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The Triumph of Free Enterprise

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Tokyo, Japan

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The Triumph of Free Enterprise

It is a great pleasure for me to visit Japan again. Four years have passed since I was here last, and while I have heard much of the progress and prosperity you have experienced, it is good to see the evidence with one's own eyes. My personal knowledge of Japan goes back some ten years. During my last visit, in early 1966, the mood was not one of universal optimism because you were then experiencing a readjustment in the rate of production and profits. There are always those who find any economic pause a justification for pessimism about the future. I have not been one of those. I have long been impressed by the great resiliency of the Japanese economy. I believe that you have discovered a formula for economic progress that will continue to bring excellent results in the future as it has in the past. That is not to say that you will not encounter problems. You will. But your resiliency lies in the skill you have developed in devising solutions to problems and your ability to work together as a nation to achieve your goals.

This is a particularly interesting time for an economist to visit Japan. As I am sure all of you recall, fiscal year 1970 was designated as a target year in the economic plan unveiled by Prime Minister Ikeda in 1961. In what many people then thought was a fantastically ambitious design for the future, he calmly announced that Japan planned to double her gross national product between the years 1960 and 1970.

It is therefore fitting, as we are gathered here today, to take note of how the actual achievement of Japan compares with Mr. Ikeda's bold projection of a decade ago. While his plan called for a national output that in this fiscal year would be twice that of 1960, it now appears that your national product will in fact be at least 180 per cent above 1960.

The Ikeda plan projected exports reaching \$9.3 billion this year, while imports would rise to \$9.9 billion. It is now believed that exports will come to nearly \$20 billion and imports to nearly \$19 billion.

The Ikeda plan foresaw Japanese steel consumption rising to 45 million tons this year. It will actually be around 80 million tons.

According to the Ikeda plan, a big expansion was to occur in automobile production. But while it was then thought that the output of passenger car, trucks, and buses would amount to about 2.2 million units, it now appears that well over 4 million vehicles will be produced this year.

I might go on with such comparisons, but it is not necessary to do so. Virtually all indicators tell the same story. Far from being overly optimistic, as many people then thought, Mr. Okita and his colleagues -- who drew up the ten-year plan at Prime Minister Ikeda's request -- were very conservative in their projections. However, I am sure that no one will find fault with them for that. They would not have been believed had they forecast the achievements that have actually come to pass.

It is interesting to recall that a few years before Japan unveiled its income-doubling plan, the Soviet Union had already singled out the year 1970 as the date by which its economy would surpass the United States in production per capita and in the standard of living. It may be worth recalling Mr. Khrushchev's precise words:

"The superiority of the U.S.S.R. in the speed of growth of production will create a real basis for insuring that within a period of, say, five years following 1965, the level of U.S. production per capita should be equalled and overtaken. Thus by that time, perhaps even sooner, the U.S.S.R. will have captured first place in the world both in absolute volume of production and per capita production, which will insure the world's highest standard of living."

To achieve this goal, the U.S.S.R. would have been obliged to more than double its per capita GNP even if the United States made no further progress and simply maintained its per capita output at the 1960 level. However, unlike Japan, the U.S.S.R. fell far short of the goal that Khrushchev had set for 1970.

The economic contest between the U.S.S.R. and the United States enters the year 1970 with the United States holding a commanding lead. In 1969, total output per person in the United States was nearly \$4,600. This was two-and-a-half times the corresponding Soviet figure. Measured in real terms, the gap between the per capita GNP of the United States and the Soviet Union was more than 25 per cent higher in 1969 than in 1960. While the Soviet growth rate was slightly higher than the American rate, the difference was so slight that if the same growth rates were maintained over the next 50 years, the per capita GNP of the United States would still be about double that of the Soviet Union in the year 2020.

