A JAPANESE-AMERICAN ECONOMIC WAR? FURTHER REFLECTIONS

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I

> "I cannot think of any major industry in America that is not subject invasion or attack by the Japanese. The problem is that 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. They zero in on a segment of our market and take it over. Then they will move into the next segment and the next." Ely M. Callaway, Jr. and Donald F. McCullough (U.S. textile executives)
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> "The real target of our international trade and monetary moves was Japan—not the Europeans. U.S. patience has worn thin with the one-sided, lopsided, inequitable, unfair economic and monetary treatment we have received from the Japanese. The day of bowing and scraping to them is over. From now on the Japanese will have to give more than they get or suffer the consequences." Pierre Rinfret (Wall Street economist and financial consultant).

Such statments are important. They do not reflect the majority sentiment of American business and labor and agriculture—yet. They are not official statements of American governmental bodies or commissions—yet. One can find in Tokyo plenty of anti-American equivalents to these anti-Japanisms, but they to do not represent Japanese business, labor, and agriculture, or the Japanese Government—yet.

I have tried as a professional economist, an amateur Japanologist (in America), and an amateur Americanist (in Japan) to push the "yet" as far as possible into the future. For such efforts one may expect to be abused as pro-Japanese in the U.S. and as pro-American in Japan. As Jesus said, blessed are the peacemakers!

II

"A Japanese-American Economic War?" was the subject of my Koizumi Lecture at Keio University in December 1970, when the Nixon and dollar shocks of 9 months later were looming up on the horizon. By the time that lecture was published[1]-the shocks had come, skirmishing had broken out, and statements

[1] Two versions were published, in the Fall 1971 issues of the *Keio Economic Studies* and the University of Illinois *Quarterly Review of Economics and Business.* The American version had one more revision than the Japanese, but both versions were based on the situation immediately prior to the Nixon programs of August, 1971.

like those quoted above were rising both in number and in vehemence.

This Koizumi Lecture isolated, and discussed separately, five groups of issues currently exacerbating Japanese-American economic relations, and also proposed somewhat vague and general solutions. These solutions were in some clases close to the Japanese position, and in others close to the American position. In all cases, they were in the direction of greater freedom of international trade and capital movements. I still believe them to constitute a "package" preferable on balance to what has come about instead, particularly from the viewpoints of consumers in both countries. But of course, the package is far from Pareto optimality. (The Japanese rice farmer would be hurt. Likewise the Japanese computer industry and its employees. Likewise the major American labor federations. Likewise the American steel industry and its employees.) The issues and proposed solutions, were, in capsule form:

1. "Voluntary" Japanese quotas on Japanese exports to the U.S., under U.S. pressure, the most immediate issue as of late 1970. (Proposal; Enact no more quotas, and revoke the existing ones.)
2. Tariff and non-tariff barriers against U.S. exports to Japan. (Proposal; Concentrate on eliminating non-tariff protection, particularly "administrative guidance" of Japanese customers.)
3. Alleged Japanese "dumping" in the U.S. maket. (Proposal: Drop the great majority of these charges, which are based on highly self-serving definitions of "dumping.")
4. Foreign, and particularly American, entrepreneurial direct investment in Japan. (Proposal: Rapid and complete liberalization.)
5. Yen revaluation, which could still be called a "submerged" or "background" issue in 1970. (Proposal: A "clean" float of the yen, with minimal intervention by the Bank of Japan.)

While standing by almost everything I said at Keio in 1970, I now wish to go a little deeper, since it now appears that, underlying these five issues, are two others which merit exploration. The first such issue is a theoretical one, and felates to the standard economic problem of the gains from trade. The second deeper issue is less an economic than a psychological one; it relates to "ways of doing business," and particularly of conducting negotiations.

III

Conventional trade theory assumes full employment in each of the trading countries, and limits the gains from trade to cheaper imports, with all countries specializing along lines dictated by comparative advantage. The theory also takes the structure of international comparative advantage as given in the short run, and as changing over time exogenously if it changes at all. That is to say, changes in comparative advantage are completely independent of the commercial policies of the trading contries. (This is of course an elementary textbook or handbook summary, which omits all the graduate-level qualifications and complications.)

Following the "Keynesian revolution" of the 1930's, trade theorists dropped the assumption of full employment in each trading country. This enabled them to consider a second set of gains from trade, which were not added to the first set but often conflicted with them. The second set of gains, in a country with less than full employment, are on the export side. They consist precisely of increased employment and output. The technical process which brings them about is summarized under the label of "export multiplier."[2]

More recently there has come about yet another revolution in trade theory, which is still incomplete. We might call it a "Hicks-Arrow revolution," although neither of these Nobel Laureates is primarily an international economist. The Hicks component in this revolution, called "induced technical change," takes explicit account of the fact that a firm or a country can alter the rate and the direction of technical progress by thanging the amount and allocation of research and development (R and D) expenditures. The Arrow component, called "learning by doing," modernizes the old infant-industry argument for tariff protection. The claim is that, with investment in any particular branch of industry, a country can bring about the "augmentation" of both labor and capital inputs, even without overt trechnical change, by a learning process akin to what anthropologists call "acculturation."

