I have gone back to visit in recent years, fewer and fewer of those beautiful, familiar fields remain. Left uncultivated and overrun with weeds, they are a desolate and heart-breaking reminder of the contradiction behind Japanese prosperity. Although everyone talks about protection, rice-growing in Japan is, in fact, bound hand and foot, and the prospects of raising productivity or of making it competitive are fraught with difficulties.

As an economy develops, products that no longer suit society’s needs steadily disappear and less productive industries are weeded out. Calling this a “hollowing out” is simply describing the symptoms without trying to understand the phenomenon itself. “Hollowing out” is actually a normal state of economic development, proof that the economy is operating efficiently. If an industry in one country “hollows out,” some other country that can fill the resulting niche will get rich in the process. The history of economic development has consisted of a succession of “hollowing out” processes.
Manufacturing eroded agriculture because it was more productive than farming. Similarly, the productivity of the knowledge industries is superior to that of manufacturing so the erosion of manufacturing is only natural. That is the law of economic development.

What Causes the Disparity between Japan’s Prices and World Prices?

The Plaza Accord Fiasco. By the end of the 1980s America had become extremely nervous about Japanese investments in U.S. real estate. In particular, the purchase of Rockefeller Center provoked a strong backlash. How could such a sale take place? The remote cause can be traced back to the Plaza Accord in 1985. The yen had started to appreciate in February 1985, and in one sense the actions taken by the finance ministers and central bankers of the five major industrial powers at the Plaza Hotel in September of that year simply confirmed the fundamental forces at work in the marketplace. There is no denying, however, that then Secretary of the Treasury Jim Baker believed that helping this trend along and lowering the value of the dollar would make American goods more competitive. This was a total miscalculation on the part of the Reagan administration, as America has come to realize. Between 1985 and 1988, the value of the dollar dropped from 240 yen to the 120-yen level. Although it later gradually rose again to around 150 yen, in September 1992 it fell below 120 yen for the first time in postwar history.

The cheap dollar policy embodied in the Plaza Ac-
cord was supposed to solve America's trade deficit and open the Japanese market to U.S. goods. The American projection was that an upward revaluation of the yen would lead to a reduction in Japan's exports and thus in its trade surplus with the United States. In due course Japan would be forced to open its markets. This did not happen. Instead, in an amazingly short time Japan had overcome the adverse effects of the high yen and strengthened its economy even further. Moreover, thanks to the high yen, Japan's income doubled in the space of a mere four or five years. The U.S. government had not dreamed this would happen; nor had it imagined that Japan would set about "buying America" with its newly doubled income. In effect, the Plaza Accord cut the value of America in half and made Japan twice as rich as it previously had been. It was a colossal mistake.

For a million yen to double in value in ten years' time, it would have to be invested at an interest rate of 7 percent compounded annually. To double in four years would require an interest rate of 15 or 16 percent. In other words, the United States gave Japan an annual growth rate of 15 to 16 percent free of charge. Anyone with even a nodding acquaintance with economics can understand how huge these figures are. Moreover, as a side effect, it contributed to the discrepancy between the price of goods in Japan and what these same items sell for abroad.

The price gap problem is two-sided. On the one hand, Japanese goods are expensive at home and inexpensive abroad; on the other hand, foreign goods suddenly become absurdly expensive when they arrive in Japan. There are two reasons for this. First, price ad-
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adjustments do not keep up with rapid fluctuations in the exchange rate. The second source of the problem is Japan’s economic structure, which has become the target of anti-Japanese attacks.

Given the continuing cheap-dollar, high-yen exchange rates, it is odd that Japanese exports have not become more expensive in the United States and that U.S. exports have not gotten much cheaper in Japan, if not in the same proportion as the exchange rate, then certainly by a considerable degree. This has not occurred. The advantages of the cheap dollar have not been passed on to American producers any more than the advantages of the high yen have been passed on to consumers in Japan.

In Japan the failure to pass along the benefits of the high yen can be laid at the door of two groups. Half of the responsibility lies with the buyers, the Japanese people themselves. Responsibility for the other half, of course, lies with the suppliers and sellers. As incomes rise, consumers are quite willing to buy expensive items; there is even a tendency, which might be regarded as a Japanese trait, to buy things precisely because they are expensive. That makes it difficult for businesses to lower their prices. The cost of materials even for luxury items is often not very great, but many Japanese feel that the more costly an item is the better it must be. That is why Japanese buy 80 percent of the brand name items produced by Gucci and Louis Vuitton, items that are ridiculously expensive. Diamonds also sell because they are expensive; if they were cheap, no one would be interested in buying them. In short, the Veblenesque price effect operates for expensive goods. On the other hand, suppliers make good use
of Japan’s complicated distribution system by taking advantage of the sole agency dealership system, which gives the supplier monopoly rights over the goods sold in a particular store. The distribution problem is indeed structural.