The wide difference between the living standards of the Soviet Union and the United States is vividly portrayed by comparisons of the number of working hours required to earn enough to buy various goods and services. It turns out, for example, that the average worker in Moscow in April 1969 had to work nearly seven times as long as his counterpart in New York to earn enough to buy an identical supply of food sufficient to feed a family of four for one week. The difference for many non-food items was even larger. The following are the multiples by which the cost of certain goods in Moscow exceeded the cost in New York, when cost is measured in terms of working time: for bath soap - 12.5 times, for nylon stockings - 14 times, for a man's shirt - 12 times, for a refrigerator - 12 times.

These comparisons are based on official prices in Moscow, not black market prices, which are, in many cases, far higher. For example, a Volga sedan costing the equivalent of \$7,700 reportedly sells for 2.5 times that amount on the Moscow black market.

Lessons from the Experience of Japan, the U.S.S.R., and the United States

Although the U.S.S.R. has failed even to come close to the economic performance of the United States, the per capita output of Japan has probably already overtaken that of the U.S.S.R. The official figure for per capita GNP of Japan in 1969 is very similar to our estimate for per capita GNP of the Soviet Union. If the figures are adjusted to allow for differences in the purchasing power of the currency that are not adequately reflected in the exchange rates, Japan appears to have surpassed the Soviet Union in 1969.

There are important lessons to be learned from Japan's extraordinary economic success and the concomitant shortcoming of the Soviet Union. The rather high rates of growth recorded for the Soviet Union in the early postwar years have not been sustained because of deficiencies inherent in the Soviet system. In a free economy, the relative strength of the demand for goods and services determines the allocation of productive resources. In the Soviet system, on the other hand, the path that production takes is basically shaped by the decisions of economic planners in Moscow.

Important economic decisions in the Soviet Union have therefore not been guided by sensitive signals such as are constantly being transmitted by costs and prices in a free market economy. To make matters worse, until recently, they were not even subject to correction by public criticism. Thus, economic success in the Soviet system came to be measured, traditionally, in terms of meeting targets set by the government, rather than in meeting the wants of consumers. This sometimes led to production of equipment that failed to work or to the output of some consumer goods far in excess of demand, while other goods continued to be in critically short supply. Such production might be expressed in a high rate of growth of GNP, but it did not spell progress in the elevation of living standards. In time, the waste involved in this process became a matter of grave concern to Soviet officials, particularly to economists and engineers.

As early as 1959, a Soviet econometrician, L. V. Kantorovich, pointed out that it might be advantageous if prices were allowed to

play a bigger role in guiding the allocation of resources in the Soviet economy. Another Soviet economist, Professor Y. Liberman, proposed that profitability rather than achievement of planned targets be used as the measure of success or failure of productive enterprise.

Although the Soviet Union has tried some experiments with reforms along these lines, there has been no correction of the fundamental flaws of the Communist economic system either in the Soviet Union or in the satellite countries. In Czechoslovakia the frustration with the results of centralized decision-making, which reached a climax during the industrial recession of the sixties, was an important factor in the reform movement in 1967-68, but the courageous effort to rationalize the economy by giving greater play to individual decision-making was brought to an abrupt end by Soviet troops and tanks in the summer of 1968.

This result was no great surprise to those who recognized that the reforms required to rationalize the Soviet-style economic system would weaken, if not totally destroy, the political control wielded by the Communist party. Faced with a choice between introducing economic rationality and the maintenance of their political power, the Russian rulers chose power. Unless and until they are willing to change their approach, it seems likely that their own economy and that of their satellites will continue to lag far behind the United States and other advanced countries of the free world.

Japan, on the other hand, has relied on the free market system, and that system has served Japan well. The Ikeda ten-year

income-doubling plan, whose goals have been so conspicuously exceeded, called for basic reliance on the private sector and on free market forces. The document which outlined the plan stated:

"In trying to achieve the economic policies contained in this plan, it is desirable for the Government to count on the originality and devices of private enterprises and individuals. It should refrain, as far as possible, from taking direct control measures for the purpose."