What this revolution means in trade theory is recognition of the fact that a country, or at least a "large" country, can (within wide limits) shift its pattern of comparative advantage by changing the volume of internal investment and by re-channelling it between different industries. Comparative advantage, in other words, is itself subject to conscious change.

The usual twists a country wishes to give its comparative-advantage structure is a concentration upon high-wage, high labor-share, industries which also have high income elasticities of world demand. This twist, if successful, increases its rate of growth as conventionally measured. It also mollifies class conflicts between capital and labor by providing large amounts of prestigious, highly skilled, highly paid employment in "modern" industry. Conversely, an advanced country feels abused when changes in the international pattern of advantages force it to assume or to resume the position of exporting raw materials and handicrafts, while importing the products of modern industry. (Were the bilateral Japanese-American trade balance filled by increased exports of American farm products and other raw materials to Japan, Americans would continue to resent Japan's "treating us like an under-developed country.")

The United States enjoyed its Hicks-Arrow revolution in its sleep, so to speak, as a by-product of the settlement of its territory, the exploitation of its resources, the immigration of European labor—and two World Wars. The Japanese, on

[2] In an overheated economy with demand inflation, and with "too much money chasing too few goods," multiplier analysis demonstrates instead an additional gain from imports in reducing the inflation rate.

the other hand, have guided their Hicks-Arrow revolution since the Meiji Era by an increasingly self-confident and detailed system of consultative or indicative planning. Since approximately 1950, the Japanese gains through their Hicks-Arrow revolution have been largely at the expense of the United States, which had "arrived" little more than a generation earlier.

This process many Americans consider basically immoral, particularly because of the guidance and planning involved. They would naturally prefer to see international comparative advantages remain where they were in the early 1950's, or, if they were to change at all, to change slowly and "naturally," without either prodding or acceleration by a foreign government American interests cannot influence greatly. It is easy for Americans to forget what American (and German) economic advances had done to the British and French international economic positions in the period 1890–1950, because the U.S. Government had played a passive role and the Anglo-French problems could be ascribed to "natural forces" rather than active American rivalry.

So we see that, in a Hicks-Arrow revolutionary world, both the U.S. and Japan want to achieve and maintain comparative advantage in the world economy over the same set of distributionally-desirable and growth-desirable modern industries. Such competition is probably inevitable, but it need not degenerate into economic warfare. To avoid such degeneration, rules of the competitive game should be both established and changed when necessary. Such rules should be worked out and adapted to changing conditions, not only by the unwritten law of market practice but by conference, compromise, and agreement between the various competitors (not only bilaterally by Japan and the United States).

IV

This brings us at once to the second underlying problem of Japanese-American economic relations, the disparity between the methods of reaching and interpreting agreements in the two countries. A mere economist without expertise in sociology, psychology, or organization theory should not "rush in where angels fear to tread," except perhaps to encourage the angels by his bad example.

Very crudely indeed: the American system of negotiation is hierarchical and legalistic. Not only this, but it often features domination by some "terrible-tempered Mr. Bang." A few top men, usually accompanied by assistants and attorneys, meet for a few hours or days, reach some sort of agreement, and reduce it to writing in a formal document binding over a certain time period. Things are often done the way "the terrible-tempered Mr. Bang" wants them done, and Mr. Bang's lawyers turn Mr. Bang's tantrums into enforceable contracts, no matter how many technicians and experts know that Mr. Bang's ideas won't work. If subordinates' interests are injured by the agreement, they can quit their jobs. If they sabotage it, they can be dismissed. If they are never told about it, or don't understand it, or can't believe it is meant seriously—or if the agreement itself is based on technical misunderstanding—it often breaks down in practice. In this case, the whole process must occasionally be repeated, without waiting for the original agreement to expire. An international example, meaningful to both Japan and the United States, is provided by the Smithsonian currency arrangements of December 1971, which were expected to end international financial crises and which in fact collapsed only 14 months later, in February 1973.

