The Chrysanthemum and the Eagle
Sato, Ryuzo

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A New Containment Policy? Early in 1991, I had a discussion with James Fallows, the Washington editor of the *Atlantic Monthly*, who is calling for drastic changes in U.S. policy toward Japan. During the course of our conversation he made a remark that helps explain the mixed feelings Americans have toward Japan. When General Douglas MacArthur returned to the United States after heading the Allied occupation of Japan, Fallows said, the general was certain he had made Japan into an American clone, a notion that was apparently shared by most Americans in those days. In the course of subsequent Japan–U.S. negotiations, however, it soon became clear that, far from having been re-created in America’s image, Japan had emerged as a country poles apart from the United States. The illusion and its betrayal, Fallows pointed out, underlie the
frustrations of the American people in their dealings with Japan.

Still, just as no two people look exactly alike, no two countries are the same. Each country has its own culture and traditions. Even the occupation authorities knew that; all they hoped to redesign in the American image were Japan’s political institutions and economic systems. The drastic reforms they launched—land reform, dissolution of the *zaibatsu* (big financial and industrial combines) and the old class system, women’s suffrage, equal opportunity in education, and freedom to unionize—did indeed make Japan totally different from what it had been before the war. Today, a half century after Pearl Harbor, the democratic political system and the capitalist economic system the United States implanted on Japanese soil have been thoroughly acculturated and indigenized, rendering them completely different from their parent models. It is easy to understand why some Americans stress the need to drastically revise a Japan policy that was adopted by the United States at a time when it thought it was dealing with a country which had the same systems as its own.

I first came to the United States in the late 1950s as a Fulbright exchange student, and for more than thirty years I have spent part of each year in the United States and part in Japan. During that time I have watched American attitudes toward Japan and Japanese products undergo a profound change. When I was a student in Baltimore I remember going to look for a second-hand car. “What about that Japanese car over there?” I asked. The salesman, a big man about six foot three or
four, put his foot on the bumper and shook the car back and forth. "You don't want to buy this," he said. "This isn't a car; it's a Japanese toy."

No one talks about Japanese toys today. Although the atmosphere of fear and hostility has eased somewhat as the United States and Japan have both turned inward to deal with their respective domestic economic problems, many Americans have come to regard Japan's economic success as a threat to their own way of life. Sensationalist accounts that imply Japan is out to dominate the world economically—although it has no such intention—merely increase Americans' unease during a period in which the U.S. economy is being radically restructured.

Since World War II, the enemy, both militarily and ideologically, has been the Soviet Union. But the 1980s saw an extraordinary reversal in American feelings toward what President Ronald Reagan at the beginning of his term of office had called "the evil empire." By the end of the decade Mikhail Gorbachev's perestroika policy had led to a new detente, brought an end to the cold war, and ushered in a new era of East-West cooperation. Since then, the Communist party has been ousted from power in all the countries of the former Soviet bloc, including the Soviet Union itself. By the end of 1991, the Union of Soviet Socialist Republics had ceased to exist, and Russia and its former allies have begun experimenting with a free-market economy. Capitalism has triumphed over communism, and the policy of Soviet containment first articulated by George Kennan has been an overwhelming success.

In 1947 an article entitled "The Sources of Soviet
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Conduct” by Mr. X (later identified as George Kennan) appeared in the U.S. journal *Foreign Affairs*. The United States, Kennan wrote:

must continue to regard the Soviet Union as a rival, not a partner, in the political arena. . . . Russia, as opposed to the western world in general, is still by far the weaker party. . . . Soviet power . . . bears within it the seeds of its own decay. . . . Soviet society may well contain deficiencies which will eventually weaken its own total potential. This would of itself warrant the United States entering with reasonable confidence upon a policy of firm containment.

History has corroborated the truth of these views, written more than forty-five years ago. America’s “Russian containment policy” has proven to be a successful strategy against the Soviet Union.

What if, in the above quote, “Japan” were substituted for the “Soviet Union,” and “in the political arena” for “in the economic arena”? This may not have been what James Fallows had in mind when he wrote his article “Containing Japan” for the *Atlantic Monthly* in 1989, but such a statement would perfectly encapsulate a Japanese containment policy. If America regards Japan as an economic adversary, and if, as some maintain, concepts of democracy, capitalism, and a free economy and society are different in Japan from what they are in the Western world, then “containing Japan” would be strongly persuasive as an effective policy measure.

Implicit in America’s view of itself is the belief that the United States has the strongest military power, the richest economy, and the most desirable ideological system in the world. The collapse of communism has provided stunning corroboration for the first and third
of these premises. But is America in fact the world’s richest country? How can one account for the fact that at the same time communism was in retreat in Eastern Europe, vast sums of “Japan money” were buying up America and that one U.S. institution after another passed into Japanese hands, including—to the great indignation of the American people—such American icons as Rockefeller Center and Columbia Pictures, which the October 9, 1989, issue of Newsweek called “a piece of America’s soul”? Or to put the question another way, why does America, the most powerful country in the world, with the most abundant resources and the most stable and desirable political system, suffer from twin budget and current account deficits, and why has it become the world’s largest debtor nation?

Clearly, Japan must be “unfair.” That is the easiest line of reasoning for the American public to understand. And, in fact, when one starts to reexamine Japan from this premise, a number of illogical or unfair practices begin to emerge—protection, controls, bid rigging, corporate groupings, winning bids of a single yen, insider trading, and disregard for the consumer. Such practices fueled the criticisms of a new school of thinking about Japan—revisionism—which began to make its presence felt in the United States at the end of the 1980s.

The views of the revisionists can be summed up as follows: For a long time America has believed that Japan is a country which has the same values as itself. That, however, is only an illusion. As the Japanese themselves assert, Japan really is unique. The American concept of free trade does not hold true for the Japanese, and the various attempts to get Japan to
change have been fundamentally mistaken. From now on America should shift policies and adopt radically different measures to deal with this very different country. The effect of these arguments has been to elevate Japan to the status of an ideological opponent of the United States.