No one can explain fully, however, why it is cheaper to buy Japanese goods overseas than in Japan. Although, as we saw in chapter 1, technological innovation and economies of scale account in part for why price increases have been held to a minimum regardless of the high yen or the low dollar, no completely satisfactory explanation has been proposed as to why Japanese goods cost less abroad than they do at home. The Japan External Trade Organization (JETRO) has argued that the high cost of land, especially in Tokyo, contributes to the price gap by increasing overhead for small retailers which is then passed on to customers in the form of higher prices. By postulating what is known in economics as “price discrimination,” one could explain why goods for export are cheap and those for domestic use are expensive, but this would be a clear case of dumping and a problem of corporate morality rather than a structural issue. In short, there is no simple economic explanation for this aspect of the price gap. Though by no means all, many products that are made in Japan are in fact cheaper in the United States. During the Structural Impediments Initiative talks the American side confronted Japan with a list of them. Cameras are a prime example. The president of a Japanese camera-making company is said to have come to America just to buy his own company’s cameras because they were cheaper here. A former prime minister, while on a state visit, is rumored to have
bought a Japanese camera at a famous New York discount store. These stories and others too numerous to mention indicate popular Japanese perceptions of the problem.

The explanation America gives for the price gap is interesting: The reason Japanese goods can be bought more cheaply in America than in Japan is that America has an extremely efficient distribution system. Conversely, the reason American goods and even Japanese goods are more expensive in Japan is that the Japanese distribution system is extremely inefficient. Whether this observation is correct or not, it is an open secret that Japan's distribution mechanism is so complex that it has been called the "Dark Continent." Reform of the Japanese distribution system was near the top of the agenda during the U.S.-Japan Structural Initiative Impediment talks.

The Japanese market is characterized by a high density of very small outlets and a multilayered wholesale system. According to a recent Japanese government white paper put out by the Economic Planning Agency, 95 percent of all small retail stores in Japan had fewer than ten employees, and there were 135 stores for every 10,000 people. In contrast, the United States had only 81 stores per 10,000 people and Germany only 67.

How can we account for the large number of small stores in Japan? The answer to that question can be found in consumer habits and cultural background. The average family in Japan consumes more fresh produce than its American counterpart and shows a strong resistance to frozen foods. Furthermore, few homes have a large storage capacity. This means that the average Japanese housewife shops on a daily rather than
a weekly basis, and stores are more likely to be within walking distance of her home. Yet another reason is that Japanese consider shopping as a form of entertainment, and a store often serves as a kind of meeting place. The Yaohan Supermarket in Fort Lee, New Jersey, is a good example of how these Japanese concepts have been imported to America and incorporated into the store’s design. In addition to shopping facilities, the supermarket contains restaurants where mothers with small children can put down their parcels and relax, have a meal and talk to friends and acquaintances. Taking the family to a department store on the weekends is a typically Japanese idea of shopping as a form of entertainment.

Another reason for the high density of small outlets in Japan is said to date back to the occupation. There is a story—perhaps apocryphal—that when General MacArthur was compiling a report on reconstruction efforts in Japan to submit to the U.S. government, the unemployment figures at the time were unexpectedly high—nearly 40 percent. Because this would reflect badly on the soundness of occupation policy, it was decided that anyone who was living with an employee of one of the many small retail stores throughout Japan would not be counted as unemployed, even if, in fact, they were. This strategy reduced the unemployment rate to 20 percent. In short, because most of the small retail outlets in Japan were—and still are—family-run mom-and-pop stores, the statistics were manipulated to conceal unemployment within families. This sort of manipulation continues to the present day and must be taken into consideration in accounting for Japan’s extremely low unemployment rate.
Shopping districts composed of dozens of these tiny stores all crowded together have traditionally played an important role in the local economy and have contributed much to the character of local society. The Large-Store Law was enacted in 1973 to prevent large supermarkets, which had just begun to move into these districts, from adversely affecting the small retailers who had been there for years. In effect the law allows the local chamber of commerce to decide whether any changes need to be made to the size, operating hours, and other plans for a proposed large store. As a result of the Structural Impediments Initiative talks, amendments to the Large-Store Law and related legislation were proposed, including shortening the deliberation process from a year and a half to a year and increasing to a hundred square meters the area in large stores where foreign imports could be sold. The American retailer Toys 'R Us has succeeded in setting up outlets, and large Japanese supermarkets have begun to follow suit.

