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A JAPANESE-AMERICAN ECONOMIC WAR?

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(Based on Koizumi Lecture, Keio University, December 1, 1970)

I

Despite the mediating efforts of Representative Wilbur Mills (D., Ark.), it is difficult to be optimistic about the propsects of avoiding some sort of Japanese-American economic conflict in the early 1970's. In any such conflict, the U. S. will be the aggressor, with increased restrictions on imports from Japan. The Japanese reaction to such economic aggression is uncertain.[(1)] We can hope, however, that this "irrepressible conflict" will not be so severe as to force Japan, which despite its new-found strength still needs exports to finance its necessary row materials, into expanded economic relations with Russia and China on Russian or Chinese terms.

(The prospect of one-sided terms, not the expansion of relations, is what concerns me. Foreign Minister Chou En-lai announced in April 1970 his government's intention to ban from the export trade to Mainland China all Japanese firms (1) aiding South Korea or Taiwan, as by sale of capital goods or extension of credits, (2) investing in South Korean or Taiwanese enterprises, (3) selling military supplies to the U. S. in connection with the war in Indo-China, or (4) affiliated with any U. S. corporation.[(2)])

* In addition to the participants in economic seminars at three Japanese and five American universities, I must acknowledge the critical assistance of Kazuo Nukazawa of the Japan Federation of Economic Organizations (*Keidanren*), assigned in 1968–71 to the Japanese-American Trade Council in Washington. Far from implicating others in the weaknesses of this paper, I should also state explicitly that most of my Japanese readers and audiences, including Mr. Nukazawa, regarded the paper as hopelessly pro-American, while American readers and audiences regarded it as pro-Japanese!

(1) An optimistic note, on the ground that the present Japanese government would do little or nothing, is sounded by Weinstein. "Prime Minister Sato and his conservative colleagues . . . do not appear in the least inclined to alter their fundamental policy of close, friendly security and economic cooperation with the United States." Martin E. Weinstein, "Japan and the Continental Giants," *Current History* (April 1971), p. 197. This statement may describe the position of the Sato faction of the government party, but can this faction retain control if it reacts passively to economic aggression?

(2) *Japan Times* (Dec. 4, 1970), noting that Japan's largest automobile manufacturer, Toyota Motor Co., has "accepted" the Chinese four-point program. (Toyota subsequently cancelled plans to build facilities on Taiwan.)

An anonymous study, "Japan, Inc.: Winning the Most Important Battle," *Time* (May 10, 1971, p. 87 f.) reported that the ex-*Zaibatsu* companies would meet the Chinese program by division of markets. "Mitsui and Mitsubishi decided to concentrate on South Korea and Taiwan, while Sumitomo took China." It is difficult to imagine the Chinese Government being fooled by such transparent tactics for any prolonged period.

II

There are both economic and political reasons for what appears to be accelerating deterioration in Japanese-American economic relations. The political aspect is shrouded in secret diplomacy. It is reasonably certain that the Nixon administration demanded economic concessions as its price for permitting reversion of Ryukyu Islands (Okinawa) to Japan in 1972, and that the Sato government promised concessions it proved unable to push through the Japanese Diet. It is further believed that the "Southern strategy" of the Republican Party in domestic U. S. politics required that these concessions be concentrated on reduced Japanese competition with Southern textile products rather than accelerated liberalization of foreign investment in Japan.(3) When, fearing a defeat in the Japanese Diet,(4) the Japanese government failed to make good on its alleged commitments, the fat was in the fire.(5)

More strictly on the economic side, 1969–70 were recession years in the U. S., where recessions always bring protectionism out in force. American protectionist interests, labor and capital alike but primarily labor,(6) have a great deal to gain from import restrictions in "stagflation" periods, and are also well organized. (Reducing foreign imports, like dismissing married women, keeping teenagers in school, and lowering the retirement age, seems an inevitable accompaniment of American recessions.) American consumers, on the other hand, with most to lose by a trade war, are hardly organized, while among American exporters, the agricultural interests are relatively dormant. True, Japan has become a billion-dollar annual market for U. S. agricultural exports. But at the same time, many

(3) See, for example, a U. P. I. dispatch from Washington under the by-line of Elizabeth Wharton, "Textile Row Traced to Election Promise—International Trade War is Real Possibility," *Japan Times* (Nov. 3, 1970). This report singles out Senator Strom Thurmond (R., S.C.) as the villain of the piece.