The Hawks, the Apologists, and the Japanologists. The Newsweek article described the two schools of thought on “the Japan problem” as a debate between the hawks and “the Chrysanthemum Club” and identified the leading members on both sides. The trade hawks, pejoratively referred to as “Japan bashers,” advocate that the United States adopt a tougher stand on trade and economic issues. In addition to Fallows, they include Richard Gephardt, the Democratic whip in the House of Representatives; John Danforth, the Republican senator from Missouri; Clyde Prestowitz, a former trade negotiator with the Commerce Department and the author of the book Trading Places; Karel van Wolferen, a Dutch journalist who wrote The Enigma of Japanese Power; and Chalmers Johnson, a professor at the University of California at San Diego who wrote MITI and the Japanese Miracle.

What most of these men have in common is that they are hard-liners who know Japan well. Their criticisms are based on a thorough knowledge of Japanese history and Japanese institutions. Clyde Prestowitz, for example, as an official in the Department of Commerce, had direct experience in dealing with the Japanese Ministry of International Trade and Industry (MITI). Karel van Wolferen and James Fallows have both lived in Japan. Their experience lends substance to their
criticisms and gives their observations greater validity. Naturally, this has had a strong impact on the American people.

The traditionalists who espouse orthodox views on the importance of the U.S.—Japan strategic alliance and the value of a free-trade economy have been called "the Chrysanthemum Club" or labeled "apologists" for Japan because they defend the Japanese position. Former ambassador to Japan Mike Mansfield is a prime example. During his tenure as ambassador, Mansfield insisted that the United States and Japan have "the most important bilateral relationship in the world, bar none" and maintained that the chief problem between the two countries was the U.S. budget deficit. James Baker, Richard Cheney, Richard Darman, and Michael Boskin were members of the Bush administration who believe that little is to be gained by being overly critical of Japan. Others named in the Newsweek article as members of the Chrysanthemum Club include Ezra Vogel, author of Japan as Number One; Professor James Abegglen of Sophia University in Tokyo; lobbyist Stanton Anderson; and Elliot Richardson, attorney general during the Nixon administration.

These two groups, for good or ill, have the greatest influence on policy- and opinion-making in the United States today. But in addition to the hawks and the Chrysanthemum Club, there is in fact a third group in America who are fluent in Japanese, have a profound knowledge of Japanese history and culture, and are regarded as having a sympathetic understanding of Japan. Perhaps the best known of these scholars and researchers would be the late Edwin Reischauer, the former ambassador to Japan, who wrote:
Certainly much of what the revisionists have pointed out is true. But they take a short-term view of Japan. When they claim that Japan does not change, they are speaking about the period after the Second World War. If one looks at Tokugawa Japan [1600–1868] or Meiji Japan [1868–1912] or Showa Japan [1926–1989], one can see that Japan has changed radically. I believe Japan is a country of enormous flexibility and resilience; as the times change, it will inevitably change as well and will be able to avoid even seemingly unavoidable frictions. In this respect the assertions of the revisionists are mistaken.

Although these comments, which I have translated from an article in Japanese by Professor Reischauer in the February 28, 1989, Asahi Shimbun, are certainly pro-Japanese, not all Japanologists should be thought of as members of the Chrysanthemum Club. Japanologists are first and foremost scholars and not mainstream American policymakers. Until recently they have tended to be individuals with a personal interest in Japan, those who were born there perhaps or who lived there in their childhood. Because they do not represent ordinary American interests, they may lecture about Japan or show their understanding of matters Japanese or participate in seminars on Japanese subjects, but with a few notable exceptions—Reischauer himself being one of them—they are in no position to exert any influence on actual government policy-making.

Herein lies the major difference between Japanologists and the members of the Chrysanthemum Club. Whether or not the latter can speak Japanese or have any deep understanding of Japan, they are mainstream politicians or political advisers who can affect the U.S. government's Japan policy. People like Michael Boskin
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and Richard Darman know almost nothing about Japan. But others like Mike Mansfield have a thorough knowledge of the country. What these people have in common is that they are part of the American political mainstream and understand its logic. The pro-Japan argument boils down to this: U.S.–Japan relations are based on mutual advantage, so disputes must be resolved in an objective and realistic fashion. Nothing productive can come of Japan-bashing. Bashing on the one side merely invites bashing on the other, and each country ends up hurting its own cause.

Under the Bush administration, the Chrysanthemum Club was in the ascendancy; the Clinton administration is more hawkish toward Japan. The current head of the Council of Economic Advisers, Laura Tyson, is widely considered to be a hawk. As mentioned earlier, many of the hawks are experts on Japan. Most of them have had “Japanese experience” and are the very people one might expect to be sympathetic to Japan because they understand the potential harm that will result if U.S.–Japan relations deteriorate any further. That makes their arguments all the more convincing to the American public, who feel that “if people who have lived in Japan say so, then Japan really must be different.” That they have become outspokenly critical is a tragedy for Japan.

The Conflict between Feelings and Logic. Members of the Chrysanthemum Club come to Japan’s defense out of a sense of rational self-interest. The hawks’ view of Japan, on the other hand, is both more emotional and more deeply grounded in experience because it is derived from what they have actually encountered first-
hand. This basis in fact, not theory, has helped to strengthen the persuasiveness of their arguments. Japan, too, has a number of America specialists who regularly air their views about the United States, but few of these self-styled experts have actually had the experience of living in the United States with their families for several years. The arguments of Japanese who have no firsthand knowledge of America inevitably seem abstract and superficial and carry as little conviction as the claims that some Japanese commentators with no particular expertise in engineering or technology have made about Japan’s status as a technological superpower. As Professor Fumio Shimura of North Carolina State University noted in the February 1992 issue of This Is Yomiuri, Japanese mass-produced computer chips may be the best in the world, but like nails in the construction of a building, they are not of much use by themselves.