The multilayered structure of the wholesale system can be viewed as a necessary result of the need to supply this extremely large number of retail stores efficiently and often. Consumers in Japan are said to be the most demanding in the world, and in recent years their needs have diversified considerably. Although diversification would seem to promote a multilayered structure, this argument is counterbalanced by the rapid growth of convenience stores which are absorbing many of the smaller stores in their vicinity. On the Izu peninsula south of Tokyo, where I spend several months of the year, I can see this phenomenon happening right in my own neighborhood: The small
stores are being rapidly forced out of business by a big new supermarket. In any event, it is fair to assume that the distribution sector in Japan faces a major shake-up.

*The Price Gap as Proof That Japan Is Different.* Is there a way to eliminate the discrepancy between Japanese and international prices for the same goods? Theoretically, yes. If a different exchange rate were adopted for each product, then the gap would soon disappear.

Broadly speaking, the exchange rate is determined by two factors. The first is the flow of trade between the United States and Japan, that is, the supply and demand for the goods actually being traded between the two countries—beef and oranges, VCRs and automobiles. If the demand for Japanese goods is heavy in America, the dollar goes down; if the demand for American goods is heavy in Japan, the dollar goes up.

The second factor is the flow of capital. When Mitsubishi bought Rockefeller Center, it could not make the purchase in yen so it sold yen on the exchange market and bought dollars to pay for the landmark property. Having purchased Rockefeller Center, Mitsubishi, of course, could not actually take it back home to Japan. What Mitsubishi received was not the asset itself but a piece of paper, the title to the property. Similarly, Japan often purchases U.S. bonds. Yen are exchanged for dollars on the exchange market, and these dollars are used to buy pieces of paper, bonds, which are taken back to Japan. This trade in assets, rather than things, is called the flow of capital. When Japan set about “buying America,” it inevitably exchanged yen for dollars so the demand for dollars increased and the value of the dollar went up. Con-
versely, in the past two years when Japan lost interest in the United States and withdrew its money, it sold dollars and bought yen, and the dollar declined. Thus, the exchange rate is determined by the flow of both goods and capital.

To understand how adopting a different exchange rate for each product would eliminate the price gap, consider land in Japan, the price for which is very high. The Imperial Palace occupies a large site in the center of Tokyo and is, of course, the prime piece of real estate in Japan. But when the book value for that single piece of property could buy the entire country of Canada—as it could in the late 1980s—something is very wrong.

The value of the Imperial Palace was so incredibly high because the dollar was then trading at around 150 yen. Suppose, however, that one dollar had been worth 1,500 yen; Japanese land would have immediately dropped to one tenth its value. If the rate of 1,500 yen to the dollar had been adopted only for land transactions, the criticism implicit in comments about how Japan’s high land prices were keeping out foreign companies would have vanished in a flash.

In the 1980s airfares in Japan were also expensive so the exchange rate for them should have been around 500 yen to the dollar. Conversely, electronic appliances were cheap so the exchange rate for them could have been set at 110 yen to the dollar; and the one for cars might have been 100 yen. Establishing a different exchange rate for each item would not only eliminate the price gap but would simultaneously solve the trade surplus/deficit problem. Such a move would satisfy U.S. demands to make things “just like they are in America.” The problem with this method is that it
might lead to cheating. Suppose, for example, someone claimed he was planning to buy land in Japan and received the real estate exchange rate of 1,500 yen to the dollar. If he then turned around and used this favorable exchange rate to purchase a car with an exchange rate valued at 100 yen to the dollar, such cheating would ultimately corrupt the conversion system.

The reason I have proposed such a fantastic hypothesis as multiple exchange rates that vary with different goods is that ideally the exchange rate system ought to prevent discrepancies in the value of a particular commodity from occurring between countries. Only in Japan, however, do we encounter the strange situation that a balance between its prices and those of the rest of the industrialized world cannot be achieved unless the exchange rate for land is 1,500 yen to the dollar and the one for automobiles is 100 yen to the dollar. This fact by itself bears witness to the fundamental difference in the economic fabrics of the United States and Japan. From an international perspective, Japan is an enormously unbalanced country.

