A Japanese View
On The Contemporary American Economy

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BOOK REVIEWED: 石崎昭彦・佐々木隆雄・鈴木直次・春田素夫著,『現代のアメリカ経済』(東京：東洋経済新報社, 1988, 277 p., ¥3,200) Teruhiko Ishizaki, Takao Sasaki, Naotsugu Suzuki and Motoo Haruta, *The Contemporary U. S. Economy* (Tokyo: Toyo Keizai Shinposya, 1988, in *Japanese*)

The U. S. economy has weakened considerably and is now on the way for decline. The United States has, however, the largest economy in the world and maintains a significant influence on political and economic activities in all other countries. To be more precise, although the United States has weakened, it has not declined to the point where another country has taken over its preeminent position. Therefore, the United States' impact on the world economy can have such major consequences that performance of the U. S. economy has been of increasing worldwide concern.

This book provides an overview in response to those of us who are concerned about the U. S. economy and its worldwide impact. The analysis section is particularly valuable. Four renowned experts on the U. S. economy, utilizing factual data, present their detailed analyses of the current status of the U. S. economy, in particular of macroeconomic developments, performance of industries, international economic relations, and monetary and fiscal policies of the 1980s Reagan administration. This book brings home to us the realization that the U. S. economy is facing serious problems.

I

In the Preface, Takao Sasaki points out the importance of analyzing

the U. S. economy.

In Chapter 1, Akihiko Ishizaki first examines how the postwar economic system was established and then discusses the progress and slowdown of the postwar economic growth. He studies the decline of the U. S. economy in its relation to macroeconomic policies.

The basis of the postwar economy of the United States was established by the New Deal of the 1930s and by the subsequent wartime economy. Since the enormous budget deficit which ran over a long-term did not deteriorate the country's economy, the belief in a normal, healthy fiscal policy eroded, to be replaced by the view that during recession expansionary fiscal policy was effective. Moreover, the sharp increase of the federal budget in relation to the GNP, the shift to the managed currency system, the expansion of the role of monetary policy in stabilizing the economy, and the Employment Act of 1946, all paved the way to the establishment of a total demand management policy. The U. S. economy went through creeping inflation at the end of the 1950s, which caused such problems as a high rate of unemployment, low economic growth and poverty. As a solution to these problems, the Kennedy-Johnson administration adopted a tax-cut policy succeeded in attaining high economic growth. In the late 1960s, however, the swollen budget deficit, a result of the Great Society antipoverty programs and the Vietnam War, overheated the economy. It brought on inflation and the dollar crisis, and hindered the United States from attaining high economic growth.

In the 1970s, the growth rate of the U. S. economy slackened further because of a reduction in oil supply, a slowdown in labor-productivity growth and decline in labor-saving technological innovation. In addition, rising inflation discouraged businesses from investing in facilities, which in turn weakened supply. The Nixon administration first set controlling inflation as its top priority, and then adopted a tight fiscal and monetary policy. Their action, however, led the economy to stagflation. Therefore, they turned to a policy of expanding total demand. In 1971 a new economic policy was implemented, which included suspension of the dollar's convertibility into gold, tax cuts and a new treatment of income. The new policy seemed to be working for a while, but soon inflation pressure, the dollar crash and oil crises

produced failures. Although both the Ford and Carter administrations followed the tax cuts and the expansionary fiscal policy to attain high economic growth and a high rate of employment, inflation in 1978 led the government to turn again to tighten the economy.

Since 1981 Reaganomics has attempted to restructure the country's economy with a significant tax cut as its backbone. They adopted supply-side economics along with monetarism. The author argues that, as a result, while it succeeded in controlling inflation and expanding employment, it also had a negative impact on the U. S. economy. It led the United States to become the largest debtor country in the world, creating huge budget and trade deficits and inviting a glut of direct investment from abroad.

This chapter succeeds in proving that the cause of the weakening of the U. S. economy lies in the policy of expanding total demand, which has been pursued excessively by one administration after another. What the author seems to leave unsaid, however, are the reasons for a tenacious pursuit of an expansionary policy and the cause for the relatively steep decline of the U. S. economy as compared to other developed countries which pursued a similar expansionary policy. In any attempt to understand the decline of the U. S. economy, above and beyond examining macroeconomic policy, it is crucial to examine the performance of industries, in particular, manufacturing industries. It is true that the loss of the manufacturing sector's competitiveness is partly due to the macroeconomic policy of the government. It seems, however, important to note that the American-style production system has also played some part in the loss of U. S. prominence in the international markets and in a falling behind in the competition with Japan in the field of microelectronics technology application. The production system was simply unable to respond to the changing economic environment caused by a short supply of resources and a diversification of the demand structure.