(4) The prospective defeat would have involved not only the united opposition of all non-government parties, but also the defection of many non-Sato factions of the Liberal Democratic party itself. (The weaknesses of party discipline in Japan are brought out in a number of sources, including Gerald L. Curtis, "Conservative Dominance in Japanese Politics," *Current History* (April 1971).)

As in any other cabinet system of government, a defeat for the Sato cabinet on an issue so fundamental as Japanese-American economic relations would have forced resignation of the cabinet, and probably also a general election.

(5) A non-economic sign that "the fat was in the fire" was President Nixon's decision "to submit to the Senate a treaty returning Okinawa to Japan, rather than handing it back by administrative action, as he had led Tokyo to expect. If the Southern textile bloc can sew up 34 Senate votes, it can defeat the treaty. Okinawa is such an emotional issue in Japan that a defeat could topple Prime Minister Sato's government." "Japan, Inc.: Winning the Most Important Battle,' *op. cit.*, p. 85.

(6) American capitalists can gain *both* by restrictions on Japanese competition at home *and* by opening of the Japanese market to U. S. goods and capital. American workers look with suspicion on any export of capital as "export of jobs," and concentrate accordingly on domestic protectionism.

farmers otherwise export dependent have been insulated by price-support programs, which give them high prices and soil-bank payments regardless of export volume. Such farmers do not particularly care whether their incomes are financed by exports, by taxes, by deficit financing, or by the printing press.

III

Four obvious economic issues—and one submerged one, or five issues in all—are involved in the deterioration of Japanese-American economic relations. These issues are:

(1) "Voluntary" quotas restricting Japanese exports to the U. S. These date from 1956. While voluntary in the sense of imposition by the Japanese themselves, they are known in Japan to have never been voluntary in fact. Japan regards them as insulting, and wants them removed or at least weakened. The American position has been to increase their number and specificity, to put more teeth in them, and to supplement them by formal import quotas when Japan resists American pressure. As of early 1971, there were 73 of these quotas. Of these, 39 were in textiles, and 17 in steel products, which remain the "hot" areas in 1971.[(7)]

(2) The height of the Japanese tariff wall, plus the arbitrariness of Japanese import licensing and customs procedures. American exporters want these changed. They want quicker and fuller trade liberalization, and feel that they have been getting only slow and tricky (*zurui*) varieties. Japanese interests competing with existing and potential imports are naturally satisfied with the *status quo.* Their interests dominate the Japanese Ministry of International Trade and Industry (known as MITI to the foreign community in Japan, and *Tsūsanshō* to the Japanese.)[(8)]

(3) American charges of Japanese dumping. These are being pressed by a number of American industries affected by Japanese import competition. Publicity has been concentrated during 1970–71 on specialty steels and color television sets. Needless to say, these charges are denied vehemently by the Japanese firms concerned.

(4) Japanese restrictions on the entry of foreign firms and of foreign equity

(7) U. S.-Japan Trade Council, *U. S.-Japan Economic Relationships in 1969* (Washington, August 1969), p. 11. I have been unable either to verify or disconfirm a widespread Japanese belief that Japan accepted the voluntary quota system on cotton textiles in 1956 in exchange for a U. S. promise not to extend the system to man-made textile fabrics, which are major subjects of controversy in 1970–71. The long-term arrangements regarding international trade in cotton textiles (Geneva, Feb. 9, 1962), did however include in Article I the language that "these measures . . . are not to be considered as lending themselves to application in other fields."

(8) The Boston Consulting Group has translated and published two strong statements of the MITI position, by MITI officials, which should be studied by all parties interested in Japanese-American economic relations. These are Naohiro Amaya, "Trade and Investment in Japan in the 1970's" and Yoshihisa Ojimi, "The Basic Philosophy of Japanese Industrial Policy." For an opposing position by a Japanese-born economist, see Robert S. Ozaki, "Japanese Views on Industrial Organization," *Asian Survey* (October 1970).

investment.[9] Americans want the same rights to establish Japanese subsidiaries, or to buy into existing Japanese firms, that Japanese enjoy but seldom exercise in the U. S. The Japanese are afraid of "excessive competition" (*katō-kyōsō*), which is hard to define but includes any form of price competition threatening "large" or "good" Japanese concerns.[10] Japanese interests would like to delay investment liberalization in a number of key industries,[11] and again MITI is on their side.