In America today the quarrel between the hawks and the Chrysanthemum Club has evolved into a head-on collision between two groups in the political mainstream responsible for formulating U.S. policy. U.S.–Japan relations have gone far beyond the stage when those who knew something about Japan clashed with those who did not. This fact has extremely serious implications for understanding the true nature of Japan–U.S. frictions. As Japan has emerged as a major world economic power, Japan–U.S. relations have come to be included among America’s main policy concerns. For that very reason, a single misstep in policy on the part of either Japan or the United States could have dire consequences.

From a different perspective, the quarrel between
the hawks and the Chrysanthemum Club might be regarded as a conflict between emotional and logical arguments. Against the more emotional hawks, the Chrysanthemum Club resorts to logic to make its point. Which, then, will prevail—feelings or logic? Reason teaches that logic should win, but emotional arguments have often carried the day, and sometimes in the long run the choices based on them have worked out for the best. What, for example, was the rationale behind the Japanese automobile industry thirty or forty years ago when it was still in its infancy? For a small country, with roads little better than farm tracks, an attempt to promote an auto industry flew in the face of reason. That was the logic of the economists of the time, not to mention the Ministry of International Trade and Industry (MITI). But the people making cars felt differently. No matter how farfetched their plans seemed to others, they had faith that they could make the Japanese automotive industry the best in the world. Today, it is clear their faith was justified.

Economic logic, in other words, does not always produce the right results. In relations between countries, especially, emotional arguments often get the better of reason. In the conflict between the hawks and the Chrysanthemum Club, it cannot be assumed that rational arguments will win. Ninety-nine percent of the American people have never been to Japan and know nothing about the realities of life there. Logic is based upon knowledge, and emotional arguments thrive on ignorance. As the hawks’ propaganda penetrates grassroots America and emotional arguments dictate public opinion, the logic of a free-market economy is being overwhelmed by the Japan-is-different argument.
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Is Japan Really Different?

Containing Japan. Just as many Americans overreacted to what they perceived as America-bashing in the pirated English version of The Japan That Can Say “No” by Akio Morita and Shintaro Ishihara (see chapter 2), many Japanese have overreacted to James Fallows’s article “Containing Japan,” which they regard as Japan-bashing. This trans-Pacific exchange of bad feelings seems to have been provoked by the titles of these two works rather than by their actual contents.

In English the nuances of the word contain are not nearly as strong as they are for the Japanese word fūjikome, which was used in the translation of Fallows’s article. Fūjikome has strong overtones—it would be used, for example, in describing the sealing off of a nuclear reactor where an accident has occurred. As a translation for the English word contain, it is a bit too strong. The meaning of contain is essentially defensive; the overtones of the word fūjikome are a hundred-percent offensive and imply a preemptive strike.

In one sense, America has already tried “containing Japan.” To counter the flood of Japanese imports in areas like textiles, steel, consumer electronics, and automobiles, it launched a containment policy that forced Japan to accept export controls and voluntary restraints. To counter a soaring trade deficit, it embarked on a containment policy that put pressure on Japan to open its markets and increase domestic demand. The 1985 Plaza Accord was yet another attempt at a containment policy. To redress the trade imbalance, the finance ministers of the five major industrialized coun-
tries (the United States, Japan, West Germany, Great Britain, and France) agreed to a currency realignment at a meeting held in September 1985 at the Plaza Hotel in New York. Despite a drastic downward revaluation, from 240 yen to 120 yen to the dollar between 1985 and 1988, the U.S. balance of trade with Japan improved a mere 15 percent, and Japan continues to maintain a healthy surplus.

Theoretically, if the value of the dollar decreases by half, prices of American goods destined for Japanese markets should also be halved, generating brisk sales that should lead to an increase in U.S. exports and a reduction in the trade deficit. Prices for Japanese goods, on the other hand, should double, causing a slowdown in sales. The resulting decline in Japanese exports should bring about a decline in Japan’s trade surplus. That, at least, is what the laws of economics dictate. And, in fact, this occurred in Europe, where a lower dollar led to an American-European trade balance. It did not happen in Japan, however. Foreign goods in Japan remained as expensive as ever, and Japanese goods sold abroad did not double in price. The annual trade deficit with Japan remained—and still remains—around $50 billion. Why? The answer must be that Japan is “different,” that structural differences are at work there that do not respond to economic laws.

This is the background against which the revisionists emerged with their call for a reexamination of U.S. premises about Japan. This is what set the stage in 1989 for the most recent round of U.S.—Japan trade negotiations, the Structural Impediments Initiative talks, which were haunted by the threat that Congress
would invoke the Super 301 provision of the 1988 Trade Act and impose economic sanctions on Japan and other countries that engage in “unfair” trading practices. In this dangerous atmosphere the use of the word ふじきome in the title of the translation of “Containing Japan” was irresponsible. It evoked associations with the ABCD encirclement and the international isolation of Japan on the eve of World War II; it also angered and alarmed the Japanese people and stirred up nationalistic sentiments. No one could have been more surprised by this reaction than the article’s author, James Fallows himself.

The Mass Media in the United States and Japan. In November 1989 I had a discussion with James Fallows at the request of a Japanese magazine and television station. Before our talk began, he was very wary of me. His extreme mistrust of the Japanese media seemed quite understandable. The Japanese translation of his article had caused a furor far beyond his wildest expectations, and the Japanese media en masse had made him out to be an enemy of Japan. As he put it, somehow or other, he had become public enemy number one. As an example of the misrepresentations the media had indulged in, Fallows told me the following story.