In general, this strange situation does not exist between Europe and the United States. In the late eighties, the German currency, like the yen, nearly doubled in value, but this did not produce the same imbalances in western Germany that it did in Japan. The German economy has a mechanism to correct any imbalances created by fluctuations in the exchange rate. Of course, a price gap for some items does exist between Germany and the United States, but nothing as extreme as in Japan, where land is worth much more than in America, but cars are only worth a fraction as much.

If we keep in mind what constitutes fair prices in the
international marketplace and try to coordinate them by setting a different hypothetical exchange rate for each item, it becomes perfectly clear, even to Japanese eyes, how unbalanced Japanese prices are compared with prices in Europe and North America. Japanese may retort that as long as they have the money and can find someone willing to sell to them, it does not matter if Japan as a country contains these imbalances whatever the rest of the world might think. To American and European eyes, however, these imbalances reflect what makes Japan "different." If, for example, the appropriate exchange rate for cars in Japan is 100 yen to the dollar and the exchange rate is adjusted accordingly, then existing prices for cars are too low. Similarly, if a fair exchange rate for land is 1,500 yen to the dollar, then existing Japanese land prices are too high.

According to the rules of capitalism, no one will buy land that is too expensive, whereas cheap cars sell briskly. Items that do not sell eventually come down in price, and the prices for things that do sell go up, thereby achieving a balance. This is what is known as a market mechanism. In Japan, however, market mechanisms do not work. According to Americans and Europeans, they do not work because Japan is different. That was the lesson they learned from the Plaza Accord fiasco. At the time, the finance ministers and central bankers of the United States, Japan, West Germany, Great Britain, and France believed that adjusting the exchange rates would remedy Japan's chronic trade surpluses and bring the Japanese economy more into line with economic conditions in Europe and North America. In other words, the Plaza Accord was based on the presupposition that Japan's economic
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structure was not different from that of the rest of the industrialized world. But, in fact, this was not the case. Not only did the Plaza Accord fail to improve the chronic surplus, it created a price gap between Japanese and international prices that even market mechanisms failed to eliminate. Japanese capitalism, the Western world has come to believe, is so different that adjusting exchange rates has no effect at all.

Emotional Borders in a Borderless Age

Ominous Signs from America's Grass Roots. With the failure of the Plaza Accord, a view began to emerge in America that exchange rates should be determined not just by the flow of trade and capital but also on the basis of PPP—purchasing power parity. Purchasing power parity is a method of determining the exchange rate in terms of the true cost of living in any two given countries. In Japan and the United States, for example, one would take the price of land, the price of automobiles, and so forth, and come up with an average by which to determine what the exchange rate should be. But for PPP to function properly two conditions are necessary. The first is that the productivity and technological skills of the two countries being compared must be roughly on the same level. Second, consumer tastes must also be roughly equivalent.

When these two conditions are present, using PPP to determine the exchange rate works perfectly. The reason the exchange rates between America and Europe are in agreement is that there are no major differences in technological skills, and tastes are remarkably
similar. The exchange rates between the United States and the countries of Europe are actually determined by the balance in supply and demand of capital and trade goods, but if the rates were determined by PPP, there would be little or no change. In contrast, the exchange rate between the United States and Japan inevitably produces a gap between Japanese and U.S. prices. This gap is caused by the fact that Japanese society and American society really are different. In the Japanese economic system, for example, there is no “invisible hand” at work to eliminate the spread between domestic and international prices. And even if no difference in technological skills existed, the two countries’ tastes are different. An extreme example of the differences in Japanese and American tastes is their attitudes toward natto. Natto is a kind of fermented bean dish that most Japanese are extremely fond of, but of all the Americans I know who claim to like Japanese food because it is low in fat and low in calories, I have never met anyone who likes natto very much. Because such an extreme difference in tastes inevitably affects the price of a product, it is only natural that natto is more expensive in the United States than it is in Japan. This is a price gap that it would be difficult even for the “invisible hand” to eliminate.

