Japanese Competition Is No Threat

Allan H. Meltzer
Carnegie Mellon University, am05@andrew.cmu.edu

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About the Cover:
Population growth in Bucks County area served by Pennsylvania-American Water Company’s Yardley District dictated the construction of this 115-foot, 1 million gallon storage tank. The $1 million tank improved pressure and fire service for the district’s 8,200 customers.

Photo by H. Mark Weidman
Japanese Competition Is No Threat

By Allan H. Meltzer

Now that the cold war seems to have receded, public attention turns to economics. Japan’s economic successes are taken as evidence of our own failures. Japan bashing has become a growth industry.

So widespread is the belief that we are being harmed by competition that the public tells the pollsters that Japan is now a greater threat than the Soviet Union. Many of our politicians pound the table and bash the Japanese. Now a leading Japanese industrialist and a prominent politician have bashed back in a new book that urges Japan to say no to U.S. pressure and become more assertive in dealing with us.

How are we harmed by Japanese competition? The Japanese produce and sell high-quality goods at competitive prices that we willingly buy. Consumers gain. Our firms are encouraged to become competitive. Our industries are encouraged to compete more effectively, to improve the quality of their products and increase their efficiency. We all gain.

All of this is the economists’ familiar response. Though it remains true, it falls on unbelieving ears. A standard response in both Japan and the United States is to point to the deindustrialization of the United States as if it were an established fact.

It isn’t true. In the nearly seven years of our current expansion, U.S. industrial production increased 41 percent, faster than in most of the industrialized countries of the world. During these years, West Germany’s industrial production rose by 22 percent, France’s by 15 percent, Britain’s by 20 percent. True, industrial production in Japan increased at a faster pace—56 percent—and Japanese firms are investing at a faster pace to prepare for future competition.

Many critics of U.S. development claim that too much of our effort goes into services like banking and finance. Now they have discovered that Japan has nine of the ten largest banks in the world, and a new “crisis” is fostered. Japanese purchases of U.S. banks in California, recent investments in a New York money center bank and in leading investment banks set off alarm bells for the worriers. Are we about to lose our once-strong position in international banking and finance?

Again, the facts tell a different story. A large part of the spurt in the size of Japanese banks shows only that the dollar has been devalued. For example, assets of the largest Japanese bank, Dai-Ichi Kangyo Bank, rose from $166 billion in 1985 to $288 billion in 1987, an increase of 73 percent. The dollar fell about 60 percent during the same two years, so most of the spurt in growth is the result of converting assets denominated in yen into cheaper dollars.

To the extent that Japanese banks owned U.S. bonds or had made dollar-denominated loans, they suffered large losses as a result of the dollar devaluation. And the same story can be repeated for other Japanese banks and financial institutions that “grew” spectacularly when valued in dollars, even as they suffered losses in the real value of their dollar holdings. Estimates put the losses in the billions of dollars.

That is only part of the story. Suppose that the Japanese banks are larger or will be soon. Have they found the winning strategy? Banking has become much more of a fee-for-service business. Large U.S. banks now do more of their business without booking loans or buying assets. They earn much more of their income by supplying financial services that do not involve buying and holding assets, so their size has become less important for success. This has been profitable, far more profitable than the Japanese strategy. Only time will tell which is the best long-run strategy, but to date the facts do not suggest that our banking industry is in decline.

Suppose that size remains of paramount importance for future success in banking. There is much that public policy can do to allow banks to strengthen their competitive position by increasing their size, if they choose to do so. Congress could repeal the Glass-Steagall Act that separates commercial and investment banking. This would give banks a new range of domestic services, similar to the services that banks supply in many other countries. Congress could permit interstate banking to spread more rapidly through mergers that combine large banks into super-banks that operate nationally and internationally.

What is true of banking is true of manufacturing. If there are problems in competing, let’s increase our producers’ incentives to compete. Congress is, once again, con-
considering changes in taxes. Reducing taxes on capital would encourage investment in manufacturing, increase productivity, lower costs of production, and improve competitive position. Substitution of taxes on spending for taxes on corporations and their capital would be a powerful signal that, as a nation, we want higher living standards and are prepared to compete.

Tax reduction gave the current expansion part of its initial momentum, and tax reform helped to boost a sluggish economy in 1986. As tax reform programs have spread to other countries, several have opted for lower, more uniform taxes on income from capital and corporations to help their producers compete in global markets. Even social democratic Sweden plans to move in that direction. A current legislative proposal, likely to become Swedish law soon, would tax corporate income at a 30 percent rate up to $30,000 (at the current exchange rate) and 50 percent beyond. These are not low taxes by our standards but, surprisingly, all incomes from investment and all capital gains would be taxed at 30 percent, even if total income is above $30,000.

Our current expansion—the longest in our peacetime history—will soon start its eighth year. We have seen that expansions don’t have to die of old age after three or four years or end in rapid inflation. Public policies that reduced inflation and strengthened private incentives for profit and performance have shown once again that they are potent and reliable means of revitalizing an economy, raising output and living standards. Because depreciation is not indexed for inflation, inflation acts as a tax on capital. A return to price stability would lower this tax, encouraging investment and increasing productivity.

Competition with Japan is not like warfare and should not be compared to a war. War destroys resources and lives. Economic competition raises living standards. We gain from the growth and improvement of the Japanese economy. If we remove regulations and reduce burdensome taxes, competition will push us toward greater efficiency. Both we and the Japanese will gain.}

Allan H. Meltzer is a visiting scholar at the American Enterprise Institute, and a John M. Olin Professor of Political Economy at Carnegie Mellon University.

Utilities, Inc., Helps NAWC Pass 300 Mark

Prior to the end of 1989, NAWC saw its number of active members surpass the 300 mark. This achievement was made possible by an early Christmas present to NAWC from Perry Owens, President of Utilities, Inc., who provided the guidance that resulted in 36 of his firm’s subsidiaries joining NAWC.

Utilities, Inc., is an investor-owned water and wastewater utility company, with water utility subsidiaries in Florida, Georgia, Illinois, Indiana, Louisiana, Maryland, Mississippi, North Carolina, Ohio, South Carolina and Virginia.

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