II

In Chapter 2, after describing the process of industrial reconversion to a service economy in the U. S., Naotsugu Suzuki examines how and why the international competitiveness of U. S. manufacturing industries

has declined.

Since World War II, the U. S. has consistently changed its industrial structure, reducing the manufacturing sector and expanding the service sector. Thus, the United States has witnessed a rapid switchover to a service economy. While the service economy has become dominant since the 1960s, the international competitiveness of U. S. industry has faltered. The author analyzes industry in two categories, mature and high-tech. Taking the steel and auto industries as typical cases of mature industry, and aerospace and semiconductor industries as typical cases of high-tech industry, the author makes a comparison with Japanese counterparts and throws light on the picture of the falling international competitiveness of U. S. industry. Along with the unique problems of individual industries, the U. S. inability to emulate Japan's mass production system, the author concludes, has caused the U. S. to lose ground in international competition.

American products have lost their preeminence both in cost and in quality, a fact well illustrated by the faltering productivity growth rate. The significant causes for this loss of preeminence are many——the swelling of service industries where productivity is low, the increase of an unskilled labor force, poor incentives for laborers, the lack of sufficient facility investment in the private sector, and the lower rate of technological innovation. Other factors have also contributed——an increase of non-productive cost caused by more restrictive government regulations, the reduced profitability of large-scale business, and the oil crises.

Suzuki takes a complex view, examining the issue from three sides, that is, government, industry and labor. In the author's view government policy such as welfare, tax increases and tight regulations tend to reduce incentives for both workers and corporate investment alike. U. S. corporations put priority on short-term profit and consequently have a strong tendency to avoid long-term and high-risk investments. The hostile labor-management relationship also lowers industrial competitiveness. Through labor agreement based on collective bargaining, unions gained wage increases, inflation adjustments and a voice in labor practices. During the period of stagflation in the 1970s, wages increased greatly despite the slowdown of productivity growth, and as

a result U. S. competitiveness was lowered. In the 1980s, however, in a period of serious recession, and as the U. S. increased imports from abroad and faced stronger international competition, conciliatory wage agreements have become more common, and a movement toward harmonious labor-management relationships has been stirring. He concludes that though major difficulties cannot be avoided, a change in labor-management relationships will inevitably take root.

This chapter studies the present status of U. S. industry, analyzing the environments which surround American corporations. The discussion includes technology, mass production systems, changes in demand structure, labor-management relations, government regulations, and corporate activities. The author correctly points out that a comparison with Japanese industry provides a very important viewpoint for an analysis of the U. S. industry. In contrast to Suzuki, other scholars of U. S. industry have usually focused on how corporations obtain their market share. Their arguments on the competitiveness of industries are in most cases uninstructive since they are not necessarily based on a full understanding of the characteristics of individual industries.

Though this chapter contains many insights into the U. S. economy, this reviewer found several problematic issues in Suzuki's arguments. First, there is the question of sampling. As noted above, the author categorizes industries into two, mature and high-tech, and chooses two industries from each category as illustrations. It is not clear, however, why the industries he has chosen are good samples of the two categories. According to the author, he has chosen them because "they are important in the national economy." This remark is not a sufficient response to the question. Had he realized what makes manufacturing competitive, he would have chosen, for instance, the machine tool industry. It is the machine tool industry which is the core of munufacturing technology and determines the quality of the whole manufacturing industry. In spite of the central role of the machine tool industry, the United States has allowed its decline. As a result, upgrading the quality of production facilities has become extremely difficult. Today's technology is so complex that upgrading the quality of production facilities requires the cooperative efforts of hardware manufacturers and software producers responding to user needs.

Secondly, although Suzuki points out many factors of the faltering productivity growth rate, he does not make clear which he considers more important than others. Futhermore, despite the fact that productivity is closely linked to facility investment, the author gives little consideration to facility investment. Although the U. S. productivity growth rate has recovered in the 1980s to the level of the period from 1960 to 1973, which is almost as high as West Germany today, the United States' international competitiveness has become weaker. In order to understand this phenomenon, it is important to consider the fact that after American corporations withdrew from industries where productivity and profitability were low, the structure of American industry has become hollow.

Thirdly, Suzuki does not discuss the development of post-industrialization and the corporate culture in the United States. It is commonly held that the most important capital equipment in the U. S. is software and that the U. S. occupies the dominant position in the field. Manufacturing is, however, of equal importance since evolution of software is not possible without continuous technological innovation in hardware. A failure to realize this point has led U. S. manufacturing to falter and has furthered the making of a hollow industrial structure. Moreover, unlike the service industry, the manufacturing industry bears special importance to the ecomomy. The economy which lacks a manufacturing sector is bound to decline. When keen competitions from other countries reduces the profitability of a business, U. S. corporations tend to yield the market easily to foreign corporations and attempt to make a rapid shift to more lucrative business. Commercial electronics and machine tool industries, for instance, have lost their technological bases in this way.