The very fact that tastes differ is evidence of a deeper difference. If tastes are different, each country’s emotional response to a product is different, and this difference in emotional response will naturally affect the product’s price. I once had a conversation with the Saudi Arabian ambassador to Japan. Noticing that he carried a lot of keys, I asked him why he had so many. One was the key to the house, he explained, another
was the key to his office, and another was the key to the television. Surprised by this answer, I asked why he needed a key to the television. "So my children can't watch it," he replied. Saudi Arabia has strict religious rules against the depiction of naked women. Thus, the ambassador could not allow his children to look at Japanese television, which features a great deal of violence and pornography.

In short, when tastes differ, people approach the same product in different ways. I do not know how much television sets cost in Saudi Arabia, whether they are more or less expensive than they are in the United States or Japan. What is certain, at any rate, is that the attitudes toward television which prevail in America and Japan do not prevail in Saudi Arabia. Even the exchange rate is virtually powerless in the face of taste. Differences in prices for the same product between one culture and another are probably inevitable. Or to put it the other way around, the role played by culture and taste is very important.

These differences in culture and taste played a large part in the rise of revisionism discussed in chapter 1. Revisionists took note of them to develop the argument that Japan is different. What lent credence to the revisionists' point of view is that adjustments to the exchange rate did not diminish Japan's trade surplus with the United States but only succeeded in creating a price gap between the two countries. A trade balance was achieved with Europe and even with Germany, which was affected by an upward revaluation of the mark at more or less the same rate as the yen. To the question why a trade balance has not been reached with Japan alone, the revisionists' answer that "Japan is different"
carried conviction. Looked at from another perspective, the fact that a trade balance has not been reached is testimony to Japan’s strength. It demonstrates Japan’s ability to transform an unfavorable set of circumstances into a favorable one. This is the theory of comparative disadvantage. A person with a disability, for example, must learn to compensate for and overcome his or her personal handicap in order to survive. Japan’s handicap is a shortage of land, which it must utilize to its highest potential if it hopes to be competitive with other countries in trade. External forces have compelled the Japanese to work more diligently than others in order to remain competitive. Hence Japan has turned a disadvantage—its limited land area—into an advantage.

Aggressive Japanese investment in the United States during the late 1980s, however, has rubbed Americans’ feelings the wrong way. The people responsible for selling Columbia Pictures and Rockefeller Center may have walked away from those deals with big smiles on their faces, but Americans are uncomfortable that foreigners now own these institutions which embody so much of the American tradition that they had almost come to be regarded as public property. In fact, of course, Rockefeller Center is merely a large piece of real estate and Columbia Pictures was just another troubled business. It is not a healthy situation, however, when the American media and ordinary Americans use the sale of these properties to make a fuss about the financial presence of Japan in the United States. If America’s grass roots come to believe that Japan aims at the economic domination of the world—though it in fact has no such aims—matters will be
complicated considerably. There are many American companies such as Motorola that are getting rich by accommodating themselves to the differences between Japan and America. Companies that are doing well, however, do not speak out; the companies that complain are always the ones that are doing poorly.

Generally speaking, American companies have far less official clout than their Japanese counterparts and not nearly as much power to affect government decisions. The American public is quite a different story. Once aroused it can move mountains.

Distorted Nationalism. Although Japanese investment in America fell from $16 billion a year in 1988–90 to $5 billion a year in 1991, if a representative sampling of Americans were asked what they thought about Japanese investment in America, I suspect a large majority would still answer that it is a bad thing. The mass media has overplayed the issue and focused only on the facts that portray Japan in a negative light. Americans who read biased articles or see sensationalized reports on television become convinced that these accounts are accurate. And once the politicians join in and begin Japan-bashing, a great chorus of “Japan is unfair” goes up throughout America.

This is what I call my “hospital patient” argument. If someone is in the hospital, something must be wrong with him. If you ask several patients if anything is wrong with them, you can be sure they will all answer “yes.” But if, based on this partial survey, you report that most of the people in the world are sick, that is obviously incorrect. The American mass media frequently resort to this sort of trick. Strictly speaking, The
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Japan That Can Say “No” expressed the views of only two people, but the book was portrayed as an expression of the views of the Japanese people as a whole. This is distorted nationalism, and nationalism in one country gives rise to nationalism in the other.