Fallows had been asked by a television station to discuss his views on the Yellow Peril theory. In the course of that interview, he made the statement that he did not endorse the view that racial prejudice lay at the heart of current American criticisms of Japan. Regrettably, racism did exist in America, but he personally was firmly opposed to those who resorted to this sort of argument, as were America’s leading policymakers. He
had accepted the television station's invitation, he told me, because he thought it provided a good opportunity to convey the convictions of Americans like himself who regard racial prejudice as something to be ashamed of, and he talked animatedly for several minutes on the subject. Sometime later he heard from the television station that his comments had been cut because they did not fit in with its plans. To learn what these plans had been, he later watched the program with considerable interest. To Fallows's dismay, he discovered the program was not about whether the Yellow Peril theory was valid. It took American racism for granted, and so quite naturally his comments did not fit in.

The program dramatically traced historical events such as the extermination of the aboriginal peoples of Central and South America by the Spanish and the mass slaughter of Native Americans in North America by later white settlers. Stressing the whites' oppression of nonwhites, and relying on the tricks and special effects of television, it conveyed the message that recent American criticisms of Japan are an extension of white America's historical racial prejudices. Where was the conscience of the Japanese mass media, Fallows asked. This program was inflammatory, an abuse of the power of television. Fallows was profoundly incensed.

I too am well aware of the propensity of the Japanese media to sensationalize, and for that reason I resist making comments about U.S.—Japan relations that might lend themselves to overdramatization. Extreme statements, even those made by people who know nothing of America, are prized by the Japanese media
because they are easy to report. But the American media are just as bad. When Sony bought Columbia Pictures, *Newsweek* described it as “a piece of America’s soul.” Columbia had been a nearly bankrupt company nobody seemed much interested in until it was sold to the Japanese. The media then reported its purchase as if Sony had stolen the crown jewels. The same was true with the sale of Rockefeller Center. The media carried on as if the traditional Christmas tree were going to be replaced with a bonsai. When Konishiki, a Hawaiian, won a sumo tournament in November 1989, how did the *New York Times* caption its account of the victory? “An American Is Enthroned and Japan Is Shaken.” What nonsense! Far from being shaken, many Japanese were thrilled at Konishiki’s success.

In both the United States and Japan such media distortions are everyday occurrences. Driven only by profit-making and rapidly becoming morally bankrupt, the media constantly sensationalize.

*After the Berlin Wall, the Japanese Wall.* James Fallows has argued that allowing Japan to expand indiscriminately and destructively is not in the best interest of Japan or the rest of the world. I agree with him. Whether these views are correct logically speaking, I cannot say, but I believe that now is not the time to think purely in terms of logic. Speaking from the logic of economics, certainly no one can claim that Japan is wrong. Working without a moment’s leisure, saving for the future, caring more about conservation than consumption, offering the world better products at cheaper prices, making money—these are all actions that live up to capitalist ideals.
Capitalism means competition; its dominant principle is that whoever wins, survives. That is the premise upon which neoclassical economic theory is based, and as a modern economist who belongs to this school, I find Japan's actions both logical and correct. But what happens if we advance that argument one step further? If a highly competitive Japan should continue to be as successful as it has been in offering its goods to the world, naturally its profits will increase. As a result, the yen will rise in value and the dollar and all the other currencies in the world will fall. If Japan one-sidedly grows so strong that it tramples on the livelihood of people in other countries, then no matter how many good products it makes, it will gradually become unable to sell them.

Economic textbooks teach that a system of checks and balances, sometimes referred to as the "invisible hand," will operate to check Japan's export strength; there is no need, therefore, for governments to set up safety nets such as tariffs and controls. Viewed from that vantage point, Japan's behavior is quite rational and it is Japan-bashing that is unfair. But is reality adhering to textbook theory? Are these checks and balances operating between America and Japan? Did sales of Japanese goods decline when the value of the yen went up? Was the Japanese surplus erased and a trade balance achieved? After the dollar became cheaper, was the United States able to rapidly expand its exports to Japan?

Unfortunately, events have not transpired the way the textbooks say they should. The system of checks and balances that operates between the United States and Europe does not work between the United States
and Japan. Why not? The answer seems to be, as Fal-
lows says, that the customs and institutions within Ja-
pan—as seen from the American side—are “dif
ferent.” Consequently, insofar as Western logic does not
work in Japan, America must come up with some sort
of national policy to take the place of the “invisible
hand” in the form either of protectionism or of man-
aged trade. This is what Fallows really means when he
speaks of “containing Japan.”

The most recent (1989–90) round of bilateral trade
negotiations, the U.S.—Japan Structural Impediments
Initiative, took place against this background. The SII
talks were based on the premise that an underlying
factor in the trade imbalance between the United States
and Japan was “structural differences”—fundamental
divergences in the two countries’ economic and social
structures. In an effort to ensure more transparent
trade practices and a more open marketplace, Ameri-
can negotiators came to the bargaining table armed
with a list of nontariff trade barriers that they claimed
prevented U.S. access to the Japanese market. Indeed,
many practices that the Japanese take for granted seem
strange when looked at from outside and certainly do
not conform with international rules. Contractors who
meet together to decide which of them will get a cer-
tain job or companies that submit a bid of one yen in
order to win a contract that will result in a long-term
relationship and a virtual future monopoly—sleazy
bidding practices such as these are carried out as a
matter of course not by gangster-controlled syndicates
but by top-ranking computer firms and the construc-
tion industry. Such practices would be inconceivable in
other countries. Bringing them out into the open is
highly embarrassing, but they must be exposed so that Japan can prepare for the future.

The Structural Impediments Initiative talks concluded with both sides promising major structural changes. Japanese concessions included promises to curb tax benefits for farmland owners in urban areas, to remove the right of small-store owners to veto the opening of large retail outlets in their neighborhoods, and to increase staff on the Japanese Fair Trade Commission. In return, the United States promised to cut the budget, increase federal support for research and development, strengthen export promotion, and require the adoption of the metric system for federal procurements beginning in 1993. Although the Japanese felt that U.S. interference in Japan's domestic problems was unwarranted, they have more effectively addressed the compromises reached during the talks, whereas until recently under the Clinton administration the United States made no effort at all to comply with Japan's demands to increase savings and decrease the government's budget deficit. Although I do not believe the Structural Impediments Initiative talks produced any significant results, they have somewhat alleviated the tension between the two countries. If they have had the secondary effect of helping to bring Japanese rules in line with international rules, then they were valuable.