(5) Possible yen revaluation has been for years the principal hidden or submerged economic issue between the United States and Japan.[12] It surfaced only in May, 1971, when a high U. S. State Department official allegedly suggested semi-officially that the value of the yen be increased. The present rate of ¥360 to the dollar was set unilaterally by SCAP in 1949. Many Americans now consider it obsolete,[13] and as undervaluing the yen. They would prefer a rate of perhaps ¥1000 to $3 or even ¥300 to the dollar, not without support among Japanese consumers.[14] Japanese export interests naturally prefer the *status quo*, as do Japanese creditors—shipbuilders particularly—to whom foreigners owe large debts denominated in dollars and unprotected by "yen clauses."[15]

(9) Restrictions upon debt investment and technical-assistance contracts exist, but are much less severe.

(10) For several examples of *katō-kyōsō* situations, not always sympathetically interpreted, compare M. Bronfenbrenner, "Excessive Competition in Japanese Industry," *Monumenta Nipponica* (1966).

(11) As a result of three "rounds" of liberalization (1967, 1969, and 1970), however, 447 Japanese industries have been placed in Class I and 77 in Class II as of early 1971. In Class I industries establishment of new joint ventures is approved automatically, when foreign participation is 50 per cent or less. In Class II industries new joint ventures are approved automatically without percentage restriction. As for acquisition of existing Japanese companies, the ceiling for automatic approval of foreign investment in stocks of companies listed on Japanese stock exchanges has been raised from 20 to 25 per cent, except that in public utilities (including banking) it remains at 15 per cent. The limit for any single foreigh interest, however, is only 7 per cent in all cases. (Japanese Embassy mimeographed materials, distributed in connection with talk by Ambassador Nobuhiko Uchiba to World Affairs Council of Pittsburgh, Feb, 16, 1971.)

In Mr. Nukazawa's interpretation, the Japanese position is that no country's capitalists should seek more than 50 per cent control of enterprises in foreign lands. Neither should they, as a matter of social responsibility, invest abroad unless there is full employment at home in the industry in question. (The American AFL–CIO would welcome the second proposition!)

(12) Another submerged issue related to American aid to the less developed countries of South and Southeast Asia. It pertains both to the volume of aid and to the extent of its "tying" to purchases of U. S. exports. The Japanese, of course, would prefer the amount maximized and the tying minimized, as per the abortive "Kishi Plan" of 1960.

(13) Also obsolete is M. Bronfenbrenner, "Thoughts on the Yen-Dollar Exchange Rate," *Keizai Kenkyu* (Jan. 1959), which I disavow as irrelevant to the current situation.

(14) *Time*, however, is uniquely guilty of the nonsensical statement. "The sooner the revaluation comes, and the bigger it is, the better." "A Yen for Revaluation," *op. cit.*, (June 7, 1971), p. 70.

(15) A yen clause specifically protects Japanese creditors against yen losses due to devaluation of the dollar against the yen or upvaluation of the yen against the dollar.

As this is written (June, 1971) a 5 per cent upvaluation of the yen is widely forecast for late 1971 or early 1972, and Americans are considering temporary countervailing duties against Japanese goods generally until the yen is revalued at its "true" international value, whatever that means.(16)

Before going into further details, let me defend myself against the charge of being a doctrinaire free trader. This charge has come up in connection with my discussion of certain of these issues in Japan.(17) The practical man, including the civil servant in an "operating" agency will tell you that free trade is optimal in theory but not in practice. My own position is almost precisely the opposite. The theoretical case for free trade and investment seems to me weak, as soon as we leave a world of pure competition, static technology, ideal or invariant distributions of income and wealth, and like-wise devoid of "externalities" or "neighborhood effects."(18) The trouble is rather with protection as she protects. Rather than remedying the various weaknesses of free-trade solutions, protection usually plays indiscriminately into the hot little hands of entrenched domestic monopolies, cartels, labor aristocracies, and power-mad bureaucrats. Both consumers and exporters tend to be neglected. If, therefore, I sound like a free trader, it is not that I love the free market so much, but MITI and the Tariff Commission so much less.

