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MAJOR THEMES IN ECONOMICS

Volume II

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A collection of papers written by students
at the University of Northern Iowa

TABLE OF CONTENTS

	Page
Investing in the Hotel Business in China Katsuyuki Ohbayashi	1
Diagnostic Related Groups Eric Nielsen	10
Where's the Beef in Japan? Or, Why Isn't Japan Importing More U.S. Beef? Katherine Calhoun	23
Book Review: <u>The Theory of the Leisure Class</u> Neal Jon Hoffman	38

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INVESTING IN THE HOTEL BUSINESS CHINA

Katsuyuki Ohbayashi

The purpose of this paper is to examine the feasibility of building a large American hotel in the People's Republic of China. The hotel will maintain 800 guest rooms and serve foreign tourists as well as business travelers. The project is based on the assumption that the hotel business in China will be very profitable because tourism in China and, to some degree, business trips to China, will be one of the major sources of the country's revenue in the future. The Chinese government recognizes the importance of further developing the tourism industry for such a purpose and has welcomed foreign investment in this sector of the nation's economy. The number of property development ventures, however, has remained small relative to that of other projects in areas of transportation, telecommunication, electronics, machinery, power, oil, food processing, and basic consumer goods. As of March, 1985, the number of U.S.-China property development ventures was only three out of a total of 91 projects. (The National Council for U.S.-China Trade, 1985). This is mainly because the Chinese government has given top priority to the establishment of a strong infrastructure for the economy, and this trend will probably continue for some years to come. After completing the task of building a sound economic basis, however, China will be more interested investing on its own and/or attracting more foreign investment in property development such as condominiums, hotels, amusement parks and other recreational facilities.

INVESTMENT AREAS IN CHINA

In China, there is currently a score of investment areas especially designed to attract foreign investment. In 1979, China established three special economic zones or SEZ's in the province of Guangdong and one in Fujian to encourage investment from abroad. A variety of incentives were provided, most notably a National Income Tax on gross profit of 15%, compared to 30% elsewhere in China for this type of venture. This was followed by simplified registration

procedures, modified exchange control regulations, and duty-free or preferential-tariff treatments for imports necessary for venture projects. These incentives, however, did not attract much investment because the provinces did not have a sound infrastructure, and this made the cost of investment very high.

In April, 1984, the Chinese government announced the "opening" of 14 coastal cities in an attempt to attract more foreign investment. The relaxed investment regulations were in many ways similar to those of the four special economic zones. Contrary to the old investment areas, these coastal cities had been economically better developed and had existing industrial bases. Deregulation of these cities was therefore designed to upgrade the existing industrial facilities rather than to build them from scratch, creating a better climate for foreign investment.

For this study, three prospective sites have been chosen: Beijing, the capital of China; Shanghai, the largest city and port in China; and Guangzhou, another large commercial center adjacent to Hong Kong. Although Beijing is not one of the deregulated coastal cities, nor located in any of the special economic zones, and does not offer an attractive investment package, Beijing might be the best location for a new hotel. There are already several first class hotels in Beijing; however, they have not provided enough accommodations. The demand for future lodging facilities in Beijing is very high, making the profitability of building another first class hotel very bright. This assumption will be supported by some additional facts: 80% of the tourists to China have included Beijing on their itineraries; in addition, the city is blessed with many great tourist attractions such as the Great Wall, the Imperial Palace, and so on. In 1983, Beijing received 509,000 foreign visitors, an increase of 12% over the previous year. (Department of Commerce, 1983) Inordinate pressure has been placed on the capital's limited hotel capacity as the lack of hotel space in Beijing meant that overall expansion of tourism in China could not be brought off without first opening the Beijing bottleneck. Moreover, the number of foreign tourists to China will most likely increase in the future, with the majority of the increase accounted for by Japanese tourists. Following the completion of this

hotel, it might be profitable to expand the hotel business to the other two deregulated cities and also to invest in other forms of property development such as amusement parks and recreational facilities.

JOINT VENTURE

The type of joint project to be considered here is a contractual turnkey venture and will be arranged with the Beijing branch of China International Travel Service.¹ In such projects, the foreign partner usually provides technology, management and marketing know-how, and capital of a given value, or some combination of these, whereas the Chinese side provides land, materials, resources, labor, buildings, and/or equipment. By convention, these production elements are assessed in money terms. The ratio of equity contribution, however, does not necessarily determine the sharing of profit or loss. It is, rather, specifically stipulated in the contract with the Chinese party. These contractual arrangements allow the foreign party to recover the principal investment with a negotiated depreciation schedule over a set term, and to be paid a fair rate of return, which should be 12% in this case.² This makes it a turnkey project, as all of the properties will be owned by the Chinese party after the principal investment of the foreign party is fully recovered. The contract will stipulate, however, that the management of the hotel should be mainly left to the Americans, for they have more skills and expertise in hotel management, finance, marketing, and growth strategies. This provision is very important because the American hotel party must make sure that the new American hotel in Beijing will live up to its international image and standards. The American party must make sure of management control before the signing of the venture contract with its Chinese counterpart to avoid any related problems in the future.

INVESTMENT AND COST RECOVERY

The total investment in this project is estimated at \$80 million.³ The American party is required by Chinese law to put up at least 25% of the total capital. Therefore, meeting this minimum

requirement means that the American party should put up 25%, or \$20 million in this case. The other \$60 million should be assumed by the Chinese party. Regarding financial arrangements, a joint bank account is to be opened and held at the Bank of China. The American party is allowed to install investment on a scheduled basis during the first four years of design and construction periods. After the completion and opening of the hotel, a 4-year, straight-line depreciation schedule is used to recover the principal investment. Throughout the investment and cost recovery periods, the interest rate on investment will be set at 12% because that is the desired rate of return.

Suppose one decides to invest \$1 million on the design of the hotel and preparation in the first year. Assuming simple interest, current interest earned in this year will be 12% of \$1 million or \$120,000. One would then spend \$6 million, another \$6 million, and \$7 million over the next 3-year construction period, making a total of \$20 million. Associated interest for each year's cumulative investment will be \$720,000, \$1.44 million, and \$2.4 million, respectively. Total interest outstanding at the end of the 4th year will be \$4.68 million, which would be evenly spread over the 4-year recovery period at an annual rate of \$1.17 million (\$4.68 million/4 years).⁴

Following the opening of the hotel, the investment of \$20 million will be recovered by \$5 million each year for four years. Current interest will still be earned on the residual part of investment at the same rate of 12%. Therefore, each year's payment to the American party is made up of a quarter of interest outstanding at the end of the 4th year (\$1.17 million), the annual depreciation expense of \$5 million, and current interest on the unrecovered portion of the investment payable to the American party. After the complete payout of investment and interest, a trademark royalty and management fee will be assessed on gross revenues at a rate of 10%.

This appears to be a reasonable arrangement. Assuming a daily average occupancy rate of 70%, 560 rooms out of a total of 800 rooms are expected to be occupied per day.⁵ Daily gross revenues from hotel operation will therefore be an average room rate of \$100 times 560 rooms occupied, which is \$56,000.⁶ Annual gross revenues will be

approximately \$20 million (\$56,000 per day x 365 days). Given these projected values, the American party should be able to recover its investment with interest out of gross revenues. A reimbursement of \$7 million each year will leave the Chinese party \$13 million. Since 15% of gross revenues or \$3 million will account for operation expenses such as wages and salaries, insurance, insurance utilities, maintenance services, and other expense items, gross income will be \$10 million.⁷ Gross income will be taxed at 33%, and this will leave the Chinese party a new income of \$6.7 million.⁸ The rate of return on investment for the Chinese party will therefore be \$6.7 million divided by the initial investment of \$60 million or 11%, while the return rate of the American party is fixed at 12%.

REGISTRATION PROCEDURES

This joint venture will be financed by Chinese and American investment and must first be approved by the Foreign Investment Commission of the People's Republic of China. If the project is approved, within one month, the foreign party is supposed to register with the General Administration for Industry and Commerce of China. This government agency authorizes its municipal office in Beijing to register and license such projects. Although the process of registration is from the central authority to the local government, first contact and negotiation must be established with the Beijing municipal office. This is very important because it is this municipal body that determines whether or not there should be another hotel in Beijing. If the city office approves of the plan, one will not be likely to have trouble in obtaining approval from the central government.

This way of negotiation is essential for successful foreign investment in China in general. Each municipal or provincial government is very sensitive to the need of foreign investment to develop and strengthen its economic infrastructure, and to promote the image of the locality it governs. On the other hand, the central government is more interested in the overall performance of the the macroeconomy rather than the industrial development of each municipality or province. The central government usually does not get

too involved in each joint venture, letting each local government judge on its own the worthiness of a specific joint project.