By adopting exactly the same policy toward Japan that it has toward its European trading partners, America has incurred a huge trade deficit and run up against an invisible wall that surrounds the Japanese archipelago. Under the circumstances it is not at all strange that Americans have concluded that there is
something different about Japan and have decided to rethink their views. Reacting against this new U.S. position, some in Japan have argued that it is America that is different. Certainly, America would appear different from the Japanese perspective; this sort of nationalistic sentiment is quite understandable. But that does not mean Japan can force its rules on the rest of the world. And to believe that America ought to be the one to change is not only impractical but irresponsible. It is unreasonable to expect Americans to understand—let alone put into practice—such Japanese concepts as group solidarity or corporate groupings or to expect them to behave like the employees of Mitsubishi who will drink only Kirin beer. For better or for worse, the postwar world plays by America's rules. That comes with the territory of world leadership, a subject I will discuss in more detail later.

America can manage quite well economically without Japan, but Japan cannot get along without the United States. Some Japanese commentators seem to be unaware that Japan does not exist independently of the rest of the world. They have projected a rosy-colored future for Japan and predict that the twenty-first century will be "the Japanese century," but even if such prospects exist at the microeconomic level, I have my doubts about these optimistic scenarios. Since 1989, Japan's attention has turned in on itself. That year many of Japan's political elite were implicated in the Recruit shares-for-favors scandal and Prime Minister Noboru Takeshita was forced to resign. Voter wrath over the imposition of a 3 percent consumption tax led to the poor showing of the ruling Liberal Democratic party in the Upper House election that July and brought
about the ouster of Takeshita's successor, Sosuke Uno, who had been discredited by a sex scandal. While Japan was absorbed by the spectacle of three prime ministers succeeding each other within the space of a single year, the rest of the world greatly changed. The democratic movements in Eastern Europe, the collapse of the Soviet Union, and more recently the U.S.-led victory in the Gulf War after Iraq's invasion of Kuwait have all been taken as proof of the correctness of U.S. foreign policy. As Eastern Europe and the former Soviet Union move toward a free-market economy, the world seems to be revolving around the American axis. Under the circumstances, it should come as no surprise that Americans have shifted their focus to the economic arena and that after the Berlin Wall the next barrier they hope will fall will be the one surrounding Japan.

*Does Money Give Anyone the Right to Buy Someone Else's Soul?* Economic activities and trends inevitably have their own rules. Economics is the science of finding those rules. The problem is that sometimes an economy operates according to the rules and sometimes it does not. When the latter happens, measures must be taken to counteract events or trends that run counter to expectations.

In the late 1980s Japan was busily buying up American assets with the excess cash from its huge trade surplus. Logically speaking, this activity was a natural consequence wholly in line with the laws of economics. The question is: Should something be allowed to happen just because it accords with economic laws? Shouldn't some consideration be given to whether the
activity is ultimately in the best interests of the parties involved? Viewed in that light, the situation takes on a completely different complexion. This is what makes the laws of economics so much more unpredictable than the laws of physics or chemistry. The field of economics has recently come to make greater use of mathematical models and is becoming a more scientific discipline. In North America and Europe it is now regarded as having more in common with the sciences than with the humanities. Because economics deals with people and its testing ground is society rather than a laboratory, however, we should not insist that it is an exact science. Economic problems have a nasty tendency to develop into political and social problems.

When rain falls on a mountain, for example, and forms into a river, it waters the fields at the foot of the mountain and enriches the lives of the people who live there. This is referred to as the workings of nature. But if several inches of rain were to fall in the course of an hour, the river would overflow and the village at the foot of the mountain would be washed away. That, too, is a law of nature, but the villagers do not just sit back and allow this to happen. They build a dam upstream to control a possible flood. And this human action to reverse the laws of nature is praised as a good policy.

Let's transpose this analogy to the economy. Since the end of the 1980s, $50 or $60 billion worth of Japanese investment a year, the equivalent of Japan's annual trade surplus, has flooded through the world, much of it buying up American land, buildings, companies, and even people (lobbyists). Should Americans stand idly by simply because an economic law is operating? Isn't it necessary to build some sort of dam?
When a policy runs counter to economic laws, however, far from being praised—as in the case of flood control—it is criticized as protectionism, regulation, or interference. Why? One reason is that natural phenomena can be readily observed, but economic phenomena are not easy to visualize. We can see the flow of water, but we cannot actually see the flow of investment around the globe. This is puzzling for economists and even more puzzling for ordinary people. But when the flow of investment does become visible, shouldn’t policymakers take bold steps, such as containment, even though that means temporarily acting contrary to economic laws?

In the late 1980s Japan’s “buying America” became clearly visible to the naked eye. There seemed no end to the land or the companies the Japanese acquired. Japan has argued that it is not the only country to have bought American property, that British holdings are even larger than Japan’s. But this argument inadvertently lets the cat out of the bag. The truth is that Japanese investment is rapidly catching up with the British, Dutch, and German investments that have been made over a long period of years. It has been a veritable torrent rather than a gently falling rain, and no one can claim that a torrential rainfall in the space of a few hours has the same effect as an equivalent amount of rain falling over a ten-day period.

This situation is most dramatically manifested in the growth of Japanese direct investment abroad. Valued at a mere $10.6 billion during the period 1975–79, direct investment for 1985–89 had risen to $118.8 billion, a more than tenfold increase in just ten years’ time. In the United States alone, Japanese direct investment
went from $67.3 billion in 1989 to $83.5 billion in 1990.* Thus, more than half of these acquisitions were in the United States and quite visibly concentrated in Hawaii, California, and New York. This was not just a torrent but more like a flash flood.