IV

We begin with export and import quotas on Japanese exports, including in particular man-made textile fibers.(19) Here I shall attempt to paraphrase an American position, with which I disagree. When the U. S. achieved an export surplus in modern industrial products in addition to its traditional agricultural staples, it developed an interest in lower tariffs on such products, and in the breakdown of quotas and other non-tariff barriers to trade in them. (This modification of American protectionism is associated with the name of Cordell Hull.) After World War II, the U. S. also developed the notion that American taxpayers contributions to Free World recovery and development deserved compensation

(16) See Edwin L. Dale, Jr., "A Special Tariff on Japan Weighted, ' *N. Y. Times* (May 24, 1971) and by Takashi Oka, "Sato, Barring Revaluation of Yen, Criticizes Comments by Americans as Interference," *ibid.* (May 27, 1971), as well as "A Yen for Revaluation," *op. cit.* An international special tariff against Japanese exports has also been considered, as an application of the "scarce currency clause" of the International Monetary Fund charter.

(17) See, in particular an interview, "Nichibei Keizai Kassen wo Keihi Suru Tame ni," *Shūkan Tōyō Keizai* (Oct. 24, 1970).

(18) These arise when A's actions impose costs (or confer benefits) on B (or on "society;", for which the market mechanism cannot charge effectively. Damage to "the ecology" or "the environment" is a type case as of 1970–71.

(19) *Vide supra*, note 7, for the Japanese belief that the U. S. position represents a breach of faith.

by other countries restraint in disturbing American firms' home markets[20]—although Americans need not reciprocate this restraint. Another one-sided American view is of longer standing, namely, that high-wage countries like the U. S. are uniquely justified in protecting their workers against low-wage competition, but that low-wage countries like Japan should not be concerned about high-wage competition.[21] The solution to this farrago of inconsistencies—"contradictions" in Marxian terminology—has been relatively low tariff rates, with the imposition of quotas on U. S. imports left wherever possible to exporting countries or to international agreements. In this way, the U. S. keeps its hands osternsibly clean.

It is accordingly considered immoral for Japan to have used any part of the \$2-billion American contribution to Japanese postwar recovery for invasion of the American home market. Also, in the special case of Japan, our bilateral trade balance not only turned unfavorable in 1965 but is now running \$1.3 to \$1.4 billion per year in the unfavorable direction. This is the largest such balance the U. S. (or any other country) has ever had with any trading partner. Any economist knows that in a multilaterally-trading world bilateral balances mean little by themselves, but the American public does not realize this, any more than it realizes another standard textbook argument about the gains of trade consisting primarily of cheaper imports. When the favorable American trade balance is shrinking, as it has done since the Korean War, it is easy to focus the resulting difficulties particularly on imports from Japan.

The Japanese have done a poor job in presenting their own case against American protectionism. Perhaps the Japanese government can do no better, in view of its own policies, than to quibble about the number and the strictness of individual quotas. It is also discouraging to find a major Japanese newspaper lecturing the Japanese textile industry for not realizing "that free trade is changing." The

(20) Disturbance of the home markets of established U. S. industries by Japanese imports is sometimes called "economic imperialism." Senator Richard S. Schweiker (R., Pa.) has blamed Japan's "imperialist trade policy" for th troubles of the obsolescent Jones and Laughlin Steel Corporation in Pittsburgh. (*Pittsburgh Post-Gazette* (April 15, 1971).) An unidentified member of the Nixon Cabinet is quoted: "The Japanese are still fighting the war, only now instead of a shooting war it is an economic war. Their immediate intention is to try to dominate the Pacific and then perhaps the world." (Japan, Inc.: Winning the Most Important Battle," *op. cit.*, p. 85. A spokesman for the American textile industry, President Ely R. Callaway of Burlington Mills, puts it this way: "I cannot think of any major industry in America that is not subject to great invasion or attack by the Japanese. The problem is the the Japanese system is the most effective monopoly that has ever been developed in the economic history of the world. The Japanese will do whatever they need to do to take over whatever part of the richest markets in the world that they want to take." "Free Trade vs. the New Protectionism," *Time* (May 10, 1971), p. 91.