INVESTMENT PROTECTION

As far as China is concerned, there are four possible cases for which one may need insurance to protect one's investment. These four cases are: (1) outright nationalization, (2) imposition of regulatory acts or decrees, (3) breaches of contracts by the Chinese government or government-controlled entities, and (4) an action of the host government or government-controlled entity in its capacity as a shareholder, director, manager or creditor of the joint venture enterprise. Since the Chinese written law includes only provisions concerning the resolution of disputes, other provisions you may want to protect your investment must be clearly spelled out in the contract.⁹

For coverage of assets and execution of contracts, you may purchase insurance policies from the People's Insurance Company of China, the state-owned insurance monopoly. From most accounts, the coverage the state insurance company offers is comparable to that obtainable outside China. These insurance policies include employer liability, personal accident, product liability, marine and transport, automobile, fire, contractor's risk, and worker's compensation. The company also offers political risk coverage in case of war, revolution, insurrection, and civil strife. This coverage, however, is not applicable to action taken by the government such as nationalization, regulation of joint enterprises, and the breach of contracts because, under these circumstances, foreign investors are regarded as "violating the law" and will be automatically excluded from the coverage. Insurance protection against these incidents, however, can be obtained from the Overseas Private Investment Corporation.

This coverage protects an investor against confiscation or nationalization of an investment without fair compensation. The policy also covers so-called creeping expropriation, a set of regulatory and/or political actions whose cumulative effect is to deprive the investor of his rights in and/or control of the investment. These actions would include an increase in taxes, repeal of investment

tax credit, lengthy depreciation, retroactive confiscatory sovereign share provisions, and so on.

OPIC also offers two other insurance policies covering (1) war, revolution, insurrection, and civil strife similar to the Chinese insurance company's package, and (2) inconvertibility of local currency. The second coverage protects an investor against the inability to convert the local currency received as profits or recovery of capital on an investment. This policy can also be used against adverse discriminatory exchange rates, although the coverage does not protect against the devaluation and/or depreciation of a country's currency.¹⁰ Conversion of local currency into dollars, however, is guaranteed provided that such currency was able to be exchanged when the insurance was issued. OPIC currently does not offer this coverage for investment in China as the Chinese currency is not generally accepted on world exchange markets.

In the case of the hotel investment project, however, we should not be concerned about inconvertibility of the Chinese currency as revenues from hotel operation will be mostly earned in foreign exchange and allocated to cost recovery of the investment.

CONCLUSION

A project such as this one has a good chance of succeeding. Beijing may welcome the presence of an American hotel because it will promote the city's image as an international city. Other cities such as Shanghai and Guangdong will also be interested in attracting such projects as they do not want only Beijing to enjoy such an international image. Thus, once one builds a hotel in Beijing, other cities will desire investments in property development in their localities, providing more attractive incentive packages. More important, however, is the fact that China is truly opening up and trying to build and strengthen its economy with a combination of free market mechanism and central planning. Thus, it will likely give others an opportunity to make money as long as it can also make money.

FOOTNOTES

1. Although there are a score of investment firms (owned by the central, provincial, or municipal governments) in China, this central government travel bureau seems to be most experienced in tourism business.
2. The Marriott Corporation maintains that 12% would be a minimum rate of return for foreign hotels investing in China and that they would not invest below that rate.
3. Currently, it costs about \$100,000 per room to build a 600-room hotel in China, compared to \$150,000 in the U.S. These rates are called the Average Room Rate (ARR). The ball park estimate of the cost of building such a hotel will be calculated by # of rooms x the ARR. The cost of this project might be less than \$80 million as the ARR declines due to an increase in the number of rooms by 200. The ARR differential is mainly attributed to differences in labor costs and land prices between the two nations.
4. Although outstanding interest is entitled to compound interest, I assumed simple interest for the sake of discussion.
5. The rate is the number of rooms used annually divided by the number of rooms available annually. Although the rate is subject to exchange rate fluctuations and changes in air fares, this is a fair assumption for international city, according to Marriott Corporation. In case of a very weak dollar or yen, however, and/or sharp rises in air fares, the demand for travel may be severely affected.
6. In the hotel business, the average daily rate should be 1/1,000 the construction cost per room. In this case, it is \$100,000 per room times (1/1,000) or \$100 per room. This figure seems to be in line with other first class hotels' rates and will not price itself out of the market.
7. This figure was obtained from the 1983 income statement of Marriott Corporation though I am not very sure of the percentage of operation expenses for a single hotel in China.
8. 33%: National Income Tax of 30% + Local Income Tax of 3%.
9. China wants disputes to be solved at either local or national levels, depending the nature of disputes. It also accepts, however, a third-party settlement such as the International Court of Stockholm.
10. The first case is considered a political action such as a tax on exchanged foreign currency, a ceiling on exchange, etc. The second case is considered a commercial act resulting from world exchange market conditions and therefore excluded from the coverage.

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DIAGNOSTIC RELATED GROUPS

Dirty Rotten Guys or Dynamic Reduction in Government Expenditures?

Eric Nielsen*

"(4)(A) The Secretary (HHS) shall establish a classification of inpatient hospital discharges by diagnosis-related groups and a methodology for classifying specific hospital discharges within these groups.

(B) For each such group the Secretary shall assign an appropriate weighting factor which reflects the relative hospital resources used with respect to discharges classified within that group compared to discharges classified within other groups.

(C) The Secretary shall adjust the classifications and weighting factors established under subparagraphs (A) and (B), for discharges in fiscal year 1986 and at least every four fiscal years thereafter to reflect changes in treatment patterns, technology, and other factors which may change the relative use of hospital resources.

(D) The Commission [established under subsection (e)(2)] shall consult with and make recommendations to the Secretary with respect to the need for adjustments under subparagraph (C), based upon its evaluation of scientific evidence with respect to new practices, including the use of new technologies and treatment modalities. The Commission shall report to the Congress with respect to its evaluation of any adjustments made by the Secretary under subparagraph (C)."

(Social Security Amendments of 1983)

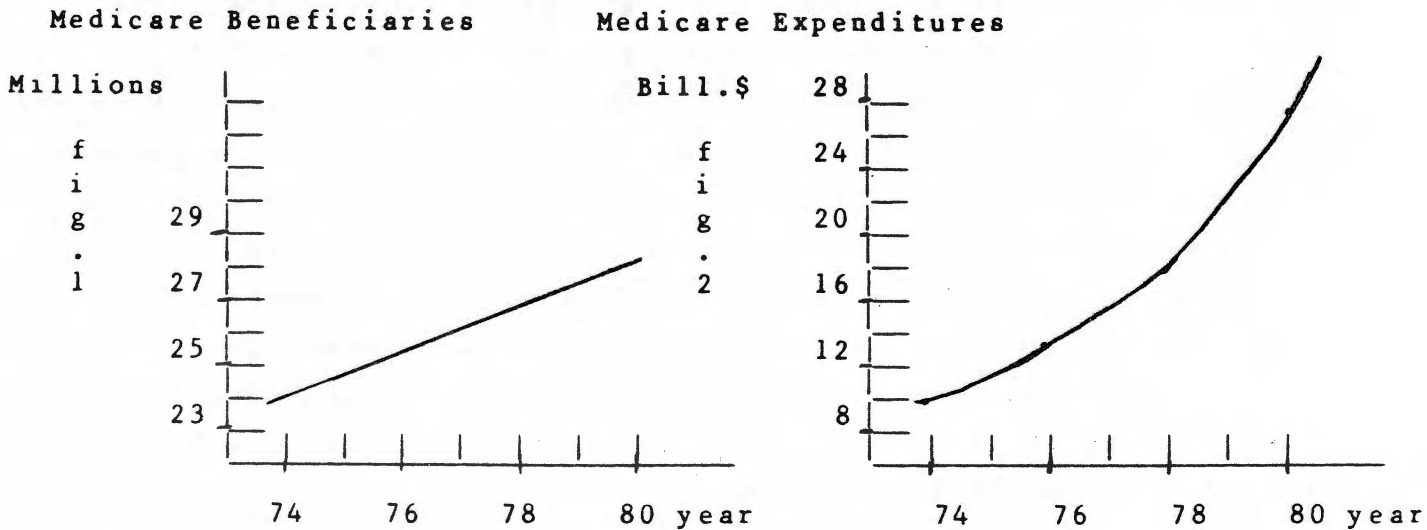
As hard as it may seem to believe, the above few sentences which were amended to Social Security section 223 have altered dramatically the course of the Medicare system in the United States and have forced profound changes on the medical field in relation to inpatient hospital care.

