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Sources of Competitiveness: Globalization and Japanese Strengths

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Few nations in recent history have seen such wide swings in the perception of its competitiveness than Japan. In this short paper, I propose to (1) trace the shifts in the perception of Japan's competitiveness over the past 60 years; (2) examine the sources of Japan's competitiveness; and (3) assess how globalization has affected Japan's competitiveness.

(1) Perceptions of Japan's Competitiveness

From the end of the Second World War through the 1960s, most of the world paid little attention to Japan economically, since it was regarded to have little consequence for the world's economic future. But, beginning with the textile dispute in the late 1960s, a large number of contentious trade issues emerged in quick succession through the 1970s and 1980s that attracted growing concern among especially Americans and Europeans, but also Asians—including consumer electronics, steel, automobiles, automobile parts, machine tools, semiconductors, supercomputers, beef, citrus, rice, tobacco, soda ash, flat glass, paper products, construction services, legal services, financial services, telecommunications equipment and services, etc. At the same time, Japan had by 1964 joined the OECD and had by 1965 surpassed Germany to become the world's second largest economy, as measured by GDP, next only to the United States.

In 1979, Professor Ezra Vogel of Harvard University published *Japan As Number One: Lessons for America*, and by the mid-1980s, many viewed Japan as the most competitive economy in the world. This was reflected in the results of annual surveys of national competitiveness taken by such organizations as IMD and the World Economic Forum, which found that Japan ranked at or near the top of the list of the most competitive nations in the world from the early 1980s to the bursting of the bubble economy in the early 1990s.

When I attended the MBA program at the Harvard Business School in the late 1970s, half of the cases in the required first-year course "Business, Government, and the International Economy" were devoted to Japan, with "industrial policy" and "Japanese-style management" being cited as the primary reasons why Japan had been able to achieve its postwar "economic miracle." When *Business Week* conducted a public opinion poll in 1989 asking the American public, "Between the Soviet military threat and the Japanese economic challenge, which poses a greater threat to the United States?" 68% responded, "Japan." This was a time when reputable economists were predicting that Japan's GDP might surpass that of the United States by the year 2000.

Then, just as Japan's star had risen meteorically in the 1970s and 1980s and had become vastly overrated, by the late 1990s its status had plummeted to such an extent that many dismissed the idea that Japan would ever again recover. In the midst of the Asian financial crisis of 1997-1998, not a few Western observers—including economists, financial institution analysts, and economic journalists—publicly warned that Japan's banking sector, saddled with huge nonperforming loans, could experience a "meltdown," leading to the collapse of the entire Japanese economy.

This new perception of Japan's economy was typified by the following observation by a former senior economic official in the Clinton Administration when asked by a Japanese businessman in summer 2001 how Americans viewed Japan:
"When I joined the Administration in 1993, most of us considered Japan to be a major economic rival. Now, I would say that most Americans look at Japan with a certain sense of pity."

(2) Sources of Japan's Competitiveness

It is curious that the two factors used at the Harvard Business School in the 1970s and 1980s to explain Japan's postwar economic growth—"industrial policy" and "Japanese-style management"—were, by the late 1990s, becoming increasingly cited as the causes for Japan's economic stagnation and decline in competitiveness.

Whereas industrial policy (government-business cooperation, especially the "guidance" to industry provided by the Ministry of International Trade and Industry and the Ministry of Finance) had been viewed in the 1970s and 1980s as a prime reason for Japan's success, the strong recovery of the U.S. economy in the 1990s, spurred by the IT revolution, led many to conclude that the suppression of market forces in Japan was the root cause of Japan's economic decline.

Japanese management practices such as "lifetime" (actually, long-term) employment, seniority-based wages, consensus decision-making, generalists rather than specialists as leaders, and avoidance of the judicial system for dispute resolution had been viewed as contributing to creating harmonious, cohesive, and competitive Japanese companies. However, by the late 1990s these aspects of the so-called "Japanese style of management" were increasingly dismissed by Western observers as outmoded and seriously limiting the flexibility of Japanese companies to respond to competitive challenges.