(21) But do not foreign workers, even low-paid ones, need protection against American "robots?" What of the folk-song about John Henry, "the steel-driving man," working himself to death in losing battle against the steam hammer? Many European and Asian workers see themselves in John Henry's position vis-a-vis their American competitors.

view that it is free to export as much as possible as long as the market of the other country is not distrupted is no longer accepted."[22] If Japan gives away this much, it might as well surrender; to make matters worse, this *Yomiuri* editorial is bad economics. I should have liked to see one or more Japanese agencies publicize in America the case against quotas as such—stressing price competition and savings to American consumers, as Volkswagen has done in the American automobile market. There is plenty of American consumer resentment against inflationary price and wage gouging; Japan has taken little advantage of it.

V

We turn to American complaints against Japanese import regulations. As has been said, Japan gets little sympathy in the U. S., partly because American protectionists can reply so easily with horror stories of high tariffs, unreasonable quotas, unwrittern rules, and arbitrary procedures. My examples are from the automobile and radio industries. Japanese tariffs on automobiles have been nearly four times the American ones, but were reduced in April 1971.[23] Furthermore, when quotas were taken off new automobiles as a "liberalization" concession, they were not taken off automobile *parts*. This meant that American automobiles had for a time to be shipped fully assembled, at higher transport and assembly costs. Turning to used cars, importation by individual foreigners has been banned at least once on the basis of nothing more than a verbal order. When it comes to radios, a veteran U. S. business man in Japan is quoted as complaining: "They said one day, 'Now you can make radios.' But when you read the fine print, it turned out that you couldn't bring in parts. You couldn t even make a crystal set. Then another round of liberalization came and, by God, now you can bring in parts—for a crystal set!"[24] We may add to such cases a pervasive rumor[25] that Japanese purchasers, particularly large companies, receive *gyōsei shido* (administrative guidance) against buying imports competitive with selected concerns which are "chosen instruments" of Japanese growth.

VI

Our third topic is dumping, on which each case is different. Dumping is both practiced widely and misunderstood widely in America. What the term supposed-

(22) *Yomiuri*, quoted in *Japan Times*, Nov. 9, 1970.

(23) *Japan Times* (Nov. 10, 1970).

(24) "Showdown in Trade with Japan," *Time* (July 4, 1969), p. 71. Mr. Nukazawa replies that Japanese duties on *trucks* have been lower than American ones.

(25) Supported in "Japan, Inc.: Winning the Most Important Battle," *op. cit.* p. 88, citing the electronic computer industry. Mr. Nukazawa insists that such rumors are for the most part false (as of 1971, at least) and that American exporters have simply been too lazy to learn enough Japanese to read Japanese customs regulations and keep up with their changes.

ly means is selling abroad below the domestic price (plus transport costs)[26] but many Americans expand or contract the concept in one or more of three ways:

(1) Dumping means sale below the *foreign* price, and thus disruption of foreign markets. (This has been done by Japanese exporters in many fields, but it is *not* dumping in the usual sense.)

(2) Dumping means sale below the "international" or "world" price. (If one accepts this view, the U. S. does not doump agricultural products when it sells abroad at world prices, although domestic prices are maintained at much higher levels.)

(3) Dumping is sale below "fair value," defined as "cost plus a reasonable profit." (This definition is applied widely to goods produced for export only, and not sold domestically.[27])

I propose to consider the two leading cases, specialty steel products and color television sets. The steel problem is that most of the specialties exported from Japan to the U. S. are made to foreign specifications and are not sold in Japan. The problem of "fair value' is therefore involved under American law. Since steel products are produced jointly, fair valuation raises questions of allocation of joint costs between individual products. American interests have asked to see the cost books of Japanese companies, so that "fair values" of Japanese export products could be computed on the basis of American accounting systems. On the other hand, cost books are trade secrets in the U. S.; why not respect their secrecy in Japan? And furthermore, why apply American rather than Japanese rules of cost accounting, since accounting practices are largely conventional rules of thumb?

Color TV sets involve the same issue, since many Japanese exports are stripped-down models for the American bargain-basement trade, and are not sold at home. But there is another problem too, because the dumping charges involve primarily retail prices. Let us assume that the Japanese TV manufacturer gets essentially the same yen price whether he sells to a Japanese retailer or to a buyer for the U. S. market. The Japanese distribution system, however, is even more costly than the American one. Resale-price maintenance is also legal in Japan, even when combined with a multiple-price system. Multiple-pricing has ruled in Japan; some Japanese consumers have been able systematically to buy TV sets more cheaply than others. The combined result has been that an American consumer can often buy a Japanese TV set more cheaply than a less-favored Japanese consumer. This is a difficult set of facts, no doubt, but I do not think it constitutes dumping unless price discrimination can be proved at the manufacturing level.