The authors of the plan recognized, of course, that the government had the responsibility of helping to create a climate conducive to economic growth. They pointed out, in particular, that it was the duty of the government to stabilize the value of the currency and to minimize business fluctuations through proper application of overall fiscal and monetary policies. But they left no doubt about their determination that the conduct of production and marketing was to be determined by private enterprises acting on their own initiative, not through state enterprises or state controls.

Japan's faith in the free market system has paid handsome dividends. Yet there were many economists and statesmen at the time when Khrushchev made his extravagant predictions who took him seriously. They argued that freedom was a luxury that poor nations could ill afford, and that these countries would therefore need to resort to authoritarian control of economic activity, if not also to outright governmental ownership of industrial enterprises, in order to augment their income and wealth. And, in fact, a number of countries in Asia did adopt in varying degrees the policy of turning over to the government

the decision-making functions that are performed by private citizens in countries that practice free enterprise.

Those who adopted this approach overlooked the fact that Adam Smith, the father of the idea that freedom was more conducive to economic growth than governmental control, had addressed himself to the problems of a nation that was then very poor and very underdeveloped -- that is, to the England of 1776. Two hundred years ago, English peasants, living at a subsistence level without any of the benefits of modern industry or science to ameliorate their condition, were probably worse off than their counterparts in most of free Asia today. And the French peasants lived in even greater poverty than the English.

Adam Smith examined the results of governmental intervention into economic activity in 18th century England and France with a perceptive eye. He came to the conclusion that the inefficient use of resources that he observed could be remedied and that wealth could be augmented if individuals had greater freedom to manage their economic affairs as they saw fit, instead of being tied down by minute and exacting regulations prescribed by bureaucrats. He saw that detailed economic regulations, often laid down by authorities far removed from the actual operations or needs of industry and commerce, produced undesirable results even though they may have been, or actually were, well-intentioned. In time, as the force of Smith's logic and evidence won adherents among men of authority, his revolutionary ideas proved instrumental in sweeping away much of the irrationality that had retarded economic progress. This paved the way for the extraordinary



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increase in living standards that has occurred in the West in the past two centuries.

It has been said that those who will not learn from the errors of the past are frequently doomed to repeat them. This has been the fate of much of Asia in the period following World War II. The Communists took control of all of mainland China, and for a time the world was told in glowing terms of the great economic transformation they were effecting there. Indeed, it was widely believed for a time that the great political contest in the world between the advocates of democracy and the advocates of dictatorship hinged on the ability of the democratic countries in Asia to perform as well as authoritarian China. The attention of all Asia was reported to be riveted on this contest to demonstrate which system was economically superior.

The Failure of Communist China's Great Leap Forward

The year 1958 was hailed as Communist China's "great leap forward." It was claimed that food output had been doubled in a single year, and that final victory had been achieved over hunger. However, these claims were soon exposed as wild exaggerations, as it became evident in 1959 and 1960 that serious food shortages had begun to reappear. Far from developing self-sufficiency in food and eliminating hunger, Communist China experienced critical food shortages in the early 1960's and was compelled to import huge quantities of grain from abroad to meet her requirements. The agricultural communes which had been so widely acclaimed as the realization of true communism were quietly abandoned or radically modified. Agriculture in China appears

to have remained virtually stagnant throughout the 1960's. Although production figures have been withheld, the available evidence suggests that output may not even have kept pace with the increase in population. In the early 1960's, the food shortages were attributed by government officials to bad weather, but this excuse was soon dropped as food imports continued to be required year after year.

The failures of agriculture had serious effects throughout the Communist Chinese economy. It soon became necessary to retrench drastically the plans for industry and transportation. Resources were simply not available to push forward the grandiose schemes that were supposed to show the rest of Asia how a country could rise from agricultural poverty to industrial affluence by pursuing the Communist path. Official statistics on economic performance of Communist China became very scarce as the boasted "great leap forward" failed to materialize. Talk of competition between Communist China and free Asia dropped to a whisper once it became evident that the free countries were well ahead in the contest.