III

In Chapter 3, Teruhiko Ishizaki examines how the structural change in the world economy, caused by the rapid growth of Japan and European countries along with the emergence of newly industrialized countries, has adversely affected the United States. He sees that this structural change has brought about the loss of U. S. predominance in the world economy in terms of productivity, trade figures and the dollar

value. For Ishizaki, the structural change has furthermore led the U. S. to become a debtor country and it has induced the recent U. S. inclination for protectionism in trade.

The degree of dependence of the United States on the world economy (especially its dependence on imports) has increased. The United States' trade balance with other countries, particularly with Japan, has worsened overall. And if we exclude aerospace and military applications, the U. S. has lost ground in every field from high-tech to agriculture. Unfortunately, while the trade and carry-over deficits have thus increased, the profit from the service industry, which ought to offset these deficits, has decreased. This situation inflated the current account deficit in the 1980s, and in turn invited a flow of capital investment to the United States from abroad. In reaction to the rescheduling of bad loans to debtor nations, U. S. banks attempted to discourage American oveseas investment. While U. S. assets abroad stagnated, assets in the United States held by foreigners who increased their investments in U. S. securities and in bank deposits grew rapidly. This process eventually made the United States the largest debtor country in the world. As a consequence, the dollar has been, since 1971 when its convertibility into gold was suspended, exposed to strong pressure to fall. After repeated wild upswings and downturns in the currency market, the dollar has lost its status as the key international currency.

Since World War II, the United States has promoted free trade as the leading country in the world economy. Its loss of predominance in the international markets in the 1970s and the 1980s, however, has made the U. S. inclined to protectionism, as seen in its efforts to strengthen protection toward domestic industries, seek reciprocal trade policies, and form trade blocs through bilateral agreements. The author is particularly interested in issues dealt with by bilateral agreement. He argues that the new round of GATT might lead the United States to pursue the formation of trade blocs, which could split the world economy.

Based upon detailed statistical data, this chapter attempts to prove that the United States' position in the world economy is on the decline. One wonders, however, if a 'decline' of a country can be explained fully by merely examining its share of production and trade, and the value of

its currency in the international markets, as the author attempts in this chapter. It might have been a better analysis had he compared the performance and the competitiveness of industries, particularly those in manufacturing. It is also possible to counterargue that the decline of production share and the worsened trade balance have been the result of surplus demand accompanied by aggressive overseas investments by American multinational corporations. The decline in production share does not necessarily mean the decline of the United States in international markets. If the author had done an analysis of the quality and quantity of facility investment to see if the competitive edge of manufacturing industry has been in fact strengthened, his argument would have been more powerful. It is most critical in discussing a country's position in world markets to examine whether the manufacturing sector is losing or gaining ground. This seems to be a topic which should have been dealt with in Chapter 2. In other words, no discussion in Chapter 2 can be valid without referring to this point. Such an analysis of American manufacturing industry would also lead to a discussion whether the economy of the United States will continue to decline or revive in the future. The author might also have touched on the problem of the aggressive plant relocation policy of American corporations during the period of a strong dollar in the 1980s. It has been argued that the U. S. was thus left with hollow corporations. One wonders, how the author would interpret the fact that the balance of direct investment abroad nevertheless has not increased.

IV

In Chapter 4, Motoo Haruta starts with a historical outline of the U. S. financial system and then he discusses major finance ralated legislative acts, bankruptcy and reorganization of financial institutions, geographical changes which have taken place in the U. S. banking business, and the monetary policies of the 1980s.

The purpose of the Depository Institutions Deregulation and Monetary Control Act of 1980 was financial deregulation to allow freer markets. The results were, however, increased competition among savings institutions, which brought about more troubles than remedies. Legislation in 1982, therefore, made it a priority to reorganize the

troubled financial institutions. Since a number of attempts were made by financial institutions to get around the regulations in order to cross the border between banking and securities, 1987 legislation aimed at putting a brake on deregulation by prohibiting the establishment of new banks and by freezing the applications submitted by the commercial banks to engage in new securities related activities. Though the Federal Deposit Insurance Corporation (FDIC) expanded its range of aid in order to facilitate the troubled financial institutions to perform efficiently, the result was a loosening of market regulations that increased the risks banks would face. Under those circumstances, banks have expanded their operations across state borders at a remarkable rate. The unique "American" banking structure has thus been breaking down.