The analogy can be taken only so far, however. In the natural world, no one benefits from a flood, but in the economic world, this flow of investment clearly was to the benefit of Japan, and inevitably it inflamed American chauvinism. Excessive growth, excessive gains in any area, are bound to produce a hostile reaction. According to an opinion poll of American chief executive officers conducted jointly by the Nihon Keizai Shimbun and the U.S. polling organization Booz Allen for the Wall Street Journal, only 54.8 percent welcomed Japanese investment in the United States. To give some idea of how low that figure is, the highest approval rate for investment by another country was 93.8 percent for Canada, with Britain, the Netherlands, and Germany falling between 76.8 and 87.7 percent. The number of respondents who said Japanese investment was not welcome was 22.6 percent.

Another reason why this concentrated investment in the United States was not welcome is that, despite the strong yen and the weak dollar, America’s trade deficit with Japan has not been reduced at all. The proposal by Fallows and other revisionists to adopt managed trade as a containment policy is a reflection of American irritation with this situation. The fact that the

*The slowdown in the Japanese economy has temporarily halted the growth of Japanese investment abroad, but as Japan’s trade surplus continues to grow, the excess will have to be invested somewhere, this time most likely in Asia.
United States, the standard bearer for free trade since World War II, has been tempted to adopt a managed trade policy gives some indication of the extent of American frustration. The very term managed trade creates a negative impression. It describes a human activity that interferes with the free working of the “invisible hand”—the golden rule of capitalism. The unspoken assumption behind the U.S.–Japan Structural Impediments Initiative talks was that America would desperately like to avoid resorting to such a course.

This is what happens when economic activity does not operate according to logic. Certainly, as Akio Morita, the chairman of Sony, has said, it is not the concentrated outpouring of Japanese exports, but the concentrated American absorption of these products, that is the problem. There is a certain logic, too, in his statement that if Columbia Pictures is a piece of America’s soul, then the problem lies not with those who bought it, but with those who were willing to sell it. In economics, however, some ideas cannot be put across simply by brandishing the correct argument, particularly when national pride is linked to economic interests.

America’s Sun Has Not Yet Set

The Supremacy of the Dollar. Structural Impediments Initiative talks or “containing Japan”—call it what you will—both are indicative of a desperate fight for the preeminence of the U.S. economy. Why has America, a country whose overwhelming postwar power and af-
fluence led it to assume the roles of the world’s banker and policeman, seen its formidable lead in world economic affairs slowly slip away? The answer is inherent in the very nature of the postwar monetary system, the International Monetary Fund (IMF), which was advantageous to the United States in the short run, but not in the long run.

Because the American dollar is the key global currency, other countries have to export to earn foreign currency (dollars) and then use those dollars to buy (import) the things they need. After the war, for example, Japan wanted to import because it had no natural resources, but it needed dollars to do so. It launched an export drive to earn those dollars and, finally, at the end of the 1970s, around the time of the second oil crisis, it achieved a balance between imports and exports. Or, to put it another way, enough profits on sales had built up in the country’s coffers so that it could buy whatever it wanted.

On the other hand, because the dollar has been the key currency used by the free world throughout the postwar period and is accepted both at home and abroad, America alone can import whatever it wants without having to export first. With some exaggeration one might even say that as long as the United States prints dollars, it has the right to buy anything in the world. Even without the money readily at hand it can buy on credit. That is one of the advantages of controlling the key currency.

This situation will continue as long as America maintains its grip on world leadership. But when, as now, American competitiveness is declining, controlling the key currency becomes a disadvantage. What was bene-
ficial in the short run becomes a handicap over the long run. The flip side to the short-term advantage of being able to buy anything you want without making any export effort is that two big bills eventually come due—a long-term deterioration of international competitiveness and an ingrained habit of import consumption.

Thus, lurking in the background of the debate about containing Japan are these systemic factors of short-term advantages and long-term disadvantages. This raises the question of whether it might be a good idea to change the system, but in point of fact there is no currency at present that is capable of replacing the dollar as the key currency. And even if there were, the United States would not accept such a course of action. Suppose, for example, that the yen grew even stronger and Japan invested huge sums of money in the IMF, thus eclipsing the U.S. contribution and winning a stronger say for itself. America would be upset. Even if the United States has declined in real strength, it is not likely to give up its prerogatives of world leadership. That is not the way superpowers behave.

If some worldwide upheaval or major cataclysm occurred, the situation would be different. The dollar replaced the pound as the key currency when world leadership shifted from Britain to the United States after two world wars. For leadership to be transferred during peacetime as the result of deliberations is inconceivable.

*The Fragility of Economic Power*. In July 1944, at the height of World War II, the foundations for today’s International Monetary Fund system were laid at an in-
ternational conference held in the town of Bretton Woods, New Hampshire. This conference to define the workings of the world economy in the postwar period was attended by representatives of the Allied countries, including John Maynard Keynes of Great Britain and Harry D. White of the United States. The conference would not only establish a monetary system, it would also determine whether the pound or the dollar would have primacy in the postwar world. By this time the Allied countries could read the signs of German and Japanese defeat and had begun to take steps accordingly.

Keynes’s concept was that the IMF should act as a clearinghouse, coordinating and maintaining a balance so that no particular country would become too weak or too strong. This, of course, was a desperate attempt to preserve British authority and save the pound. White’s plan was to place America at the center and subordinate all the other countries around it like satellites. It tied the dollar to the gold standard and created a fixed exchange rate for all other currencies. Despite Keynes’s strong opposition to White’s plan, there was no contest between the ascending dollar and the setting sun of the British pound. Keynes’s arguments fell on deaf ears. The key currency shifted from the pound to the dollar, and world leadership shifted from Great Britain to the United States.