As of 1983, private payers (Blue Cross, insurance companies, and corporate health plans) were the source of 60% of hospital revenues. These people started to rebel against the exploits of the Medicare system. Employers requiring employee deductibles for health benefits doubled in 1983 from 18 to 34%. (Teitelman, 1984) The result is that people are staying away from hospitals in droves.

*The author wishes to thank Mr. Raymond Burfeind, administrator of Schoitz Medical Center in Waterloo, Iowa, for his assistance in researching this issue.

As measured by per capita inpatient days, the peak for hospitals was in 1975, this in spite of the fact that hospital costs have continued to rise since World War 2. Since 1975 however, there has been a steady decline in the rate of per capita inpatient days. Overall admissions and patient days have increased because of the rising population, but the growth rate dropped in 1982, this according to the American Hospital Association.

At the same time, the Medicare system has been in trouble. Medicare payments have increased since its inception due to inflation, increased numbers of beneficiaries and higher utilization rates (see fig. 1 & 2). (Hospital Research and Educational Trust, 1983)



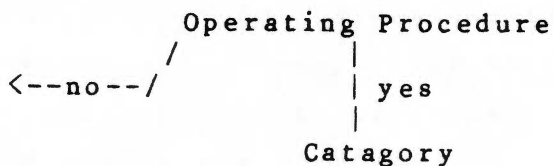
The Social Security system has been in increasingly difficult financial straits. In order to deal with the Social Security problem, Congress diverted money from HITF (Health Insurance Trust Fund) from which Medicare is paid to the Social Security fund. Now Congress is finding out that the HITF will not be solvent much longer. To remedy this situation, Congress developed a new prospective payment system to save an estimated 18 billion in HITF through 1989. This would be done by the use of Diagnostic Related Groups (DRGs). This system was described at the beginning of this paper (Social Security Amendment of section 223). The legislation requires the Secretary (HHS) to establish a DRG-based patient classification system for hospital inpatients and to develop a method for assigning specific patient discharges to each DRG. The Secretary must update this system for

patient discharges in federal fiscal year 1986 and no less than once every four years thereafter. The amendment also requires the Secretary to consult with and receive recommendations from a commission of independent experts for the purpose of evaluating scientific evidence on new medical practices and the use of new technology and treatments. The Secretary is directed to assign an appropriate cost weight to each DRG that reflects the relative use of hospital resources for patients within a DRG compared to all other DRGs. Through this amendment, Congress specifically directed the Secretary to use the DRG patient classification system as the basis for Medicare payment to hospitals for inpatient care. This means that all hospitals must develop or acquire systems to group patients by DRG, and must develop cost systems that will allow hospitals to aggregate cost by DRG. Such information will be necessary if hospital managers are to function effectively under the prospective payment system. Otherwise, they will be unable to determine why they are making or losing money (Social Security Amendments, 1983).

So what exactly are DRGs? First, diseases, ailments, and illnesses of all types were put under 23 general headings called MDCs, Major Diagnostic Categories. Then subsections broke these MDCs, into 467 diagnostic categories. These 467 groups are the DRGs. (Grimaldi and Micheletti, 1982)

Anytime someone enters a hospital for treatment and treatment is to be paid by Medicare, they must be put into one of these 467 groups. Medicare will pay a set amount for each patient in a particular DRG. Following is an example of a DRG area scheme. (Grimaldi and Micheletti, p. 230-231, 1982)

MDC 8: Diseases of the Musculoskeletal System (Surgical Partitioning)



Major Joint	Operating Procedure		Category		Operating Procedure		Category	
	yes	<--no-->			yes	<--no-->		
Hip and Femur	DRG 209	Age / \ 18+ 0-17	Amputation	DRG 213	Over 70 with complications / \ yes no	DRG 216	Biopsy	DRG 216
Back and Neck							Wound Debridement and Graft, ex. Hand	DRG 217
							Lower Extremity and Humerus	DRG 217
							Knee	DRG 217
Over 70 with complications	DRG 210	DRG 211	Over 70 with complications	DRG 213	DRG 214	DRG 215	Over 70 with complications	DRG 220 221 222
yes		no	yes		no		yes	no
DRG 210		DRG 211	DRG 210		DRG 211	DRG 210	DRG 218	DRG 219

Under the old cost-based Medicare reimbursement system, Medicare payments were determined by cost reports, prepared by hospitals, which identified "allowable, reimbursable, and reasonable" costs. Under the new system, payment will be determined by the number of patients treated in each DRG and a schedule of DRG prices. The DRG price is calculated by applying a DRG weight to a standard Medicare price. The weight reflects the average cost of treating a patient in each DRG during fiscal year 1981. For example, a fracture of the hip, DRG 236, has a weight of 1.3855. Costs for the procedure were 38.55% higher than the average Medicare patient in 1981. (American Hospital Association, Report 6, 1983)

This reimbursement system was started in October 1984. Separate payment rates apply to urban and rural hospitals in each of nine census divisions created in the United States. Payments were and will be made according to the following formula: 1984-25% paid on regional rates, 75% based on hospital cost; 1985-50% paid on national and regional rates (25% national, 75% regional) and 50% paid on institutional costs; 1986-75% paid on a blend of regional and national rates (50/50), and 25% on costs. By 1987, all payments will be determined by the national DRG payment method. (Billock, 1983) The hospital component of price come from hospital costs of its TEFRA (Tax Equity and Fiscal Responsibility Act) base year. Costs include all things except depreciation, interest, capitalized lease costs, return on equity for investor hospitals, and the costs of education. Malpractice costs, which TEFRA did not include, are included under this prospective payment system. (American Hospital Association, Report 6, 1983) The federal components were established during fiscal year 1984. The urban rates were derived from costs in Metropolitan Statistical Areas (MSAs), and rural rates from those places outside MSAs. [TEFRA rates were determined using SMSAs, Standard Metropolitan Statistical Areas, a slight change in the system.]

Most acute-care short term, nonfederal hospitals that serve Medicare beneficiaries will be covered by the DRG system. However, psychiatric, long term, children's, and rehabilitation hospitals are exempt. Additional exceptions may be made for hospitals that serve a disproportionately large number of low income or Medicare patients

(outliners). (Hospital Management Quarterly, 1983) I have just described DRGs and the new Medicare payment system in a nutshell. But the DRG set up is not what the controversy is really all about; the controversy is over the results of its implementation.

To understand the problems, one needs some background information. The Reagan Administration bases many of its policies on the effects of incentive. In the health field it is no different. The Administration's policy is based on a belief that the way in which medical care is delivered and priced depends on the economic incentives at work in any given transaction. This view is shared widely on Capitol Hill, lending credence to the notion that health care is more nearly an economic product than a social good. The Department of Health and Human Services said in its original report to Congress that Medicare's traditional payment method involved the wrong set of incentives.

...Currently Medicare reimburses hospitals under a cost-based system. In cost based reimbursement, hospitals are paid essentially whatever they spend. There is no incentive for hospitals to operate more efficiently since all allowable costs are fully reimbursed. In fact, cost-based reimbursement encourages just the opposite behavior. The larger a hospital's costs, the larger will be its Medicare reimbursement. Thus, there exists an incentive to spend because the current system provides no incentive to save. It is not surprising, therefore, that hospital expenditures are increasing. During 1982, inflation in the hospital sector increased three times faster than the overall rate of inflation. Medicare expenditures for hospital care have increased 19 percent per year during the last three years....Increasing Medicare expenditures constrain the ability of the federal government to fund other health programs. For example, the annual increase in Medicare expenditures for hospitals is nearly as large as the total budget for the National Institutes of Health. (Iglehart, 1983, p. 1429-30.)

The clear intent of the new law is to compel hospitals, through a new set of economic incentives, to change their institutional behavior and in turn persuade physicians to husband resources more judiciously. The DHHS report explained its thinking in this regard in its report to Congress.

...Because hospitals can keep any surpluses they achieve, hospitals will be encouraged to introduce technologies and management techniques which control costs. Administrators

might question physician requests to procure more equipment and to provide more services that extend beyond regional medical norms. Within each hospital, staff physicians can be expected to compete with each other for available resources as the hospital's budget is constrained. This competitive atmosphere will encourage recognition of the costs as well as the benefits of existing treatments and new technologies as they are developed. Peer pressure should influence physicians with relatively costly and cost ineffective practice patterns to modify their behavior. (Iglehart, 1983, p. 1429-30.)