Economic Success in Free Asia

The countries of Asia that have retained the free market system and have avoided the centralization of economic decisions in the hands of the government have clearly been winning the economic contest. The countries that have done the least well have tended to be the ones that either rejected the free market or severely limited it by governmental controls.

The great economic success stories of Asia in the 1960's are found in countries like Japan, the Republic of Korea, Nationalist China, Thailand, Hong Kong, and Malaysia. These countries, in the 10 years ending in 1968, have all recorded average increases in real output of 6 per cent a year or more. Japan, of course, has been one of the outstanding performers, with an average annual growth rate of 11 per cent in this period.

Rates of growth of GNP can be misleading, especially in countries where the underlying statistical data are inadequate and of doubtful validity. It is therefore desirable to check the growth figures of GNP against other records. One useful indicator of underlying growth is the trend of exports, since this is a measure of a nation's ability to compete in world markets. Export performance is a test of a country's efficiency in keeping up with the standards being set elsewhere in the world.

Professor Ota Sik, the architect of the short-lived economic reform in Czechoslovakia, called attention to the fact that the Communist economies have had great difficulty in meeting the test of economic efficiency posed by exports. As he put it: "On the foreign markets, Czechoslovak production is absolutely unable to adjust to changes in demand." This has been largely due to the tendency to neglect quality in production. Over-priced, shoddy goods can be sold in a market that is shielded from foreign competition, but they have little chance in export markets.

It is significant, therefore, that the countries in Asia that have achieved high rates of overall economic growth have also done very well in expanding their exports. The whole world knows what an outstanding record Japan has piled up in export markets. In the period 1958-68, Japanese exports expanded at an average annual rate of 16 per cent a year. It is perhaps less well known that the Republic of Korea, Nationalist China, and Hong Kong have also expanded their exports at phenomenal rates.

There are fascinating stories behind the export statistics of free Asia. I have just come from Korea, and I am very impressed by the remarkable change that has taken place there in just the last decade. Korea's expansion of exports from almost nothing to over \$600 million last year is a modern miracle. I am also impressed by the fact that tiny Hong Kong, with a population of only 4 million, exported about as much as all of India in 1969.

The experience of these Asian countries in achieving such outstanding success in the face of what many people once thought were overwhelming odds illustrates how difficult it is for any economist, no matter how farsighted he may be, to chart the future course of a nation's development. I know that many of you could cite interesting examples from your own experience of the achievement of what once seemed practically impossible.

Some of you may recall the pessimism that prevailed in the years immediately after World War II about Japan's economic future. The development of nylon obviously posed a great threat to the future

of silk, which had been one of Japan's leading exports before the war. No one foresaw at that time that Japan would become one of the world's great producers of synthetic fibers and fabrics and that Japan's exports of these goods would eventually far exceed the value of her prewar exports of silk.

Japan has demonstrated the shallowness of the belief that late-comers in economic development are unable to compete successfully with countries that have gotten a head start. I remember the late Prime Minister Ikeda telling me of the first tape recorder he had ever seen. It was on one of his visits to New York in the early 1950's. Neither he nor many of his compatriots then foresaw that tape recorders and other electronic products would play a major role in the tremendous expansion of Japanese exports that has occurred over the last decade.

One of the great strengths of a free economy is that it permits the development of the unexpected. Given proper incentives, the Japanese, the Chinese, and the Korean entrepreneurs have found new uses for their land, labor and capital. In many cases, the raw materials, such as wood for the plywood factories of Japan and Korea, had to be imported from distant lands. There were failures as well as successes, but the end result has been the rapid development of production and exports that had not been dreamed of, much less planned.