(26) The standard text is still Jacob Viner, *Dumping, a Problem in International Trade*(Chicago: University of Chicago Press, 1923).

(27) American anti-dumping laws use this principle. Compare Noel Hemmendinger, *Non-Tariff Barriers of the United States* (Washington: U. S.-Japan Trade Council, 1964), pp. 15–17.

VII

Capital exports from America to Japan are the next cause of Japanese-American economic ill-will. Here I see no more reason for excluding foreign firms and capital from any advanced country overseas, including the U. S. This is the American position. It is also what I wish President Nixon had insisted on, rather than export quotas, as the Japanese economic concession in the Okinawa negotiations.

When it comes to capital imports, Japan has a long history of paranoia about foreign firms operating independently on the Japanese market, or buying interests in Japanese companies. Since automobiles and computers are among the fields most permeated by this paranoia, we might consider these fields particularly.

General Motors has bought the Opel firm in Germany, but everyone knows that Volkswagen and Mercedes-Benz are holding their own. Chrysler has bought the Simca firm in France, but everyone knows that Renault and Peugeot are holding their own. Ford set up a British subsidiary many years ago, but Morris is holding its own, while some report that Ford would like to withdraw. Why could not Toyota, Nissan, or Mitsubishi do as well in Japan? Furthermore, international capital movements are bilateral. The Italian business-machine company Olivetti has bought the Underwood Company in the U. S., and competes with I. B. M. and N.C.R. on their home grounds.

The main opposition to faster capital liberalization in Japan seems to come from *zaikai* interests jealous for their monopoly-oligopoly interests on the increasingly important Japanese market, from *kambatsu* interests hungry for arbitrary powers of "guidance," and from the spiritual heirs of Tokugawa Japan with its colosed economy. The answer to *Le Défi Americain—The American Challenge*[28] —recommended by Servan-Schreiber was not exclusion but imitation-plus-improvement-plus-outperformance. Imitation-plus-improvement-plus-outperformance has always been a Japanese specialty, even though it cannot be guaranteed to work in any and all cases.[29] It is easier to admire Servan-Schreiber than the MITI apologists for rigidity. And one should remember, when caonsidering competition with General Motors or I.B.M. in Japan, that the Japanese will be competing not with these firms' total assets but with what they can spare for the Japanese market, and not with their first management team but with the same level of talent that existing American firms send overseas. My guess is that the battle in Japan would be less rather than more difficult than Servan-Schreiber made it out to be in Europe.

Were we discussing Japan in 1870 or 1945, I should feel differently.[30] Also,

(28) Jean-Jacques Servan-Schreiber, *op. cit.* (New York: Avon, 1968).

(29) It has failed, for example, to keep the Coca-Cola Company from dominating the Japanese soft-drink market, or Nestle the Japanese instant-coffee market, or Heinz the Japanese ketchup market.

(30) One of the more successful SCAP programs was directed against "carpetbaggers"—Americans trying to buy up Japanese industrial assets cheaply in the disturbed climate of 1945–50.

when we consider contemporary Korea or Okinawa, it is easy to understand Korean or Okinawan fear of the unlimited influx of Japanese capital. My criticism is that, as regards capital movements, Japan is strangely ignorant of its own strength. Japan reminds me of the college student who considers himself a man for purposes of burning down the ROTC building, but a little child when punishment is being considered.

VIII

The principal submerged Japanese-American economic conflict has concerned the proper value of the Japanese yen. This conflict may never become as important as any of the others.

Despite some practical experience in setting of exchange rates[31] I am more willing to trust the market of fix the yen-dollar rate than the guesses of SCAP bureaucrats who set the 360–1 ratio in 1949. To trust the market means, in practice, to let the yen and dollar float, with no fixed parity between them. Such a system requires an expanded foreign exchange market, so that future as well as present rates can be quoted, which will permit hedging and reduce the exchange risks in long-term capital movements. Bankers dislike the free market system because it will lessen the somnolence of their business, and make them work harder to set up new financial devices and institutions to reduce risks on long-term transactions. But there seems no valid reason why foreign exchange rates, which are an important set of prices, should be fixed arbitrarily any more than any other set of prices.[32]

There is a widespread belief that, in a free exchange market, the yen could only rise relative to the dollar. Such a change would raise the dollar prices of Japanese exports overseas, and lower the yen prices of imported goods in Japan. It would therefore make life harder for both Japanese exporters and import-competing Japanese domestic producers, and easier for both American exporters and import-competing American domestic producers. It would tend to reduce the present Japanese trade surplus and increase the American one. (The Japanese trade surplus, of course, is the main reason why the yen is expected to rise on a free market. World demand for yen would also increase if Japan liberalized foreign capital inflows more completely.)