Allowing hospitals to retain any differences in DRG prices paid and actual costs would indeed create incentive to economize. However this same reasoning may cause hospitals to underserve patients also. This leads into one of the major criticisms of DRGs.

Questions inevitably surface about the potential impact of cost containment campaigns on the quality of care. Rate setters often answer the questions by contending that reimbursement cuts can be counterbalanced by gains from functioning more efficiently. If hospitals eliminated unnecessary services, organizational slack, and other forms of waste, they argue, reductions in reimbursement would not hurt quality. Unfortunately, this dogmatic assertion usually is not accompanied by a widely-accepted measurable definition of quality or efficiency, nor is the value of potential efficiency gains identified. Nevertheless, after a hospital functions in a stringent regulatory climate for a long time period, efficiency gains are likely to be nominal. At that point, tighter reimbursement policies must have a negative impact on quality or translate into fewer admissions, all things given. (Grimald and Micheletti, 1982)

The potential effects of rigorous regulation are exemplified by events in New York State. Between 1974 and 1978, 90 voluntary hospitals incurred operating losses in excess of of \$500 million. (Hospital Association of New York State, 1979.) Since much of the loss was funded via depreciation reserves, "savings" today may represent a postponement of expenditures that will have to be financed at a future date, perhaps partly by another generation. Sizable future expenditures may also be unavoidable inasmuch as current savings are realized by suppressing hospital workers' wages below

market levels and narrowing low-income persons' access to requisite services.

Would a cutback in quality, a slowdown in the diffusion of medical technology, or a reduction in the availability of hospital care be socially desirable? No, answer almost all health professionals, most of whom strongly believe that every patient should receive the best care and are upset by statements assigning monetary values to human life. Nevertheless, often embodied within cost-containment programs seems to be the unspoken belief that certain medical technologies do not justify the price. The belief is bolstered by a recent study that suggests the social benefits of the artificial kidney, open-heart surgery, diagnostic radioisotopes, the electroencephalograph, special coronary care units, and intensive care units are not worth the cost. (Russell, 1979)

Another concern raised with DRGs is the issue of assigning correct diagnosis for payment. Correct identification of the principal diagnosis is the most critical factor in accurate assignment of DRGs. The principal diagnosis is defined as that condition which, after study, is determined to have occasioned the admission of the patient to the hospital. The principal diagnosis should be distinguished from the admitting diagnosis, which refers to the likely cause of the patient's admission, and the primary diagnosis, which refers to the condition that best explains the patient's use of hospital services. Under medicare prospective pricing, only the principal diagnosis will be used to classify patients into DRGs. (American Hospital Association, Report 7, 1983) This problem can be illustrated by a recent study of hospitals in Minneapolis-St. Paul under the partial implementation of DRGs.

The Minneapolis-St. Paul metropolitan area contains 32 community hospitals, 26 of which agreed to participate in a study. These 26 hospitals represent approximately 88% of the area's 86,242 Medicare discharges for 1980 and 89% in 1981. In this area, Medicare represents approximately 24% of all hospital inpatient admissions and one-third of hospital inpatient revenues. (Johnson and Aquilina, p. 103) Each hospital began by securing its own actual Medicare claims data for 1980 and 1981 from the local fiscal intermediary.

These are the same data HCFA (The Health Care Financing Administration) has in its data base. HCFA's MEDPAR file is a 20% sample of these data. Among other variables, these claims data include the following pertinent information with regard to DRG payment for each discharge: discharge diagnosis code, surgical procedure code, date of patient's birth, patient's sex, disposition code, length of stay, and total charges. Each claim was then appended to the corresponding medical record abstract for the patient. The data from the patient's medical chart include: final discharge principal diagnosis code; principal procedure code; patient's date of birth; patient's sex; disposition code; length of stay; second, third, fourth, and fifth diagnosis codes; and second, third, and fourth procedure codes. More than 90% of all final claims were successfully merged with their correct medical record and this became the study base data. It is recognized that the medical record information is more accurate in terms of the patient's medical condition, reasons for treatment, and specific details of the treatment. The hospitals were thus able to compare the claims data (i.e. HCFA's) with their case mixes as measured by medical records data. Analysis was done comparing these two sets of data. In 1980, the two sets agreed 49.4% of the time. The range of agreement by hospital was from a low of 31% to a high of 74%. Although 17 hospitals had agreement rates of 50% or better, a definite trend emerged: the larger tertiary care hospitals ranked on the lower end of the agreement scale and the smaller hospitals, especially those in the fringe suburban areas, had the higher agreement rates. As the volume of patients and the complexity of cases increase, perhaps discrepancies in the claims data DRGs and the medical record DRGs also increase. One reason put forward for such discrepancies is that the correct discharge diagnosis codes are often unknown at the time of billing and the incorrect preliminary codes are supplied to the business office, or untrained business office personnel are improperly translating the medical text into the proper code. Analysis did discover two additional explanations for the high rate of disagreement: 1) Although most of these hospitals submitted secondary diagnostic and procedure information on the narrative portion of the Medicare claim, the local fiscal intermediary

is not obligated to submit these data to HCFA as part of the MEDPAR file. Thus, when the DRG was computed on the claims data, the program acted as if no secondary diagnostic information was submitted. HCFA has noted that in its calculation of the case mix index, a significant proportion of the claims in the MEDPAR file did not include the presence of secondary diagnosis. (Pettengill and Vertress, 1982) 2) The sex and date of birth variables on a claim were often missing or wrong. Many claims contained the date of birth as "01/01/01" (the default code). Because DRGs rely on the accuracy and presence of age and sex, this would have a bearing on the agreement rate.

In short, there are four potential claims data errors that could cause a patient to be classified into another DRG: 1) the diagnosis code is in error; 2) secondary diagnostic and procedure data may somehow be omitted; 3) the age code is missing, wrong, or invalid; and 4) the sex code is missing, wrong, or invalid. The lack of documentation on claims is most likely to occur for more complicated cases, so these errors tend to occur in larger tertiary care hospitals. (Johnson and Appel, 1984)

Most of the problems seem to be related more toward bookwork than anything else. I would think that as the system is fully incorporated and used, these problems should be rectified. In the meantime, they should be watched closely, and attempts should be made in an effort to improve the bookwork procedure.

I have discussed in depth two major areas of concern about DRGs, but many others are of concern also. These I will attempt to discuss briefly.

First, what about extreme cases of illness? The problem of "outliners," those patients who have prolonged stays or expenses, needs to be examined. Payments in addition to the DRG price will be made when a patient's length of stay or cost exceeds a "trim point" (a period beyond the average for a particular DRG). The additional payment is only 60% of the federal per diem rate beyond the 150% trim point for that DRG. (American Hospital Association, Report 6, 1983) This creates a problem of deciding who is going to pay the rest of the fee. Will patients pay out of pocket? Will hospitals absorb the cost? Will some other party? This question deals with cost-shifting.

Another problem is the desire for revenue maximization by hospitals. Like the problem of cheating on income taxes, plans to increase revenue will be tried by many. Clinical-based reimbursement submerges medical records personnel into the arcane world of maximizing reimbursement, something that was virtually nonexistent under contemporary per diem methods. Maximization relates to the coding and sequencing of diagnoses in a way that yields the most income for services rendered. Such efforts may be legal or illegal, depending upon whether they violate state-established procedures pertaining to the recording of diagnostic information. Illegal efforts relate primarily to predicating the principal diagnosis on the payment rates regardless of the diagnosis that actually occasioned a hospital admission. To illustrate, a patient may have been admitted with appendicitis but have had another problem that in its own right could have warranted hospitalization.

By using a "maximization computer program" (which actually exist), staff could identify the diagnosis with the highest payment rate and dishonestly report it as the reason for admission. Such behavior is fraudulent and uncovered instances should be handled accordingly. Legal efforts to maximize revenue are seen in the meticulous way coders search a patient's record to identify all clinical information properly. Maximization issues also arise from uncertainty about the cause of a hospital admission, that is, there may be no consensus about the condition that triggered an admission, but rather a couple of equally plausible possibilities based upon alternative interpretations and perceptions of a patients condition. (Gimaldi and Micheletti, 1982) This problem is known as "DRG Creep."

Another concern in this area is the idea that hospitals may also try to increase revenue via admissions. The new system may encourage shorter hospital stays, but at the same time it introduces incentives for hospitals to increase the number of admissions in order to maintain total hospital income at a higher level. (Reagan seems to be correct on the effect of incentives.) Recent legislation sponsored by Sen. Edward Kennedy and Rep. Richard Gephardt attempts to lower payment rates for hospitals that have excessive admissions. (Munnell, 1985) How "excessive" is to be defined is as of yet unclear to me.