As for monetary policy, in October 1979, the operating procedures which were designed to regulate the money supply by controlling bank reserves through open-market operations replaced traditional operating procedures with the use of federal funds rate targets. Open-market operations represent in a way the Federal Reserve's commitment to monetarist policy. Although the M_1 monetary aggregate bears great importance to a monetarist, its behavior has been so unstable that since the end of 1982 M_1 has ceased to be considered a reliable indicator of monetary policy. While the tight monetary policy since the end of the 1970s caused a high interest rate and the soaring dollar and the serious recession, it also helped keep the inflation rate low because care was taken not to stimulate the market excessively. The author argues, however, that it was not the monetarist policy which fought inflation. Had the policy makers not been so absorbed in inflation (unemployment being the utmost problem), the traditional operating procedures before 1979 could have been effective enough, he argues, to raise the interest rate in order to control inflation.

Though brief and rather difficult as an introduction, the description of the U. S. financial system in this chapter is much to the point and very instructive. However, some parts in this chapter need more elaboration in content and terminology. This chapter deals generally with a description of the U. S. financial system, but with monetary policy it only covers the 1980s. The author might have described, for example,

how the decline of the dollar affected the financial market and monetary policy. This reviewer also has one major point of disagreement with the author regarding the new operating procedures which came into being in 1979. Haruta argues that the change in operating procedures itself is a secondary issue; the critical question is whether or not the new system came about as a take-off from inflation bias. From a historical point of view, however, can we say that it is possible to raise interest rates without limitation? Had federal funds rate targets been pursued, it would have been impossible, one would argue, to push the interest rate up to levels of the 1980s.

V

In Chapter 5, Takao Sasaki examines federal budget policies and government regulations since the 1960s, and the consequences of Reagan's policies. He also analyzes why U. S. fiscal policies have created such a huge budget deficit.

The author considers that the allocation of the federal budget is determined by three main forces, that is, the military, welfare programs and tax-payers' sentiment against 'Big Government'. Spending on welfare has rapidly increased since the Great Society antipoverty program. It is true that since the 1970s the growth of welfare spending has slowed down due to a declining economy and a shift toward conservatism. However, welfare programs have been so well established in U. S. society that Reagan's attempt to reverse the growth of welfare spending proved unsuccessful. Furthermore, financing of welfare by cutting military expenditure marked a national shift in emphasis from military to welfare. Because of the rapid increase of subsidies by the federal government, the role of the federal government in financing has been strengthened.

Welfare policies mitigated poverty and contributed to social and economic stability. At the same time, however, they weakened social and economic vitality and soundness, and brought about budget rigidity. Since the mid-1970s, tax increases in response to the growing welfare programs induced people's opposition against government spending. The anti-Big Government sentiment prompted the Reagan tax cuts theoretically supported by supply-side economics, which advocates

tax incentives to encourage savings and the correction of unfavorable high marginal tax rates. At the same time Reagan pursued military budget increases in the midst of a deteriorating economy. Despite the large tax cuts, however, supply did not pick up, and military budget increases were implemented before a sufficient reduction in welfare spending was made. All of these factors contributed to the swollen federal deficit. Fiscal deficit increased to the level of 3-6 % of GNP, which, along with a low domestic saving rate, caused a drastic increase of the trade deficit. The United States is now confronted with 'twin deficits', trade and fiscal. In the final analysis, Reaganomics had more of a negative impact in weakening the U. S. economy than positive achievement in controlling inflation.

In the latter half of the 1970s, the view that overregulation was a cause of inflation and a low productivity growth rate came to be more widely held. As a result, the movement towards loosening government regulations began and gained momentum during the Reagan administration. However, the loosening of social regulations did not make much headway in the face of opposition from federal courts and the Congress. Financial deregulation, on the other hand, succeeded to some extent, but it created negative effects as well. These negative effects dampened the enthusiasm to further pursue the course of deregulation.

This chapter refers to the military, welfare programs and anti-Big Government sentiment as the three determining factors of U. S. budgetary policy. The author argues that the United States' economy depends on which course it takes at the moment——the course of a militaristic nation, a welfare oriented nation or a deficit ridden nation. This reviewer was quite fascinated with Sasaki's unique analysis. The author's argument, however, might have been strengthened if he had considered budgetary discipline as another important factor. One can think that the increase in the fiscal deficit was partially a result of a loose budget discipline. Since Keynesian economics allowed a greater budget deficit and inflow of foreign capital seemed to cover the deficit at first, the U. S. loosened its budgetary discipline, which has resulted in a huge fiscal deficit.

As a whole, the analysis in this book is detailed and instructive. The causes of the weak American economy are not, however, fully ex-

plained. This reviewer believes that in the study of the American economy what is most important is to understand the causes of the declining economy. This reviewer found it a little unsatisfactory that not all authors of this book share this important viewpoint.

This book is a revised version of the acclaimed first edition published in 1983. The book has now become a standard textbook on the U. S. economy in Japan. This book's emphasis on fresh approaches to crucial issues on the U.S. economy can only enhance the standard of American studies in Japan.

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