The Japanese "economic miracle" has in any case inspired among Americans an extraordinary respect for the black-magical Japanese method of negotiation, and particularly for the *ringi* system. Here each negotiator's "position paper" has already made the rounds of his backers or subordinates, and each has already commented on it and revised it insofar as his own interests or operations are concerned. Also, before any agreement is finalized, backers and subordinates have the opportunity to raise their questions and objections. If these cannot be met, the draft agreement comes back up for modification again and again, until they are met. Every effort is made to avoid injury to any interest group. If indeed someone must be hurt, one of those who are helped can usually make some sort of side-agreement with the aggrieved party, compensating him on the side now or promising to do so in the future. If by reason of technical errors or Acts of God the agreement is unworkable as reached, or if an unanticipated loss to some participant results, nobody sues anyone else under this agreement or insists upon specific performance; modification is the order of the day. "The terrible-tempered Mr. Bang" has, of course, Japanese counterparts named *Muriyari* and *Ōbō*, but the *ringi* process gives them time to cool down and restore themselves to rationality.

But the *ringi* process takes time, and time may be "of the essence." In this case, the Japanese system gets involved in red tape and paralysis at critical moments, unless these have already been foreseen. The Japanese-American impasses of 1970–71 and 1972–73 were both cases in point.

Japanese dislike, and with reason, references to "Japan, Inc.," insofar as the term means that the government and business bureaucracies or, in Galbraith's term, "technostructures", dominate the economy and ride roughshoud over the rest of the population. Actually, the Japanese conservative Establsihment seems to harbor at least seven overlapping and participating interest groups. For Japan to make any significant voluntary policy change in response to the international (not merely American) complaints about the Japanese export surplus and closed internal markets, something would have to be done for each of them to be sure that none was disappointed in its legitimate expectations.

V

Who are these seven groups? What are their main concerns? And why is each of them important? The list which follows represents a foreigner's attempt to answer these questions:

1. The export interests, meaning primarily big business and the trading companies. These are main sources of campaign funds for the Government party. They want to minimize yen upvaluation, and dislike the uncertainties involved in floating exchange rates.

2. The import-competing interests, of which the most important is probably organized agriculture, the rural mass base of the Government party. They do not want trade liberalization or yen up-valuation, both of which mean cheaper imports.

3. Medium and small business interests, who form the shaky urban mass base of the Government party. Many of these people are in either export or import-competing branches of the economy, and have been covered in (1) and (2) above. In addition, and often most importantly, small business fears the competition of foreign firms in the Japanese market to an extent that big business does not, and there is good reason for its fear. Small business, in other words, is the main opponent of capital liberalization.

4. Labor interests, whose anti-Government militance the Government party strategists would like to blunt. Japanese workers are attached to "lifetime employment" and the security it provides. They do not want to see their employers subject to foreign competition on the Japanese market, which might drive them out of business, or force them to personnel cuts, or otherwise arouse threats of unemployment. On this point, the interests of organized labor are identical with those of small business.

5. Capital-export interests, mainly in mining, lumbering, and the initial levels of natural-resource processing. Like the exporters in (1), these interests are major sources of Government party financing. These firms, predominantly large, are entirely willing on principle to invest large sums abroad, primarily in developing countries, and reduce the positive Japanese balance of payments in the short run. On the other hand, they require protection against the risks of nationalization, and they desire foreign partners acceptable to themselves. (In countries where nationalistic or anti-Japanese sentiment is strong, the Japanese dislike the blatancy of the wholly-owned Japanese branch plant and subsidiary company. Perhaps, in this respect, they have profited by American mistakes.) It follows that the capital-export interests are somewhat hesitant, do not want to be rushed, and want the assurance of Government support.

6. Civil-service interests, especially in the Ministry of Trade and Industry, are opposed to all forms of liberalization as threats to their own status and power. These are the people who operate Japanese administrative guidance on a day-to-day basis, for they are the administrative guides. Intellectually gifted and occasionally arrogant, these people are attracted to the Civil Service, despite its relatively low salaries, by the power it gives its members while still young and forceful. A Japanese civil servant also faces retirement at the relatively early age of 55, and must consider the possibility of a post-retirement "advisory" position with some firm or interest group for whom he has been able to do favors during his Civil Service tenure. Liberalization, obviously, would lessen his opportunity

either to exercise administrative discretion or to do favors for potential future employers.

7. Taxpayer interests, whose importance to any party's mass base needs no spelling out. The Japanese taxpayer has come to expect lower rates and higher exemptions almost every year, especially in his income taxes, and to an extent greater than required to keep up with inflation. It would be bad politics to disappoint the taxpayers merely to compensate fully those persons whose interests have been hurt to secure agreements with the United States.

VI

It is an extraordinarily difficult problem in chess, in *go*, or in game theory to devise a Pareto-optimal package of provisions or arrangements which can simultaneously avoid any injury to any of these interest groups without cheating a little on one's concessions to the American side and its "terrible-tempered Mr. Bang." It should surprise no one that the Japanese have found no quick solution, and instead have asked continually for more time. The American side has, however, come to interpret these requests for more time as evidences of deviousness and insincerity, rather than as faith in the Marshallian long run.