Undoubtedly, there are many other issues and concerns that tie into the DRG question. I could write over 1000 pages and never fully explain all the facets of the DRG system (or so it seems). But some basic summary comments can be made. First, the new payment policy will certainly constrain future growth in Medicare hospital payments, but these steps come nowhere close to solving the long range financing problems that loom ahead for the program. Since 1970, Medicare outlays have been increasing at an average annual rate of 17.7%, and in fiscal 1982 they were more than \$50 billion. Current projections by the Congressional Budget Office estimate that the HITF will be depleted by 1988 and will run increasing deficits in the years afterward. By 1995, under the old system, the fund could be \$300 billion below its income needs. (Iglehart, 1983 p. 1432)

Secondly, problems may appear because of the fact that today's problems in Medicare seem to have a great deal to do with the actions of physicians, e.g. ordering large numbers of tests, etc. Yet Congress is using hospitals to implement changes in policy. It could be that the government is barking up the wrong tree.

Finally, as seen by issues discussed in this paper, DRGs have many implementation problems. No one can question that the recent Medicare system was a poor one, but I wonder if this new system is going to be much better. I guess the only way to see is to give the system a chance. It could be that some of the kinks will be worked out and some of the fears of abuses may not prove to exist. One can only say that the next few years will be ones of great changes and uncertainty. Only time will tell.

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WHERE'S THE BEEF IN JAPAN? OR, WHY ISN'T
JAPAN IMPORTING MORE U.S. BEEF?

Katherine Calhoun

INTRODUCTION

In the beginning, God created the heavens and the earth. And on the earth he put man, and cattle. And God said "this was good."

But the earth was without trade because man did not know of its benefits. However, unto man appeared an angel. "Because you have a comparative advantage in cattle, you shall trade with other men, who can produce other products more efficiently than you."

So man traded. And this was good. But lo' and behold, man discovered that other men did not trade as fairly as he thought he did. And man was upset.

This story symbolizes the basic problem with trade between the U.S. and Japan: the U.S. tries to maintain an open market while the Japanese limit imports of cattle from the U.S. Various beef industry people are screaming "foul" because Japan is not importing more U.S. beef and because Japan does not play by the same trade rules as do U.S. traders.

Japan has erected some subtle, and some not so subtle, trade barriers, thwarting U.S. efforts towards encouraging a more open trade between the two countries. However, even with restrictions on trade, Japan remains the U.S.' best customer of beef and veal. In fact, Japan is the number one export market for U.S. beef and veal, according to the U.S. Meat Export Federation (MEF). U.S. beef industry experts say the beef trade with Japan could be further enhanced if the U.S. was allowed greater access to Japanese markets.

If the U.S. and Japan already enjoy a good beef trade, then why are there still tensions and barriers to increasing trade? This is the main focus of this paper and will be explored in the discussion on trade barriers. But first, a brief history of the beef trade between the U.S. and Japan is in order, as well as as look at the current situation. This will be followed by a discussion of current trade barriers, which is the thrust of this paper. Third, the future

potential of the U.S.-Japan beef trade will be explored. Finally, the paper concludes with a summary.

HISTORY AND CURRENT STATUS OF U.S.-JAPAN BEEF TRADE

The U.S. has not traditionally emphasized meat exports, although that now appears to be changing. Nonetheless, Japan has always been a major importer of U.S. meat.

Table 1 U.S. Beef and Veal Exports to Japan

Year	Total U.S. Beef Exports	Exports to Japan	% Share
1979	57,403 MT \$214.6 million	35,254 MT \$149.6 million	61%
1980	59,503 249.3	59,503 142.3	100
1981	74,669 299.9	43,696 163.3	59
1982	78,781 351.8	52,364 232.3	66
1983	93,009 391.8	60,575 258.9	65
1984	111,500 469.6	78,966 328.5	71

Source: Foreign Agriculture Service as reported by the MEF Export, April 19, 1984.

As Table 1 shows, Japan has not taken less than 50% of total U.S. meat exports. As total U.S. meat export tonnage has increased, Japan has tried to increase its percentage share of U.S. beef imports.

The Japanese Ministry of Agriculture, Forestry and Fisheries has recently confirmed this trend. It estimated that the U.S. has steadily increased its share of the imported beef market from 12.6% in Japanese Fiscal Year (JFY) 1976 to 30% in JFY 1984 (the JFY runs from April to March). At the same time, Australia's market share has dropped from 81.7% to 70.4%. (McCarthy, 1984 and 1985) Australia is one of the U.S.' major competitors in the beef export market.

Japan imports quite a bit of beef. Countries such as the U.S., Australia, New Zealand, Argentina and Canada have the comparative advantage in beef production versus Japanese cattle producers. Japan has been able to import both high and low quality beef much cheaper than it can produce it.

"The meat Japan imports comes from all around the world, and any country can submit bids," noted Leslie Roth, market analyst with the MEF. However, Japan does have agreements with countries, such as the

U.S., which decreases the amount of meat available from other sources, Roth said.

Table 2 shows Japan's beef imports for selected years. It also delineates the sectoral and geographic distribution of beef imports.

Table 2 Quota Allocations in Metric Tons

Year	General	HQB	Hotel	School	Okinawa	Boiled	Total
1979	116,500	16,800	3,000	2,500	5,800	6,700	134,500
1980	119,000	20,800	3,000	2,250	5,850	4,700	134,800
1981	111,000	24,133	3,000	2,250	5,850	4,700	126,800
1982	119,200	27,466	3,000	2,250	5,850	4,700	135,000
1983	125,200	30,800	3,000	2,250	5,850	4,700	141,000
1984	133,200	37,700	4,000	2,250	5,850	4,700	150,000

Source: MEF's Tokyo Office as reported in the MEF Export Report, April 1984.

The U.S. supplies nearly 100% of the High Quality Beef (HQB) and the beef under the Hotel Quota. Australia generates most of the general beef category, which is primarily grass-fed animals.

In comparing Tables 1 and 2, in 1984 the U.S. shipped more than 78,000 metric tons of beef and veal to Japan in spite of the 37,700 metric ton restriction on HQB. The additional beef came into Japan under Special Quotas, such as the Hotel Quota or it was skirt or hanging tender beef. This is not counted against the HQB import quota.

The quotas in Table 2 are initially established by the Japanese Ministry of Agriculture. Then, countries, such as the U.S. bid to be able to ship meat to Japan. The U.S. and Japan negotiate the total amount of meat that Japan will allow the U.S. to export to Japan. Most U.S. beef entering Japan is in the HQB and Hotel categories.

The previous HGB quota agreement that the U.S. held with Japan from April 1979 to March 1984 increased total grain-fed beef imports from 17,600 metric tons in April 1979 to 30,800 metric tons in March 1984. This was a yearly increase of 3,300 metric tons. The Hotel Quota was set at 3,000 metric tons of HQB.

During 1983 and 1984, the U.S. and Japan renegotiated import quota agreements on beef and citrus. The Japanese had offered to take an additional 5,600 metric tons per year while the U.S. asked for

annual increases of 9,300 metric tons. An agreement was finally reached on April 7, 1984 after a year of negotiations. Under the new agreement, Japan would increase its HQB imports 6,900 metric tons per year. That would put total HQB imports at 58,400 metric tons ending in March 1988, which is an average annual increase of 17.3%. Also, the Hotel Quota tonnage was increased from 3,000 metric tons to 4,000 metric tons. This agreement did not affect the low quality beef quotas.

The Reagan Administration watched these beef and citrus negotiations with Japan closely. The ability to settle the differences concerning the beef and citrus trade was said to have symbolized whether other negotiations between the U.S. and Japan on larger trade differences would be successful. Apparently, the atmosphere is conducive for further trade talks because of the success of the beef and citrus negotiations. Had the Japanese failed to make concessions on the beef and citrus quotas, the New York Times reported that the U.S. was prepared to draft measures to restrict Japanese products and/or file unfair trade action under the General Agreement on Tariffs and Trade (GATT). (Brinkley, 1984)

At this time the U.S. is trying to eliminate all Japanese import quotas, thereby assuring a free market. This will be covered more extensively in the section on future potential.

BARRIERS TO INCREASING THE BEEF TRADE

"Japan is increasingly seen as an exploiter of the international trading system - a rogue threatening the very foundations of trade. It limits its own markets to world exports and amassed huge trade surpluses with many."