The present IMF system thus came about in part through American steamrolling, and America is unlikely to give up control of the IMF unless it is forced to do so. The IMF was created at a time when America accounted for 52 percent of the world’s Gross National Product (GNP) and two-thirds of the world’s gold sup-
ply. That America with a mere 3 percent of the world’s population had so much wealth is amazing. That period was indeed an unprecedented golden age for the United States, which was able to do whatever it pleased.

Despite Keynes’s desperate efforts at Bretton Woods, the outcome was inevitable. Britain no longer had the political, economic, or military clout to prevent the dollar from replacing the pound as the key currency. Though it has declined since those heady days, the United States remains a great power. Replacing America today with second-place Japan or Germany would leave much to be desired. But even if these countries were absolute equals with the United States, the transfer of leadership as the result of discussion is inconceivable. History teaches that there has to be some dramatic upheaval for world leadership to shift.

We therefore cannot expect any change in the IMF system until America becomes much weaker and the number-two powers much stronger—and much stronger not only in terms of their economic capabilities. In order to attain superpower status a country also needs physical, that is, military, strength. Economic power is too fragile to respond in emergency situations. In the 1980s Japan went on a shopping spree, buying up America and investing elsewhere overseas. If the laws changed or a war broke out in any of those foreign countries, however, Japan’s foreign investments would be frozen or confiscated and that would be the end of that.

At present Japan does not even have the power to protect Japanese corporations that have set up businesses overseas. Take the case of the Iran Japan Petro-
chemical Company, a joint venture between Iran and members of the Mitsui group. Its plans to build a petro-chemical company in southern Iran were interrupted first by the Khomeini revolution and then by the Iran-Iraq war, resulting in the loss of millions of dollars. If Japan had had military capabilities, the results might have been different. Japanese oil tankers sailing into the Persian Gulf would not have had to seek American protection during the Iran-Iraq war. At the very least, there would have been no outcry in the United States about Japan’s getting a free ride militarily. More recently during the Gulf War, I repeatedly heard Americans ask why the lives of American young people should be sacrificed to give Japan access to the oil it needs so that it can go on making money. Despite having contributed $13 billion to the war effort, Japan had little say, diplomatically speaking, in the postwar settlement. Most Japanese sense that Japanese diplomacy carries little weight. Does any country look to the prime minister of Japan for leadership? Though it may pride itself on being an economic superpower, Japan is still frustrated by its relative powerlessness on the world scene.

To turn the argument around, it could be said that Japan, which has so little political or military strength, has come to have too much economic power. Having written this, I should hasten to say that I am not a Japanese nationalist or a hawk who wants to see Japan rearm. As a realist I am merely pointing out the obvious. Shintaro Ishihara’s statement that Japan might call on Russia to defend it if America tried to contain Japan is nonsense. In such an event, Russian demands are unlikely to stop at microchips. To put it bluntly, as
far as most Japanese are concerned, Russia is not the country that they are most likely to trust. The realistic view is that it would be far better for Japan to listen to America's complaints than to join hands with the country that stole Japan's Northern Territories at the end of World War II.

*Excessive Exports versus Excessive Imports.* In order for the dollar to function as the key currency, America must reconsider its special right to cheap imports and exercise restraint. If it is going to be the world's leader, it must act like a leader and show more self-control. This means becoming more internationally competitive and achieving a trade balance through an export effort or through a further devaluation of the dollar. Competitiveness can be achieved by letting the dollar fall even further, but there is an inherent contradiction in a constantly declining dollar. A key currency that falls unchecked makes no sense as a key currency. Thus, as long as the dollar is the key currency, it must not be allowed to fall indefinitely.

After the Plaza Accord, the dollar plummeted and by 1988 it had reached an exchange rate of 120 yen. At the time some predicted that the dollar might drop even further to the 100-yen or 80-yen level. (At the time this book went to press, the exchange rate was fluctuating between 125 and 104 yen to the dollar.) Although logically speaking it is not strange for the value of the dollar to go down, as a key currency it should not do so. It cannot depreciate so much that it loses its meaning as the key currency. So, in fact, America had no alternative but to become more competitive and increase exports. Since it is impossible to regain over-
night something that has been lost over a period of years, the real agenda behind the SII trade talks was to get Japan to import more American goods and to get the United States to import less from Japan.

This put Japan in a peculiar position. Because exports had exceeded imports for some time, Japan had excess reserves that enabled it to import whatever it wanted. It was no longer necessary, as it once had been, to export in order to import. Thus, just as America continues to import even though it can no longer afford to do so, Japan continued to export even though it no longer needed to do so.* This exporting for the sake of exporting is illogical, economically speaking. The more Japan exports, the stronger the yen grows and the more unprofitable exporting becomes. It would make far better sense to spend the money at home. But no effort whatsoever was made to apply the brakes to Japan's export drive. The more Japan exported, the more money came in so that it became even harder to say "stop." What corporation would be willing to cut back exports and reduce tangible profits for the intangible good of the state? The worst aspect of all this is that Japanese society looks up to businessmen as its heroes, and everyone—both inside and outside government—listens to their views. The Recruit scandal and, more recently, the revelation of payments made to leading Diet members by Sagawa Kyubin, a parcel-delivery company, have given a glimpse of how pervasive the practice of influence buying is in Japan, and how deeply politicians are in the pay of business.

*Japan's economic growth has reduced the already low level of Japanese imports still further. As imports decline and exports increase (or even remain the same), the trade surplus continues to grow.
America faces a similar dilemma. The fact that the dollar, as the key currency, cannot fall below a certain point, makes it even more difficult to say "stop importing." Paradoxically, what has happened in both Japan and the United States as far as business is concerned is entirely rational economic behavior, and we can only assume that the present situation will continue as long as the IMF system remains unchanged.