The problem, while difficult, may conceivably be solvable if we allow side payments to otherwise-injured parties, special subsidies and tax reliefs, take account of third-country trade, and so on. Or, unfortunately, the problem may not be solvable at all. It may be like squaring the circle, reducing π to a rational number, or putting 100 per cent of the people into the top 10 per cent of the income distribution. The main point, for our purposes here, is only that no quick solution has been found, or is likely to be found in the immediate future.

In which case, if some Japanese interest must indeed be hurt to assuage the aggrieved Americans, it would seem good Japanese political strategy to avoid injuring that interest themselves, and to refuse assent to any agreement which injures it. It would seem good Japanese political strategy, in other words, to have the injury come unilaterally from the Americans, so that the Japanese Government can shift all blame to the unreasonable and uncontrollable foreigners' refusal to understand Japan's position. What the unreasonable and uncontrollable foreigners do, the Japanese Government cannot undo. But it can perhaps avenge what it cannot undo, and from successive reciprocal vengeances springs actual economic warfare.

VII

If this analysis is correct, the lowest-political-risk strategy for the Japanese side in the present "crisis" or "contradiction" is to continue stalling passively for time, and leave the offensive to the Americans. A possible form of the next American offensive move, as of March, 1973, seems to be a punitive and discriminatory surcharge of 10 to 15 per cent upon dutiable imports from certain unspecified countries which the American authorities judge to be undervaluing their currencies or frustrating the effects of their up-valuations upon their bilateral balances of trade and payments with the United States. Such legislation, if enacted, would be aimed squarely at Japan.

Should the United States enact such legislation, or turn generally protective along the lines of the Burke-Hartke Bill, Japan may react. I have no idea what form the reaction might take, but we may assume the reaction will injure American exporters to Japan, American comeptitors with Japanese exports in the U.S. and in third countries, or American affiliates particularly in Japan. This reaction may arouse an American counter-reaction, and so back and forth in a pattern of hostilities which may either escalate or die away, depending on whether the successive reactions increase or decrease in their intensity.

These remarks are not intended as alarmist. In fact, I consider myself the reverse of an alarmist. When I suggested a floating yen in 1970, I anticipated perhaps a 5 or 10 per cent up-valuation, not the 25 or 30 per cent up-valuation that has in fact occurred. Similarly, using the forbidden word "economic warfare," I have in mind only brush-fire skirmishes and guerilla tactics. Between Japan and America, there is only infinitesimal chance of either side's resorting to the full economic warfare arsenal—competitive devaluations, embargoes, preclusions, multiple currencies, blocked accounts, economic alliances, currency blocs, co-prosperity spheres, and other preliminaries to political warfare. But even so, the situation of the representative consumer and citizen in each skirmishing country will be worse under brush-fire economic warfare than under peacetime normality, unless of course the man in the street enjoys the atmosphere of mutual suspecion, recrimination, and general unpleasantness. Eventually a corner may be turned and relations normalize again, but the vague game-theoretic considerations of Section VI make it difficult to see where that corner is located, let alone how it can be turned in the immediate future.

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APPENDIX

The preceding pages were written in late March, 1973. This Appendix seeks to bring the story four months nearer "up to date." Four developments are involved:

1. The American balances of trade and payments, both generally and bilaterally with Japan, have greatly improved. The corresponding Japanese balances have greatly deteriorated. This change is ascribed to delayed effects of the 1971 currency devaluations; it is still too early to expect visible effects from those of 1973.

2. The general American mood does not, however, appear to have softened. Richard Du Boff says in "The Devalued Dollar" (*Commonweal*, March 30, 1973, quoted in "The Dollar Crisis: What Next?" *Monthly Review*, May, 1973, p. 9): "It would not be far-fetched to assert that a 4-cornered trade war among the U.S., Canada, Japan, and the EEC, has begun. Although public awareness seems scant, the Nixon administration began a coordinated campaign of harassment against its major trading partners a year ago."

3. An important new source of Japanese-American conflict was the "soybean shock" of early July, 1973. As an anti-inflation measure, the U.S. unilaterally suspended soybean exports to Japan (and other customers) without notice. As the Japanese press immediately pointed out, such tactics reduce any prospects for freer world trade in important agricultural commodities. At the same time, as the Japanese press has not pointed out, Japanese trading companies (*shosha*) are in a special position to bid up world prices and injure foreign consumers. They are in this position because of Japanese government and bank support which effectively underwrites any losses if commodity prices fall subsequently, and makes their speculation almost risk-free.

4. Also in July, the Ministry of Trade and Industry modified its operating policies, ostensibly to give greater regard to the Japanese consumer and his living standard, less to industry and the measured growth rate. There is no sign of willingness to trust the free market or weaken MITI's own arbitrary *gyosei shido* interventions which so frighten foreign exporters of both goods and venture capital to Japan.