This quote from Business Week (April 8, 1985) sums up the tensions that exist between the U.S. and Japan in regard to trade. The U.S. has been trying to get Japan to either limit its exports to the U.S. or import more U.S. goods. With respect to U.S. beef, the Japanese have been reluctant to increase U.S. beef imports. Several problems exist that seem to counter U.S. efforts toward increasing beef imports to Japan. They include 1) protection of Japan's domestic cattle industry; 2) a sluggish Japanese economy; 3) barriers to trade, such as a complex tendering system, surcharges, tariffs and high

prices; 4) inadequate marketing by U.S. firms; 5) strength of the U.S. dollar; and 6) other competition. Each area will be explored.

Protection of Japan's Domestic Cattle Industry

Because Japan is so dependent on other nations for many of its goods, the Japanese government has been encouraging self-sufficiency. This is why it has encouraged domestic cattle and dairy production. But the Japanese government has had to subsidize its cattle industry because it cannot compete with U.S. and Australian beef imports, which are cheaper. Many of the raw materials that Japanese farmers use to produce beef must be imported, thus driving up the final cost of beef.

With the influx of more U.S. beef imports from the April 7, 1984 new beef import agreement with the U.S., the Japanese Agriculture Ministry said it may have to increase subsidies to beef producers by \$20 million in the near future to ease the effects of the increased U.S. exports. (McCarthy 1984)

Much of Japan's beef product (70%) comes from culled dairy cows and bulls. A culled cow is worth \$2,000. The other 30% is high quality Kobe beef. Jointly, the cattle and dairy farmers form a strong lobby that pressures the government to keep import quotas low. With Prime Minister Nakasone up for reelection this year, meat industry sources speculate that he will want to keep the home front happy. On the other hand, Nakasone has promised President Reagan that he would reduce trade barriers to eliminate some of the tension between the two countries.

The Sluggish Japanese Economy

Another problem that Japanese prime Minister Nakasone faces is a subdued Japanese economy, which has been lackluster since 1982. Japan has been pursuing a policy of fiscal restraint to control inflation. The thriving export sector has covered up a lingering recession in consumer demand. The April 1985 World Economic Outlook noted that one half of the growth in Japan's 1983 GNP figure was due to its positive net foreign balance. The Outlook, however, expects domestic demand in Japan to accelerate in 1985 and into 1986 due to increased private consumption.

Japan is trying to stimulate domestic demand and at the same time, alleviate trade tensions with the U.S. In July of 1985, Japan put forth a package of reforms to push up the value of the yen relative to the dollar, loosened 88 rules that inhibit imports and lowered tariffs on 1,853 items, to be fully implemented by 1988. However, agricultural products, such as beef, were ignored. (Alm, 1985)

Trade barriers

Japan has shielded its domestic market through various tariffs, quotas and to her subtle barriers to trade. The biggest barrier to increased beef trade with the U.S. is the limited ability of suppliers to communicate directly with end-users.

In this regard, the Livestock Industry Promotion Council (LIPC) blocks U.S. exporters' abilities to negotiate with end-users. This quasi-governmental agency controls 90% of the General Beef Quota and about 80% of all the beef entering Japan. The LIPC was established in 1961 to help stabilize major livestock prices through buying and selling operations.

Here's how the LIPC works. Once import quotas are established, the Ministry of Agriculture, with input from the LIPC, determines the upper and lower price levels for domestically produced beef prior to the start of each Japanese fiscal year. These set prices are meant to stabilize wholesale beef prices in Japan. If beef prices begin to move toward the lower end of the set price level, the LIPC purchases beef to keep prices within the targeted price zone. To prevent beef prices from penetrating the upper price level, the LIPC will sell imported and domestic beef from its own inventory to the domestic market. When wholesale beef prices stay within the targeted price range, the LIPC will sell imported beef through tenders according to the current price of domestically-produced beef. (McCarthy, 1984)

These tenders are held periodically throughout the year based on domestic supply and demand, current LIPC inventories, and other factors. Tenders only include imported beef. Once a tender has been issued, U.S. packers and other countries can either bid on the tender directly or through a broker to 37 LIPC-designated importing companies.

The LIPC then selects its suppliers based on the lowest price offered, as well as the company's ability to meet LIPC volume and product specification guidelines, according to the MEF.

Only Choice or Prime grade beef, Yield Grade 1,2 or 3, with a carcass weight of 650 to 850 pounds will meet LIPC specifications. There is a 25% duty on the delivered price of imported beef.

Once the 37 approved trading companies import the beef, the product is resold to the private sector via public auctions held in Tokyo and 26 other designated markets. LIPC also names the 2,500 retail outlets which are approved to sell imported beef to the consumer. (McCarthy, 1984)

This tendering process is long, and involved. Imported beef can be disqualified at any point in the process - from too high a price to not meeting LIPC specifications. Plus, the end-user may not be able to acquire the amount of HQB that he or she wants because of LIPC quantity limits.

However, once U.S. HQB makes it into Japan, the beef is subject to several markups and surcharges. If American sirloin enters Japan at \$2.65 per pound, by the time it reaches the Japanese consumer it costs \$7.83 a pound. The following table shows some of the usual added costs to U.S. meat.

Table 3 U.S. Tenderloin Prices in Japan

Imported price (C&F)	\$ 3.85/lb.
+Duty (25% on C&F)	4.81
+Import expenses (insurance, exchange rate, documentation, etc.)	5.05
+Surcharge to Hotel, cost to Retailer or Hotel	5.51
+a. Wholesaler to Hotel (add 8%)	5.95
+b. Wholesaler to Retailer (add 10%)	6.06
+Hotel markup (30%)	7.73
+Retailer markup (25%)	7.58
Hotel a la carte: cafeteria	10.05
Main dining room	13.15

Source: MEF Tokyo Office as reported in the MEF Export Report, April 1984.

Additional imports of U.S. beef probably won't bring Japanese beef prices down. The Japanese Ministry of Agriculture has said that retail beef prices will be kept at their present levels to protect domestic livestock farmers. Plus, the LIPC will maintain the price controls.

Though the price is high, Japan's annual per capita beef and veal consumption has increased from 3.5 kilograms in 1976 to 6.1 kilograms in 1984, according to the MEF and the Organization for Economic Cooperation and Development figures. This is probably due to the increase in income for much of the population and the fact that the income elasticity of demand for beef is greater than one. Consumers 30 years old and under and those in the heavily populated areas choose beef often. Meat is usually served within a day or two of purchase because home freezing is uncommon in Japan. Also, steaks and roasts aren't consumed.

Inadequate Marketing by U.S. Firms

Perhaps one step toward encouraging more U.S. beef consumption is through better marketing efforts in Japan. One of the Japanese' chief complaints about the U.S. is their lack of knowledge and marketing ability in Japan. For instance, an observer recently stated that "either U.S. business is incredibly stupid or incredibly naive" when it came to marketing U.S. products in Japan. (Business Week, 1985)

However, U.S. meat exporters are trying to correct this perception and do a better job of selling U.S. meat to the Japanese. Excel and IBP, two of the U.S.' largest beef packers, both boast offices in Japan. Most other packers have international sales offices, with personnel regularly visiting Japan and tuned into the language and culture.

"We're attempting to cut beef for Japanese preferences and do just about anything we have to to make a sale," recounted Hiram Jensen of Excel. MEF's Leslie Roth pointed out that the smaller beef fabricators have the best chance of doing the best business. These fabricators have the flexibility to meet a particular market's needs. King Pack International of California is an example.

Strength of the U.S. Dollar

The Reagan Administration has maintained that it is the strong U.S. dollar, and not closed markets, that is the reason for the merchandise trade deficit. U.S. Trade Representative Clayton Yeutter told Congress the strength of the U.S. dollar is overwhelming everything else. (Alm, 1985) And, if U.S. prices are too high, how

can we expect the Japanese to buy our products in general, commented Sony cofounder Akio Morita when asked why Japan doesn't buy more American goods. (Alm, 1985)

So, U.S. beef is already high priced in Japan due to surcharges and tariffs. But add the foreign exchange problems and U.S. beef becomes even more expensive to the Japanese.

Following are some comments from U.S. meat exporters on how the strong dollar has hurt beef exports to Japan:

"These problems (strength of the U.S. dollar) have to be addressed at a higher level. Our company can only come up with a strategy to be profitable in those markets (Japan) with existing situations." George Rivers, international sales director, Rose Packing Co.

"Politically, the U.S. should do something to combat unfair competition from subsidized items. But for the strong dollar, we can't do anything about that." Dennis Norton, Swift Independent.