Nationalism plainly resides in the human heart. At the time of the FSX hearings, I was perplexed at America’s behavior, which seemed only a pretext for getting its own way. The reason for my reaction was, quite simply, that I am Japanese. When I visited Japan still angry about the incident and discussed it with the then chairman of Mitsubishi Heavy Industries, he was calm and collected. “Don’t get so excited,” he told me, “it’s only business.” Perhaps a businessman’s heart is an uncongenial place for nationalism to reside; perhaps he only has room in his heart for business. The American business world is just the same. If an American asked Rockefeller what he thought he was doing selling Rockefeller Center, he would undoubtedly say, “Don’t get so upset. I’ve just made an extremely good deal with Japan.”

In fact, both Mitsubishi Estate Company and Rockefeller were very concerned about the American public’s reaction and held repeated discussions about how to announce the deal. Just as they feared, the announcement created an uproar. The American media, who had nothing directly to do with Rockefeller, caused a stir that reverberated throughout the country. The same thing happens in Japan. When an American company is bought by a Japanese company, Japanese newspapers report the takeover as though it were a natural and normal activity. What happens when the shoe is on the other foot, however? When T. Boone
Pickens acquired a mere 26 percent in the Koito Manufacturing Company, the Japanese mass media treated the incident as a matter for grave concern.

By American standards of common sense, it is perfectly reasonable for someone holding 26 percent of a company's stock to ask to be on the board of directors. In fact, Toyota, which holds only a 19 percent share in Koito, has three representatives on the board. Logically, Pickens should have had at least the same number of board members as Toyota. But Koito refused Pickens's request for a single seat on the grounds that he is a "greenmailer" who has a bad reputation in the United States. Emotional issues aside, this decision was totally irrational from an economic standpoint.

When stocks are offered for public sale, no one is in a position to dictate how many any one individual buys. Those who buy in large quantities become major stockholders, and it is natural that they should have a say in management. Because there is no law that prevents people with bad reputations from buying stocks, Pickens's request was absolutely legitimate. That may be unsettling to the company whose stock he bought, but it makes perfectly good economic sense.

Pickens ultimately gave up, but during his two-year fight for a seat on Koito's board, he encouraged U.S. authorities to investigate other exclusionary Japanese business practices on the grounds that they might be monopolistic or involve other illegalities such as collusion. His own dealings, however, left many questions unanswered. The New York Times on May 5, 1991, reported that Pickens had "bought the stock from a Japanese entrepreneur who, after failing to get Toyota to buy it at a premium, took it to Mr. Pickens in hopes that
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an international incident would arise. He also lent him the money to buy the shares, apparently guaranteeing him against risk.... So every time Mr. Pickens demanded that Toyota come clean, the Japanese demanded that he do the same.”

Even though economic borders may now in fact be next to nonexistent, emotional borders, in the form of resistance and opposition to international mergers and acquisitions within both Japan and the United States, are growing even stronger. Despite the grumbling on the American side, the flow of money and goods between the United States and Japan is already fairly free. But when people enter the equation, they are regarded as “intruders,” as in the Pickens affair, and touch off Japanese defense mechanisms. America’s instinctive defensive reaction against Mitsubishi was another instance of an emotional border.

Furthermore, the people who actually benefit from these transactions in most cases are not the foreign companies that provoked the defensive reaction. In the Koito case, the unidentified Japanese entrepreneur behind Pickens did not become an issue; nor did Rockefeller come in for any criticism when he profited from the sale of Rockefeller Center. Instead, Mitsubishi Estate Company was accused of stealing an American landmark. The economic frictions between the United States and Japan that have become prominent recently teach us that, regardless of whether our economies are borderless or not, the emotional borders that divide one country from another are as firmly in place as ever.

Today the phrase “borderless economy” is quite common. To be sure, the flow of people, things, and money ignores national borders. But one border still
remains, the border that exists in people’s hearts. No matter how much progress is made in creating a global economy, I suspect people will continue to harbor nationalist sentiments to the very end. After so much Japan-bashing, many Japanese, I am sure, heartily agreed with Shintaro Ishihara’s statements. A proportional number of Americans were probably equally annoyed when they read his book.

Until recently I used to think that these emotional borders should be dismantled as soon as possible. But living as I do in American society which, more than fifty years after Pearl Harbor, has still not overcome its wariness of Japan, I am now more inclined to be realistic. Emotional borders in the form of nationalism and chauvinism will always be with us; the heart is one area that can never become completely borderless. Since there is no point in holding up unrealistic, unattainable ideals, let us make honest efforts to see to it that, in the problem areas that remain, we do not make political issues out of these emotional barriers.