The lesson to be learned from these experiences is an old one. Where men are given the opportunity and the incentive to make and sell the products of their labor in free markets, they will tend to act in ways that increase productive efficiency and thereby raise the living

standards of the country as a whole. To be sure, freedom of entrepreneurs, workers, and consumers to make their own decisions is by no means the sole determinant of how well a country will perform economically. A nation must also pursue sound monetary, fiscal, and trade policies in order to achieve its economic potential. But there cannot be the slightest doubt, in view of the experience accumulated over centuries, that free and competitive markets are a major determinant of economic growth and widespread prosperity.

It is no accident that the Asian countries that experienced the slowest rates of growth in 1958-68 were also the countries that leaned most heavily on centralized economic controls. The countries at the bottom of the scale in terms of growth of real GNP include Ceylon, Burma, India, and Indonesia. Each of these countries has experimented extensively with government ownership or control over economic activities.

Burma in particular has gone far toward economic authoritarianism. By exercising far-reaching controls over production, trade, and finance, both its production and distribution have been injured. Burma's main crop, rice, has been adversely affected by pricing policies that have denied producers adequate incentives. Over the past decade, neighboring Thailand has increased rice exports by 28 per cent, while Burma's exports of rice have fallen nearly two-thirds. The result is that Burma's total exports are now running at less than half the 1963 level. The ability to import has fallen correspondingly.

Indonesia under President Sukarno followed economic policies that were in some respects more disastrous than those of Burma. In

addition to establishing stifling controls over production and trade, Sukarno's government borrowed heavily abroad, largely to build up a military machine, but partly also to finance ambitious projects that in the end yielded little or no economic return. The productive capital of the country was therefore badly eroded, exports fell sharply, living standards declined, and the country found itself saddled with huge foreign debts and with diminished ability to produce the exports needed to service the debt. Fortunately, Indonesia is now in the process of liberalizing her economy, but the country will require many years to recuperate from the damage wrought by the Sukarno policies.

The adverse impact of authoritarian economic policies has also been felt in India, though to a much lesser degree than in either Burma or Indonesia. India over the past decade and a half has emphasized strong centralized control over investment, backed by extensive restrictions on imports and foreign exchange expenditures. Fortunately, the earlier decisions to emphasize heavy industry at the expense of light industry and agriculture are now being questioned. The failure to provide incentives to exports has left India lagging far behind many other countries, and has contributed to balance-of-payments difficulties which necessitated ever tighter import restrictions. As a result, India has passed through a difficult period during which many of her industrial enterprises were deprived of the supplies and equipment needed to keep operating at reasonable rates.

Division of labor, territorial specialization, freedom of trade, and decentralization of economic decision-making -- these were

key elements in the thinking of the founder of classical economics, Adam Smith. It is gratifying to see that the practical statesmen of the world are gradually rediscovering these essential truths. In this rediscovery of truth, we owe a debt to countries like Japan, the Republic of Korea, Nationalist China, Hong Kong, and Thailand that have most recently demonstrated how nations practicing economic freedom can outperform authoritarian countries.

I see a basis for optimism about the future in the economic experience of both the countries that have forged ahead and those that have lagged behind. What has gone wrong, after all, is not something immutable. A country can change its future, for the better, by changing its policies. The countries that have lagged in the economic contest have the opportunity to learn from experience and to alter their course.

Economic Role of the United States

In concentrating, as I have, on the power of free markets to spur economic growth, I am not unmindful of the responsibilities that the advanced industrialized countries have to assist the developing nations. We have, at times, overestimated our potential contribution. There has been a tendency to think that external technical assistance, or external capital, could of itself provide sufficient impetus to generate rapid growth all over the world.

We now know that the solutions are more complex. Nevertheless, technical assistance, capital flows, whether governmental or private, and liberal trade policies on the part of the industrialized countries can contribute significantly to the process of economic development.

It is even more important that the advanced countries maintain their own economic strength if the world economy as a whole is to prosper and international trade is to flourish. Clearly, the prosperity and growth of the developing countries depends heavily on the economic well-being of the advanced countries, which provide the major export markets as well as the principal source of the capital and technology required to promote rapid economic development.