"You can't blame the Japanese for buying product from other countries when it's cheaper. The currency problem is an even bigger problem than subsidies." Lyle Spence, Wilson Food. (Miller, 1985)

It was comments like these that caused the U.S. and four other industrialized nations to stem the strength of the U.S. dollar. Most of 1985 saw one dollar of beef equal to 240 to 250 yen. But at the end of September 1985, the Group of Five industrial nations made a concerted effort to depreciate the dollar, which in turn should help bolster U.S. exports. Beef exports could be a beneficiary of this decline. The dollar's depreciation has about 180 yen buying \$1 of U.S. beef. That should help stimulate beef exports because U.S. beef has become cheaper.

But some economists are skeptical as to how soon export increases will occur. Some economists are estimating that it will take from six months to three years for the exchange rate changes to work through the system because the markets can't adjust to these kinds of changes that quickly. Therefore, beef exports will not see a benefit from the dollar's drop in the immediate future.

The benefits of a falling dollar will be delayed even further by Japan's slow growth, as discussed before. Japan had shown little inclination to cut taxes or raise interest rates to shore up its

currency until recently. It has now raised its interest rate, further propping up the value of the yen. (Mervosha and Pennar, 1985)

Other Competition

As the U.S. dollar appreciated, other currencies were relatively stable versus each other. The yen, however, did appreciate slightly against several currencies, such as the Australian dollar. This made Australian beef more attractive to the Japanese. Australia already holds a significant share of the Japanese beef market, but it is the lower quality, grass-fed beef that makes up the General Quota.

Australian beef is attractive to the Japanese because it is cheap. To keep their beef inexpensive, Australia subsidizes its beef and grain production. It can meet or beat most prices in the world. One Japanese farmer told visiting U.S. meat specialists that the U.S. should push for higher quotas instead of the elimination of quotas because the Australians would undercut U.S. beef prices so badly that the market for U.S. beef in Japan would evaporate. (Eftink, 1983)

However, Australian beef is of lower quality than U.S. beef. Therefore, the U.S. shouldn't be too worried about Australian competition in the HQB or Hotel categories unless Japan lowers its specifications.

In addition to the quality of the beef and its price, the Japanese highly value the reliability of their suppliers. Generally, Australia has been considered a reliable supplier. But recent years have seen back-to-back droughts that have cut the number of cattle Australia has produced. Australia did have to cut back beef exports when cattle numbers became too low. This did jeopardize their reliable supplier standing somewhat to the Japanese.

Other major competitors that are vying for a share of the Japanese beef market include New Zealand and Argentina. Argentina supplies little beef to Japan because it is considered an unreliable supplier. New Zealand is in the same position as Australia.

FUTURE POTENTIAL OF THE BEEF TRADE

The U.S. is stepping up its efforts in Japan via trade groups, such as the MEF and through industry representatives.

The MEF has gotten U.S. packers more involved in the Japanese markets. Activities include the exchange of trade teams, participation in international food show, in-store and hotel/restaurant promotions and public samplings and seminars. There is also a continued public relations effort designed to educate both the trade and consumers on the economic benefits of imported U.S. beef. It is hoped that this will encourage a strong working relationship between U.S. suppliers and Japanese wholesalers and retailers.

MEF/packer efforts are obviously having some effect as consumption of beef has increased. MEF's Asian director Phil Seng expects consumption to rise at an average annual rate of 4.3%. Japanese consumers are much more receptive to U.S. beef than in the past.

Seng projects that by 1990 Japan could be importing between 216,000 to 230,000 metric tons of beef a year. And by the year 2000, that could jump to 367,000 to 448,000 metric tons. These forecasts are predicated on the assumption that Japan will liberalize beef imports after 1987. So the potential is there to capture a larger share of the market.

The U.S. is beginning to show that it is committed to enlarging the export potential for U.S. beef. USDA's Foreign Agriculture Service approved \$1.5 million for MEF's 1986 overseas market development program. MEF will allocate 50% of this to the Far East and Southeast Asia.

And the MEF and USDA are working on combatting subsidies, such as those given to Japanese cattle producers. The MEF has submitted proposals to USDA's Agriculture Enhancement Program, which targets sales to specific markets. Although the program is primarily for grain, MEF hopes to get in under the provision that cattle eat grain. There have been no results. Japan is slowly relinquishing some of its trade barriers to U.S. meat. One of the biggest barriers is the LIPC, which the U.S. has tried to circumvent. An agreement allowing U.S. beef exporters direct access with Japanese end-users was announced at the beginning of the year. Although it is limited to 10% of the beef under the General Quota, meat industry sources felt it was a step in

the right direction. The LIPC still approves final bids and meat specifications. Many barriers are expected to be eliminated by 1988, or at least that's what the U.S. and Japan are working toward.

Better marketing efforts and a relaxation of barriers should pave the way for more U.S. beef imports to Japan. Helping the situation would be a stable U.S. dollar at these lower levels. Although, some currency analysts predict the U.S. dollar could drop even lower, with the 190 yen level not unrealistic. Once a trend materializes in the currency markets, it take quite a bit to reverse it, one analyst reminded.

And perhaps the Japanese attitude is changing. Excerpted is a passage from a story in the Japanese daily Yomiuri:

Japan has built its present prosperity by selling goods to the U.S., which has been an open and enormous market. But the Japanese market has been inaccessible to American goods. This selfish policy cannot be allowed now that Japan has become an economic giant. (Eftink, 1983)

SUMMARY AND CONCLUSION

Problems still exist for the U.S.-Japan beef trade. But there is hope. Japan is the number one importer of U.S. beef and the U.S. is predicting that it will get Japan to increase its share.

On one side we have the Japanese protecting its domestic cattle industry, a once strong U.S. dollar, a sluggish Japanese economy with little domestic demand and many quotas, tariffs and other subtle barriers.

The other side shows a declining dollar, a willingness to reduce trade tensions, some progress on eliminating trade barriers, better U.S. marketing efforts, a change in the mentality of Japanese consumers and a pickup in the Japanese economy.

Protectionist sentiment is running high in the U.S. and perhaps the Japanese are afraid the U.S. will deny them access to its lucrative markets. On the other hand, Japan has promised to relax trade barriers before and has not always followed through with its intentions. Maybe it will take some protectionist U.S. legislation to show Japan that the U.S. is serious.

The potential is there for an ever increasing beef trade between the two countries. It won't alleviate the trade deficit between Japan and the U.S., but it could reduce approximately \$500 million of it and that's a start.

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BOOK REVIEW: THE THEORY OF THE LEISURE CLASS. BY THORSTEIN
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Neal Jon Hoffman

The Leisure class, according to Thorstein Veblen, has its genesis in the earliest forms of social organization. It is first identifiable in its inchoate form as societies move from the basically "peaceable and sedentary" savage stage into the more consistently warlike and predatory early primitive stages. Present even in the "savage" stage of society Veblen identifies a most basic human "instinct," a propensity for purposeful and effective action which he calls "workmanship." In the savage culture, this productive efficiency becomes the means of "an emulative demonstration of force" which in turn becomes the basis of invidious comparison of individuals within the group. Nevertheless, this individual display of productive prowess in the sedentary society works out to the benefit of the whole group.

The change from the "savage" to the early "primitive" culture involves several important aspects. With this change come more or less concurrently the institution of private property, the first division of labor and the "predatory" attitude. This last, the change from peaceful to predatory culture, is, according to Veblen, a "spiritual change" arising from and made possible by the changing material conditions in a culture. Predatory skills (hunting and fighting) are uncertain means of livelihood that could only be supported in a culture with the tools and technology to produce a surplus above subsistence, or to produce subsistence for the group with less time and effort spent collectively. This social surplus then makes possible the first division of labor, which, according to Veblen, was probably made initially on the basis of sex. The division arose between activities of exploit, which fell to the men and were directed at the animate world (hunting, war against other groups and also dealing with the mysterious forces of nature which required a priestly class), and the drudgery of productive labor that involved the inanimate world (horticulture and including domestic animals) that provided most of the material support for the group.

This division of labor became the basis of invidious distinction among persons with honor and worth attached first to those of the predatory class based on the value they brought to the group, but later to the honorific lifestyle of leisure and the display of personal possessions that became prima facia evidence not only of efficacious activity, but of the inherent worth of the individual. "The possession of wealth," says Veblen, "...becomes...itself a meritorious act." (p. 37) But it is important to note that, for Veblen, the emergence of the institution of private property is closely associated with the change from a form of group consciousness that involves self-realization through the group, to a narrower, self-serving behavior centered on individual and aimed at emulative gain. This original sense of group "solidarity" remains with the individual if often in apparent dormancy, into the predatory and emulative stages. It survives as "the pervasive trait that shapes [the individual's] scheme of life." (p. 40) Workmanship, then, remains the fundamental and guiding economic motive.