Made in Japan—Breaking Down the Exchange Myth. As I mentioned earlier, when the value of the dollar declined by half and the yen doubled, Japanese corporations ended up making exactly the same profits as before. That was odd enough, but the 1985 currency realignment caused another strange phenomenon to occur. American exports to Japan ought, in theory, to have sold for half their former price (provided that demand elasticities were close to unity). This did not happen. At the very least, the curious sight of Japanese bringing back armloads of European goods that they had bought in the United States ought to have disappeared, but the crowds of Japanese shoppers in airport duty-free shops did not diminish at all. In other words, the benefits from the yen's sharp rise against the dollar were not adequately passed on to Japanese consumers. Nor did prices for Japanese goods rise sharply in the United States. Since the value of the dollar was half what it used to be, the prices of Japanese goods ought to have been double what they once were, but that was not the case.

In fact, between 1985 and 1989 the prices of Japanese exports to the United States rose only about 8 to 10 percent despite the fact that the yen had doubled in
value. How was that possible? There are two lines of thought on this matter. The first view is that Japanese businesses did not take much of a profit on their exports, that they made their money by setting a high price domestically and holding down export prices to a level where they at least did not sustain a loss. The other view is that, to ride out the strong yen, Japan focused its efforts on restructuring and technological innovation. As a result, costs came down so substantially that there was no need to raise prices.

Although the cheap dollar seemed to offer the United States the perfect opportunity to expand its exports to Japan, it was unable to do so. Why? There are two lines of thought on this question as well. One is that America’s export effort was inadequate; the other is that the Japanese market has so many barriers that no matter how hard America tries it cannot get in.

All of these views are probably true. The price of Japanese goods certainly did not double. That is because Japanese business took the loss, and also because they steadily reduced costs and thereby increased their ability to resist the effects of a strong yen. The fact that American exports to Japan did not noticeably increase is due both to the failings of America’s own export efforts and to Japan’s reluctance to open its market. These overlapping factors formed the background to the Japan–U.S. Structural Impediments Initiative talks.

Yet, while everyone complained that the price of American exports to Japan did not go down in proportion to the yen-dollar exchange rate, even though this proved disadvantageous to the Japanese consumer, everyone blithely accepted the fact that prices for Jap-
The Rise of Revisionism

anese exports to the United States did not rise much. Properly speaking, the amount of increase or decrease should be symmetrical, and it seems unfair that there was so much hostility to the one and no acknowledgment of the other. After all, if the price of Japanese goods ought to have risen by 100 percent, but Japanese companies kept the increase down to only 8 to 10 percent, they ought to be thanked for their contribution to holding down inflation in the United States. But instead of being grateful, Americans blamed Japan for the fact that U.S. products did not sell for half price in Japan. This is what economics calls asymmetry.

Physical phenomena usually occur symmetrically. If 70 degrees Fahrenheit is the ideal temperature for human beings, then anything higher than 70 degrees is considered hot, anything lower is cold, and discomfort is felt proportionally at the higher or lower temperatures. Although the same ought to hold true for economic phenomena, one extreme was welcomed, the other was decried. That is what makes economics so difficult. It is human nature, of course, to keep silent about something advantageous to one’s own pocketbook. The Japanese, however, should have drawn attention to this situation and stated their case firmly, but they remained strangely inarticulate. If Japanese officials and the mass media had made Japan’s position better known to the American public, the attitude of ordinary Americans might be considerably different. It would certainly be more beneficial to both countries if the Japanese media concentrated their talents and efforts on giving a clear account of Japan’s position rather than producing sensationalist programs like the one mentioned earlier on American racism.
The appreciation of the yen and the devaluation of the dollar after the 1985 Plaza Accord did not have the expected results. The participants now concede that all their tinkering with the exchange rates had almost no effect on imports and exports. Take, for example, the videocassette recorder (VCR). In the beginning neither the Japanese nor the Americans anticipated the size of the market for VCRs. The machines did not sell well at all in the 1970s, but in the early eighties they suddenly became popular, and by 1985 nearly a third of all American households had VCRs, almost all of which were made in Japan. After the Plaza Accord the yen suddenly shot up and the dollar dropped, until ultimately the yen was worth nearly twice what it had been. Logic dictates that the price of Japanese VCRs should have doubled during that period and sales should have dried up. In fact, after 1985 sales of VCRs rose by leaps and bounds, first, because the price did not go up and, second, because American incomes increased greatly after 1985. As a result, Japanese exports of VCRs grew seventeenfold between 1985 and 1990, and by 1989, 75 percent of all American households had a VCR.

One other factor needs to be taken into consideration to account for the failure of the currency realignment to affect sales of VCRs: Japan’s virtual monopoly of the VCR market. A monopoly renders the exchange rate mechanism ineffective because the exchange rate can adjust for surpluses and deficits only when substitute products are available from other countries. At present, export figures for VCRs are declining, an indication that the market is mature and that most purchases now are to replace older models. But a situa-
tion quite similar to the one for VCRs in the 1980s is evolving in the market for facsimile machines. As in the case of VCRs, Japanese companies have a virtual monopoly on fax machines.

Although, all things being equal, the currency revaluations should theoretically have caused the Japanese share of the VCR market to fall from 33 percent to 15 or 16 percent, just the opposite occurred. As American prosperity led to increased absorbability, economies of scale were brought into play and unit costs came down. Meanwhile, to counter the strong yen, Japanese businesses restructured and put greater emphasis on technological innovation and automation that led to wholesale cost reductions. In short, economies of scale and technological innovation made possible low-cost mass production so that Japanese VCR manufacturers were able to achieve a seventeenfold increase in sales despite the adverse climate resulting from the strong yen.

As a result, the Japanese consumer electronics industry achieved an unrivaled position, nearly a monopoly, flooding world markets with goods labeled “made in Japan.” Japanese goods earned such enormous profits that the question of who was more at fault for this flood tide—those who import or those who export—ceased to have any relevance. Nothing seemed to be able to check the Japanese export juggernaut. Under the circumstances, what other course was open for America except, as Fallows suggests, to consider the new ploy of containment?