I am fully aware of the importance of the role of the United States in keeping the world economy on a sound basis. At the present time, the exercise of our responsibilities in this regard requires that we bring an end to the inflationary pressures present in our own economy. This is proving to be a difficult task. As a result of restrictive monetary and fiscal policies pursued last year, the rate of economic expansion slowed appreciably and some slack has developed in markets for labor and other resources. However, while we have succeeded in eliminating excess demand in our economy, we are still experiencing rather strong upward pressures on costs and prices. Expectations of consumers, businesses, and workers have not yet fully adjusted to the current balance of aggregate demand and supply.

The continuance of rising costs and prices in the face of a sluggish economy has been deeply disturbing to many observers. Some have concluded that success in our battle against inflation might require so restrictive a monetary policy that a liquidity crisis could develop. Concern about this has given rise to some turbulence in our financial markets in recent weeks. Let me assure you that the Federal Reserve

Board is fully aware of its responsibility to prevent anxieties of this kind from leading to a scramble for liquidity. Any such development could harm the world economy, as well as our own. Fortunately, we in the United States have the legislative authority, the tools, and -- I believe -- also the knowledge and wisdom to enable us to deal quickly and effectively with any problems of this nature that might emerge.

While the process of getting inflation under control in the United States has been difficult, there have been scattered signs recently of moderation in the rate of advance in some major categories of prices, and also of some improvement in the trend of productivity in the manufacturing sector of our economy. I believe we will be able to extend the progress that is beginning to emerge in these areas, by pursuing stabilization policies that prevent the reemergence of excess demand later this year or in 1971. However, we must also be careful to ensure that the economic slowdown which began last fall does not become more pervasive or continue much longer. On this score, I think there is room for optimism too. Both monetary and fiscal policies have become less restrictive in recent months, and I believe we may look forward with reasonable confidence to a resumption of sustainable economic growth in the near future, as well as to a gradual diminution in the rate of advance in prices.

For a time, however, we must expect to see a continuation of cost-push inflation, with increases in wage rates and prices reflecting the excess demand that existed in the past, the effects of which have not yet fully worked their way through the economic system. There are

some who think that, under the circumstances, we should abandon our traditional reliance on market forces and impose mandatory controls on wages and prices to halt inflation. I have always been strongly opposed to direct controls, since they are discriminatory and a source of great inefficiency. But I think the Administration has taken a proper step in announcing the establishment of a procedure to review the economic implications of wage and price increases in key industries. In a transitional period of cost-push inflation, such as we are now experiencing, the moderate incomes policy recently announced by the President should help us to avoid an increase in unemployment and yet hasten the return to reasonable price stability.

The task of bringing inflation under control has caused, and will continue to cause, some discomfort in many sectors of our economy. The anti-inflationary program pursued in the United States has had repercussions which have even extended as far as Japan, I understand. However, I can assure you that our economy is fundamentally sound and resilient. Just as I had confidence that the lulls in Japanese growth that I observed on some of my earlier visits were only temporary, so I have confidence that economic growth and progress will be resumed in the United States in the near future. We are still a long way from having exhausted the possibilities of improving our standard of living or increasing our productive capacity.

Man has taken a giant step forward in entering the era of interplanetary exploration. Our technology and education will continue to advance. How well the industrial countries or the less-developed

countries use new knowledge to better man's lot in life will depend on many things. It will depend in part on the goals that we set for ourselves. It will depend in part on our ability to live together in peace and to maintain the kind of mutually beneficial relations that have existed between Japan and the United States for nearly a quarter of a century. It will depend on the willingness of the advanced nations to assist those that have lagged behind in the economic contest. But it will also depend in important measure on the extent to which the nations of the world recognize the great advantages of the free market system and are willing to pursue fiscal, monetary, and commercial policies that are compatible with its efficient operation.

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