Veblen's portrayal of the beginnings of the society that we know today as shot through with economic conundra and moral incongruities is reminiscent of any number of "original sin" explanations; myths describing a golden era before "human's inhumanity to human," not the least well known of which is the biblical Garden of Eden myth. Veblen's story, however, more closely resembles the Marxian notion of an original alienation of the person from their product (which is, for Marx, the re-creation of the natural world in human form, the external realization of one's species being). In Veblen as in Marx there is the notion that the effectiveness of the individual in and on the material world is, in some fundamental sense, a function of or is made possible by one's social relations. Any of these stories taken literally is open to severe criticism and certainly does not constitute anything like a cogent historical or anthropological "proof" of the way it in fact was. But, as Veblen admits, the evidence for such a "peaceable stage" (such a Garden of Eden) is mostly "psychological." (p.33) This suggest that Veblen's story, like the others, might best be understood metaphorically. That is, the "peaceable stage" need not be understood as a actual time slot in

human history, but rather as representing a primordial imperative charging the individual with the welfare of the group, and this not the concession of a self-sufficient individual to a convenient social arrangement, but the recognition of the "other," of society as the ontological ground of each individual's own being. This sort of imperative shows up in Veblen's notion of the "instinct of workmanship," part of which involves a basic human propensity for "useful" activity. Given the economic connotations of the word in orthodox utility theory, Veblen must reclaim the common sense meaning of "usefulness." What is useful then, according to Veblen, is that which enhances human life on the whole and "furthers life processes taken impersonally." (p. 78-9)

But a metaphorical interpretation of Veblen's method does not mean that his approach is ahistorical. In fact most of Veblen's method is in effect a genealogy of the Leisure Class and the institutions on which it is based and which it preserves and perpetuates. The speculative and, as I have suggested, metaphorical "ancestral origin" of such a genealogy does not invalidate the historical evidence that Veblen garners in support of his critique of the Leisure Class and certainly does buttress his contention that any particular institution is more often than not justified only by a historical entrenchment and maintained only by social inertia.

Veblen's historical sketch of the Leisure Class follows its development from its origin with the first invidious distinctions based on exploits in the early barbarian cultures. Gradually the honor came to be attached not to the acquisition of wealth via exploit, but to the possession of wealth as prima facia evidence of individual worth. As industrial activity replaced predatory activity, material possessions became the basis of invidious comparison of individuals, the economic struggle was no longer aimed at providing material subsistence, but became a struggle for honor. Here Veblen identifies the need for increased production not to improve the absolute well-being of society or even of the individual, but to satisfy the, in principle, instable desire to improve one's pecuniary status relative to others in the same class. In its purest form, the Leisure class exhibited its status through conspicuous leisure.

Members of the Leisure Class flaunted their status through activities that meticulously avoided even the appearance of productive labor or useful output. Later, due in part to the basic human instinct for purposeful activity, it became more effective to display pecuniary status through conspicuous consumption of goods. In either case the effect is essentially the same; society's resources are wasted in the struggle for individual pecuniary gain instead of being used to the benefit of society as a whole.

Because the Leisure Class became the standard of value in society, the predatory traits on which it originated became imbedded in the institutions that make up societies. But institutions arise in response to historically specific conditions that are constantly changing and these institutions must evolve to meet the changing conditions. Changes in the abstraction that is "society" must come about through changes in class attitudes and finally in the real individuals that make up classes and society. But the very institutions that must evolve are also arranged to protect the Leisure Class members who have a disproportionate effect on the composition of those institutions and so have a vested interest in seeing them preserved. This means that institutions have an inherent conservative tendency. In as much as the controlling interests are sheltered from what in modern industrial society are the "economic exigencies" of the day, the resulting institutions will inhibit the productive efficiency of society.

The problem then is that as long as existing institutions are allowed to determine the criteria by which they themselves are to be judged, there can be no meaningful evaluation of their performance, only an incestuous perpetuation of the status quo. But despite Veblen's castigation of the particular institutions of his day, he is not apparently prepared to throw out the "Institution" of institutions, so to speak. The method of The Theory of the Leisure Class seems for the most part to be a negative one, a method of criticism. The critic will, however, inevitably be asked to offer a replacement for the institutions s/he would do away with. But if Veblen were to offer new institutions to replace the old, would not he be subject to the same criticism as were the proponents of the old?

Does not any new institution either carry with it its own built-in justification or the value judgments of its proponents? And if so, what objective criterion can there be on which to base a choice between two opposed and ultimately subjectively justified options?

These are not easily answered objections, but Veblen would appear to have (at least) three possible replies. The most obvious response lies in Veblen's claim of a fundamental human instinct or propensity toward production that is (or toward institutions that are) "useful," that "further[s] life processes taken impersonally." Veblen could also point out that this criterion is of a form that could hardly be partial a priori to any particular institution, even if every person in a society had a different conception of the appropriate institution to be put in place. But this seemingly perfect impartiality indicates another more serious objection which is exactly its perfect impartiality. Veblen's notion based on "generic" life processes is of basically the same form as the Kantian categorical imperative and the biblical injunction to "do unto others...." But each of these is so general, so impartial that it can only be interpreted subjectively. So, in each case, the problem is pushed back only one step from a lack of objective criteria for a choice of institutions to lack of an objective criterion for a choice between interpretations of the "objective criterion."

A second option for Veblen could be based on his comments aimed at a choice of institutions that would adjust to the economic exigencies of society:

...phenomena are here apprehended from the economic point of view and are valued with respect to their direct action in furtherance or hindrance of a more perfect adjustment of the human collectivity to the environment and to the institutional structure required by the economic situation of the collectivity for the present and for the immediate future. (p. 176)

But the objection to this formulation is that it is subject to the charge of a sort of economic determinism. Veblen might immediately counter this charge by pointing out the qualifier "apprehended from the economic point of view" which is intended to fend off just such a charge. Veblen frequently throws in such qualifiers to suggest that there may be grounds other than economic on which phenomena could be

found to be perfectly justifiable. But Veblen has written also that:

The pressure exerted by the environment upon the group, and making for a readjustment of the group's scheme of life, impinges upon the members of the group in the form of pecuniary exigencies; and it is owing to this fact - that external forces are in great part translated into the form of pecuniary or economic exigencies - it is owing to this fact that we can say that the forces which count toward a readjustment of institutions in any modern industrial community are chiefly economic forces; or more specifically, these forces take the form of pecuniary pressure. (p. 135)

The purpose of this last quote is not to make the case for economic determinism, but mainly to show that Veblen does indeed, despite the disclaimers, take economics to be "very important" in understanding change in institutions. But though "very important" does not a case for determinism make, this excerpt also reinforces what is apparent in the previous quote. In both there is indication of a duality consisting of a social reality and an environment to which the social reality must adjust. There is some confusion in the formulation above (p. 176) for Veblen seems to be saying that the "human collectivity" must adapt to the "environment" and to the "institutional structure required by the economic situation of the collectivity." But given what is for Veblen essentially an economic translation of environmental into pecuniary forces, this formulation, like the second passage (p. 135) reveals this dualism between material reality and a second, social reality that is or should reflect the first. This model is subject to the same (mis?)-interpretation as is the Marxist model. In both cases the social reality must somehow adapt to or reflect the material reality. This requires an explanation in terms of a direct and unbreakable causal link, which would render meaningless our experience of real contingency in our future and of our effective role in choosing, and creating that future, or, if there is not such a link between the two "realities," if material "reality" does not impose a constraint on social "reality," then the collection of institutions that is "society" could close in on itself, and, needing to recognize no external constraint (because to recognize anything would be to recognize it as internal, as part of the whole), could isolate itself in a societal solipsism.

There is a third, more promising answer for both Veblen and, I think by the same token, for Marxism. This is to deny any dualism whatsoever. That is, deny both the material/social dualism and deny also any dualism based on the is/ought distinction. The material/social dualism is simple enough to dispel if we recognize that humans are in the world and if with Marx we assert that there is no such abstraction "society" but that in fact there are only human beings that are themselves species beings, that is, that are literally social animals.

The second dualism is a more subtle one. But if we accept the metaphorical interpretation of Veblen's "peaceable stage" as representing a primordial imperative that reveals the freedom of other persons as the ground and possibility of my own consciousness and of my own freedom to choose, then there is an "ought" given in all my experience and underlying all my choices that does not determine my choices or my actions, but is at once the limitation and possibility of them.