Perhaps the two factors cited above were not the real (or only) reasons for Japan's remarkable growth in the postwar period. Some of the other factors that might be cited are as follows: (1) the political environment provided by the Cold War, in which Japan was viewed as an indispensable political and security ally of the United States, leading to a "grand bargain" of Japan's political allegiance to the United States in return for U.S. cooperation to allow virtually unimpeded access to the U.S. market; (2) the provision of Japan's military security by the United States, allowing Japan to focus single-mindedly on economic recovery and growth; (3) Japanese efforts to keep the yen relatively weak versus the dollar in order to support export industries; (4) a relatively corruption-free government; (5) a plentiful and highly educated and disciplined workforce; (6) an educational system that emphasized relatively uniform achievement, especially in applied mathematics and the natural sciences; (7) extensive on-the-job training in companies; (8) a relatively cohesive family structure; (9) curiosity about the outside world and a historical legacy of active efforts to benchmark and learn from the experience of other (especially industrialized) countries; (10) high attention given to technology and technological innovation and application; (11) a relatively long time horizon that allows for investment in human, financial, and product resources; (12) capital markets (including stock market) that support the long-term focus of companies; (13) "*kaizen*" (continuous improvement) and the attempt to achieve zero defects; (14) the management philosophy of putting the customer first; and (15) a strong sense of national identity and pride that have allowed the Japanese leadership to spur the public to strive for world-class achievements, whether in the economy, technology, or cultural pursuits.

(3) The Impact of Globalization

It could be argued that Japan's economic decline in the 1990s was in large part a result of the delay in its response to globalization. That is, the structures, processes, and behaviors that served Japan well in the 1950s through the 1980s were not necessarily those needed to win in the 1990s and beyond, when the use of IT had led to the "death of distance" and the need to respond quickly and decisively to events around the world, rather than relying on the slow, cumbersome consensus-style decisionmaking that is still so common in Japan.

Most countries find it hard to embrace change, and Japan is no exception. In some ways, Japan is an extreme example of a country that would like to cling to the orderly, certain, consistent, predictable and known past unless there is an overwhelming requirement for change (as in the Meiji Restoration of 1868 or the defeat in the Second World War in 1945). The forces of globalization that have swept the world since the collapse of the Berlin Wall in November 1989 are slowly but surely having an impact on the Japanese economy. This is reflected, over the past 10 years, in more instances of mergers and acquisitions than in the past; greater foreign direct investment into Japan; more foreign executives joining the ranks of the top management and boards of directors of Japanese companies; greater transparency in government processes and procedures and in corporate governance; increased job mobility among elite Japanese males; etc.

As these recent trends indicate, Japan possesses certain underlying strengths that allow it to continue to adapt to changes in the world environment, especially responding in a pragmatic and effective way to ensure its economic survival and even prosperity. In this context, it is remarkable that the problem of non-performing loans in the Japanese banking sector, thought by many outside observers as a potential time bomb that threatened not only Japan but the world economy, has essentially been resolved over the past four years. The major economic problems that Japan now faces—aging population, low birth rate, government debt, pension, health care system, etc.—are essentially issues that require a political, rather than an economic, solution.

In contrast to the economic challenges faced by Japan, which I believe the Japanese government, companies, and citizens are capable of surmounting, I am increasingly concerned about Japan's ability to deal effectively with the political and security challenges it faces. Japan's chilly relations with virtually all of its neighboring countries—China, Russia, South Korea, and North Korea—is troubling, and an indication that there are some fundamental issues that need to be confronted and resolved before Japan can play the positive and constructive role it has the potential to do in the future of Asia and the world. But this is a topic for another session of this conference, so I will close my comments here. I hope that I have provided enough food for thought to stimulate active discussion and debate.