The yen might very well rise on a free international market, but full liberalization would also release forces working on the other direction. The most important such cahnges would be the reduction of Japanese tariffs and the complete freeing

(31) I assisted in fixing the Okinawan yen at ¥120 to the U. S. dollar in 1949. The job took less than an hour, using a crude statistical approximation to economists' "purchasing power parity."

(32) This sentence assumes that free exchange markets are technically stable. Even if stable, free exchange markets may be dangerous for minor currencies which can be manipulated because of the thinness of the markets for them. For such currencies, tying to major currencies may remain a practical necessity.

of Japanese capital to escape "guidance" and trade unionism at home by overseas investment.(33) The futurologist Herman Kahn predicts in *The Emerging Japanese Superstate*, probably on the basis of more "vision" than analysis, that Japan may wish to invest between $5 and $10 billion annually in the "Non-Communist Pacific Area" in the 1970's and early 1980's, and that this region will shortly replace North America as Japan's principal trading partner.(34) If Japanese capital export comes to pass on anything like the scale predicted by Kahn, the world's exchange markets may be glutted with yen and the call for upward revaluation may vanish. The weight of informed opinion, however, is to the contrary.

IX

Some attempt at a conclusion is overdue. I have accepted neither the Japanese nor the American case in its entirety. What I favor is rather a new approach in Japanese-American economic negotiations. This approach is a trade-off, to minimize or prevent economic warfare between the two countries. It consists of reopening the American market to Japanese exports free of quotas, and in exchange, opening the Japanese market for almost the first time to foreign goods and foreign capital. I should also like to see the floating of the yen, and the dropping of the principal dumping charges made in American against Japan.

Many minor trade-offs are also possible within this large one. For a single example, consider citrus fruits. I like both fresh American grapefruit and fresh Japanese tangerines (*mikan*). In Tokyo, grapefruit cost ¥1000 ($2.80) apiece; a few years ago, I could not get them legally at all. The reason: Japanese tangerine growers must be protected. In Pittsburgh, on the other hand, I can't get fresh *mikan*. The reason: American orange and grapefruit growers must be protected. How foolish can we get?

The trade-off approach is a bolder and newer look than the current quibbles about export versus import quotas, and *n* versus *m* schedules therein, not to mention precise liberalization dates for specified kinds of capital movements in individual industries. The trade-off approach will increase economic freedom, and help consumers in both countries. It may even help check inflation in the U. S., although probably not in Japan.

The trade-off policy will not, of course, be good for everyone in either country. I cannot claim that it will help the textile industry in the American South, or President Nixon's alleged "Southern strategy" for the 1972 elections. Neither will it make the leading AFL–CIO trade unions happy. It will not help the automobile or computer industries in Japan, or their allies among the planners

(33) Mr. Nukazawa registers a strong disagreement here. His belief is that Japanese capital exports to advanced countries and to stable developing countries are in fact free. He doubts that many Japanese capitalists would risk their money in the unstable (or Socialist) LDCs of Africa and Latin America.

(34) "Kahn Predicts Japan Will Seek Armed Might," *Japan Times* (Nov. 10, 1970).

and guiders in the Japanese government. Insofar as insulation from competitive risk has encouraged domestic investment in Japan and thereby raised the measured Japanese growth rate, I cannot prove that the trade-off policy will permit this rate to be maintained at 12 per cent. To many of these unhappinesses, however, I would myself say, so much the better, the complainants having earned their tou-bles by price-gouging, wage-gouging, or dictatorial tactics in the recent past.

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Note (*Octobdr, 1971*): The text of this essay is as revised in June of this year. It therefore takes no account of the "Nixon" and "dollar" shocks of August, which apparently mark the outbreak of economic warfare between our two countries.

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